

PJEPA:

Strengthening the Foundation for Regional Cooperation and Economic Integration

Vol. II



Edited by Erlinda M. Medalla

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for Regional Cooperation
and Economic Integration**

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Erlinda M. Medalla



Philippine Institute for Development Studies
Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas



Philippine APEC Study Center Network



Department of Trade & Industry Philippines

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Table of Contents

List of Tables, Figures, Boxes, and Appendixes	viii
Foreword	xvii
Preface	xix
Acknowledgment	xxi
List of Acronyms	xxiii
Chapter 1	
Toward a Philippine-Japan Economic Cooperation in Agriculture	1
<i>Amelia Bello, Zenaida Sumalde, and Carlos Lorenzo Vega</i>	
Introduction	1
Philippine Agricultural Performance	2
Agricultural Trade Patterns	3
Philippine Agricultural Exports to Japan	4
Philippine Agricultural Imports from Japan	8
The Philippines' Share in the Japanese Agricultural Food Market	10
Japan's Agricultural Food Imports from other Countries	10
The Japanese Vegetable and Fruit Market	12
Distribution Routes	13
Market Access	13
Plant Quarantine Law	14
Food Sanitation Law	14
Rules on Labeling and Packaging	14
Expanding Economic Cooperation	14
Facilitating Existing Trade	16
Potential Agricultural Commodities that Can be Exported	16
Other Means for Expanding Trade	19
Specific Plans of Action	20
References	21
Chapter 2	
Prospects and Problems of Expanding Trade with Japan:	23
A Survey of Philippine Exporters	
<i>Rosalina Palanca-Tan</i>	
Introduction	23
Objectives of the Study	23

Methodology	24
Summary Data on Philippine Exports to Japan	25
How Important is the Japanese Market to Philippine Exporters?	26
Philippines' Position in Japan's Markets	29
Philippine Exporters to Japan: Strengths, Weaknesses, Opportunities, and Threats	38
Making the Agreement Philippine Exporters-Friendly	56
References	68
 Chapter 3	
Toward a Strategy for Manufactured Exports to Japan	71
<i>Ferdinand Maquito and Peter Lee U</i>	
Overview of Export Performance	71
Investment and Trade Relations with Japan	76
Strategic Implications	95
References	100
 Chapter 4	
Analysis of Industry and Sector-Specific Impacts of a Japan-Philippines Economic Partnership	103
<i>Royce Elvin O. Escolar</i>	
Introduction	103
Background	104
FTA Negotiations/Conformity to WTO Arrangements	108
Previous Studies	109
Conceptual Framework and Methodology	110
Philippine Industry and Sector-Specific Prospects and Impacts	112
On Liberalization and Adjustment Costs	140
Conclusion and Policy Implications	143
References	165
 Chapter 5	
Small and Medium Enterprise Development Experience and Policy in Japan and the Philippines: Lessons and Policy Implications	169
<i>Ronald Tamangan, Frances Josef, and Cielito Habito</i>	
Introduction	169
Operational Definitions	170
Overview of Philippine and Japanese SMEs	172

SMEs and Their Contributions to the Economy	204
The Philippine SME Development Experience and the Historical Policy Environment	206
The Japanese SME Development Experience and the Historical Policy Environment	219
SMEs in the Global Economy	240
Philippine Exportable Products to Japan	246
Trade Cooperation with Japan: Policy Implications	250
References	254
 Chapter 6	
Prospects of Services Trade Liberalization in the Japan-PH Bilateral Agreement	259
<i>Gloria O. Pasadilla</i>	
Introduction	259
Overview of Trade in Services	260
Preferential Trade Agreements	268
Analysis of Japan, Singapore, and Philippine Service Commitments	273
Options for the Philippines	285
Summary and Conclusions	309
References	325
 Chapter 7	
Developing the Japanese Market for Philippine Tourism and Retirement Services: prospects and Impediments	327
<i>Winston Conrad B. Padojinog and Maria Cherry Lyn S. Rodolfo</i>	
Background	327
Objectives of the Study	328
Removing Barriers to Trade in Tourism Services: Toward Developing the Retirement Industry	328
Japan as a Tourism Market	329
Regional Competition	348
Implications on the Development of the Philippine Retirement Industry	353
Summary and Conclusion	359
References	352

Chapter 8

Philippine-Japan Economic Linkages: A Case Study of Cebu 363

Victorina H. Zosa

Introduction	363
Regional Situationer	364
Cebu-Japan Economic Relationship	365
Contribution of Cebu Ecozones to the Regional Economy	370
Movement of Natural Persons	377
Information Technology	380
Sociocultural and Political Factors	380
Economic Competitiveness of Cebu	382
Elements of the Cooperation Framework between Cebu and Japan	389
Summary and Conclusion	392
References	394

List of Tables, Figures, Boxes, and Appendixes

Chapter 1

Table

1	Revealed comparative advantage in agriculture and selected Export crops, 1980–1998	2
2	Philippine agricultural exports to Japan and the US, 1990–2000 (Value in FOB million USD, share in %)	4
3	Top 10 Philippine agricultural exports, 1991–2000	5
4	Philippine agricultural exports to Japan, 1991–2000	7
5	Philippine agricultural imports from Japan and the United States, 1991–2000	7
6	Philippine Agricultural Imports from Japan, 1991–2000	9
7	Average percentage of top three agricultural imports to total agricultural imports from Japan, 1991–2001	9
8	Japan's top imports from the Philippines	10
9	Top 10 exporters, by country	11

Chapter 2

Table

1	Export product shares, annual average, 1998–2002	26
2	Export growth rates, annual average, 1998–2002	27
3	Japan's share in Philippine exports, annual average, 1998–2002	28
4	Products for which: $PRCA > 1$, $PRCA > JRCA$	29
5	Products for which: $JI > 1$, $0.1 < PRCA > 1$, $PRCA > JRCA$	30
6	Products for which: $PRCA > 1$, $PRCA > 1$, $PECA > JRCA$	31
7	Philippines' exports to Japan market position matrix: optimal quadrant	32
8	Philippine exports to Japan market position matrix: lost opportunity quadrant	35
9	Japan's custom duties on selected agricultural and food products	42

Figure

1	World Bank's market positioning classification	31
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Appendices

1	Philippine exports to Japan market position matrix vulnerable quadrant	59
2	Philippine exports to Japan market position matrix retreat quadrant	64

Chapter 3

Table

1	Share of manufactured exports to total exports, Philippines, 1985–2000	72
2	Values and share of Japan's exports to the Philippines and Philippine exports to Japan, 1998–2000	73
3	Top 10 products in Philippine-Japan trade, 1999 and 2000 (in million USD)	74
4	Productivity estimates	79

5	Grade of competitiveness by commodity	87
6	Export production function estimation results	90
7	Percentage of respondents procuring locally, by share of material parts	94

Figure

1	METI's Regional Approach Framework	85
2	Optimum supply network of the automobile industry in ASEAN	86

Appendix

	List of interviewees in survey/personal interview	99
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Chapter 4

Table

1	Japan-Philippines trade (in USD million)	105
2	Value of Japan imports by principal country of origin (1975-2001)	106
3	Value of Japan exports by principal country of origin (1975-2001)	107
4	Summary of Philippine merchandise exports to Japan by major product grouping	113
5	Top export markets of Philippine Furniture, 2001	113
6	Summary of Philippine furniture exports to Japan by major product grouping (FOB value in USD)	114
7	Summary of houseware exports to Japan by major product grouping (FOB value in USD)	116
8	Summary of Philippine electronics export to Japan	119
9	Machineries/transport equipment/apparatus and parts export to Japan	121
10	Summary of Philippine construction materials export to Japan	122
11	Sanitary wares topic market for export	125
12	Philippine imports of cement by country of origin, 1996-September 2001	123
13	Philippine export of fresh food (FOB value in '000 USD)	124
14	Philippine Fresh Food Exports to Japan	130

15	Japan GSP coverage of selected agriculture products	132
16	Major Philippine marine products export to Japan	134
17	Philippines' yellowfin tuna exports by major destination, 1999	135
18	Philippines' frozen skipjack tuna export by major destination, 1999	135
19	Microsoft-certified professionals	137

Figure

1	Export share of major category to total Philippines export to Japan	108
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Box

1	Tariff commission vs. DTI: the case of protecting the cement industry	127
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Annexes

I	Obstacles faced by Japanese firms overseas (%)	147
II	Republic Act No. 8800	147
III	Trade adjustment assistance	163

Chapter 5

Table

1	Summary of main definitions of SMEs in ASEAN-5	171
2	SME definition by employment and asset size	172
3	Number of establishments, by size category and industry, 2000 and 2002	173
4	Share of establishments to total, by size and category and industry, 2000	174
5	Growth establishments, by size category and industry, 2000 and 2002	175
6	Number of employees, by size category and industry, 2000 and 2002	177

7	Share of employment to total, by size category and industry, 2000	178
8	Growth rate of the number of employees, by size category and industry, 2000 and 2002	179
9	Number of establishment, by size category and region, 2000 and 2002	181
10	Share of establishments to total, by side category and region, 2000 and 2002	182
11	Growth of establishments, by side category and region, 2000 and 2002	183
12	Number of employees, by size category and region, 2000 and 2002	184
13	Shares of employment to total, by size category and region, 2000 and 2002	185
14	Growth of employment, by size category and region, 2000 and 2002	186
15	Value added by small and medium enterprises (SMEs)	187
16	SMEs export orientation, 1994	189
17	Export orientation of SMEs and large enterprises with and without foreign ownership, 1994	190
18	Number of business enterprises by industry and size (private), selected years	194
19	Number of persons engaged by industry and size (private), selected years	196
20	Number of employees by industry, 1999	199
21	Main financial indicators, profit status and main financial ratios of business corporations for all industries, selected years	200
22	Main financial indicators, profit status and main financial ratios of business corporations for manufacturing, selected years	201
23	Main financial indicators, profit status and main financial ratios of business corporations for wholesaling/retailing, selected years	202
24	Main financial indicators, profit status and main financial ratios of business corporations for services, selected years	203
25	Summary of basic differences in SME Basic Law	225
26	Number of clusters, average cluster size, and average firm size, by industry, 1996	232

27	Summary of cluster development experience of 14 Japanese locations	233
28	Source of advantage in Japan's clusters, by Industry (%)	239
29	Total Philippine exports to Japan: shares and growth rates, 1998–2002 (%)	247
30	Philippine exportable products to Japan: Japan's import index > 1 and Philippine RCAa >1, 1999	249
31	Philippine exportable products to Japan: Japan's import index > 1 and Philippine RCAa <1, 1999	250
32	Share of Philippine exports in Japan's imports, 2000 (%)	251

Chapter 6

Table

1	Restrictive measures affecting services	266
2	Approaches to services liberalization	271
3	GATS vs. NAFTA types of approaches	272
4	Philippine commitments in WTO and AFAS	273
5	Comparison of three preferential trade agreements	275
6	Sectoral coverage of specific commitments, Singapore	280
7	Sectoral coverage of specific commitments, Japan	282
8	Sectoral coverage of specific commitments, Philippines	283
9	Philippine financial services commitments in WTO and AFAS	293
10	Japanese liberalization commitments in health services	297
11	Philippine hospitals: Number and bed capacity	298
12	Application of trade rules to segments of energy sector	300
13	Global environmental market, in USD billion, 1996	303
14	Growth prospects and potential advantages in selected countries	304
15	Share of Wholesale and Retail Trade in the Economy (%)	305
16	Retail Trade Liberalization Act of 2000 (RA 8762)	306

Appendices

1	Services sectoral classification list	311
2	Sample sector commitment	318
3	Philippines service sector commitments in AFAS	319
4	Regulations and restrictions in banking and insurance	322

Chapter 7

Table

1	Number of households earning USD 50,000 per annum or more in selected Asian countries (in '000)	330
2	Visitor arrivals from Japan to Asia-Pacific destinations	332
3	Air access between Japan and the Philippines (direct flights only)	334
4	Age distribution structure	335
5	Lifestyles of Japanese seniors	337
6	Japanese living abroad, by country, 1975–2000	338
6a	Japanese living abroad, by country: percent share, 1975–2000 (in %)	341
7	International comparison of old-age pensions	345
8	What will make them stay	345
9	Comparison of average medical care expenditures in selected countries and the presence of private insurance	346
10	Cost of long-term care in Japan: public and private silver businesses	347
11	Malaysia's wellness paradigm (health screening packages)	351
12	Percentage share of additional housing per region classified according to type of development (H&L and lots), 1992–2002	356
13	Comparative real estate housing size and rates in the Philippines and Japan	358

Figure

1	No. of brochure pages and courses of top 10 Japanese travel agencies devoted to ASEAN beach destinations	333
2	Projection of necessary number of care workers (in thousands)	348
3	Regional distribution of condominium projects, 1993–1999	357

Chapter 8

Table

1	Share of Central Visayas exports to Philippine merchandise exports, 2002	366
2	Top 10 exports and imports, Philippines and Cebu, 2000	368

3	Distribution of Japanese firms in PEZA, by selected characteristics, 2003	371
4	Central Visayas and Cebu Ecozone foreign trade indicators, 1991–2002	372
5	Share of CEZ in regional employment and investments, 1990–2000	374
6	Share of CEZs in PEZA employment, exports, and investments, 1994–2002	375
7	Foreign tourist arrivals in the Philippines and Cebu, 1982–2002	376
8	Selected information on overseas contract workers, October 2001	378
9	Distribution of OCWs in Japan, by occupation, 2001	379
10	Number of recipients of Japanese scholarships and trainings, 2003	379
11	Ranking of location factors by Metro Cebu businessman, 2003	383
12	Competitiveness of Cebu, in terms of top 5 ranking in investment-related costs JETRO surveys of 26 Asian cities, 2002	387

Foreword

There is no denying the potential economic benefits of trade opening via free trade agreements (FTAs). Thus, the Philippines has actively pursued trade deals—regionally in the case of the Association of Southeast Asian Nations and its dialogue partners, and bilaterally in the case of the Philippines-Japan Economic Partnership Agreement (PJEPA). Openness to trade has been a hallmark of Philippine economic policy, and as a result, the country is involved in 15 FTAs, seven of which have already been signed and in effect, two are under negotiation, and six have been proposed. PJEPA, negotiated between 2004 and 2006 and ratified by Congress in 2008, was a milestone in Philippine trade policy. It signaled the Philippines' commitment to develop its economy within the framework of international trade as well as its willingness to embark upon more binding economic agreements.

Beyond negotiation and ratification lies the challenge of utilization. Lack of information among firms is the biggest stumbling block to maximizing the benefits offered by trade agreements. It is in this context that the Institute offers to the public the two-volume book *PJEPA: Strengthening the Foundation for Regional Cooperation and Economic Integration*. This second volume, along with the first volume released last year, documents the research effort that paved the way for the approval of this landmark economic partnership between the Philippines and a major trade partner, Japan. While Volume 1 gave an overview of PJEPA and tackled the big picture, including Japan's motivations and the dynamics of economic cooperation between the two countries, Volume 2 focuses on specific sectors—agriculture, exporters, manufacturing, small and medium enterprises (SMEs), services, and tourism. There is also a case study on Cebu. In all, the PJEPA Research Project, a collaboration between the Philippine Institute for Development Studies and the Philippine APEC Study Center Network and commissioned by the Department of Trade and Industry, produced 17 studies that provided support to the Philippine negotiating panel.

The recommendations of these studies continue to be relevant today as they point to the critical constraints needed to be overcome for ordinary Filipinos to benefit from PJEPA. For instance, greater market access of agriculture and food products to Japan requires meeting exacting Japanese standards. SMEs need to link up with larger manufacturers to be able to tap the lucrative export market, which requires improving access to credit, technology, and training. Competitive industries should lie at the forefront of an effective export strategy. More importantly, the Philippines has to maintain a stable macroeconomic and investment environment as a backdrop to competitiveness efforts, if it wants technology transfer, trade, and investments to broaden under PJEPA.

It needs to be reiterated that PJEPA is not a panacea that will cure the country's economic problems in an instant. Rather, it provides opportunities to harness free trade and closer economic cooperation in achieving sustainable growth and development. This book is a reminder of the need for well-thought-out policies that will support these very objectives. We thank all the individuals and institutions that made this important research project possible.



Gilberto M. Llanto

President
Philippine Institute for Development Studies

Preface

The difficult process of securing the landmark Philippines-Japan Economic Partnership Agreement (PJEPA) was most definitely a learning experience for policymakers, trade negotiators, and indeed all stakeholders concerned. More than five years since its ratification, the consensus has been that the Philippines was better off with its first economic partnership agreement, than if it had passed off the opportunity. Considering its outcomes so far, PJEPA is proof of the need for good policy research, and for decisionmaking to be backed up by evidence, especially with national interest at stake.

This is the second volume of *PJEPA: Strengthening the Foundation for Regional Cooperation and Economic Integration*, which documents the outstanding work of the team of researchers under PIDS and the Philippine APEC Study Center Network, which was commissioned by the Department of Trade and Industry to conduct studies in support of the Philippine negotiating panel for the PJEPA. This two-volume work looks into the major considerations that shaped the Philippine stance in negotiations for the bilateral deal, and should be a useful resource for those interested in trade and trade policy. Eight more studies are published in this final volume, in addition to nine in the first volume released last year, or a total of 17 studies.

Although it is too early to conduct a comprehensive assessment of the PJEPA's impact on the Philippine economy, our initial ex-post review validates the work of the PJEPA Research Project. We had expected the short-run impact of the PJEPA on gross domestic product to be small, but the dynamic benefits to be very significant. Results of the initial assessment showed that based on a number of key trade indicators, the Philippines has not suffered major adjustment costs because of the PJEPA. The scary scenarios did not materialize. Moreover, the country was able to secure concessions comparable to other partner-countries of Japan in similar agreements. In fact, the Philippines obtained the most tariff concessions among six other countries in the Association of Southeast Asian Nations, and there has been improved market access for some Philippine products particularly in agriculture. Japan, it should be noted, dislodged the United States as the top trading partner of the Philippines in 2010.

The approval of PJEPA has allowed the Philippines to avoid the cost of non-participation in the new global trade regime. With multilateral talks under the World Trade Organization stuck in a state of extended hibernation, plurilateral, regional, and bilateral agreements are expected to continue to figure prominently in the international trade agenda. The Philippines cannot afford to play catchup as countries in the region integrate their economies and

find new sources of growth. At any rate, the PJEPA has built-in mechanisms that will allow the country to protect its interests. The Philippines can also take advantage of joint training, capacity-building, and other cooperation programs.

The legacy of PJEPA is in institution-building. In future economic partnerships, Philippine negotiators have the benefit of savvy, knowledge, and skills as a result of the PJEPA experience. Also, the importance of public buy-in for the successful implementation of such a wide-ranging treaty cannot be underestimated. PJEPA has spurred reforms in the way trade policy is crafted—the government has since allowed greater participation of civil society organizations and other groups by way of soliciting comments prior to trade negotiations. There is now some measure of awareness by the public of the welfare effects of government trade policy. This publication is the Institute's contribution to the continuing effort of disseminating information to all concerned stakeholders and building broad support for sound socioeconomic policy.

A handwritten signature in black ink, appearing to read 'E. Medalla', with a stylized flourish at the end.

Erlinda M. Medalla, Ph.D.

Project Leader, PIDS PJEPA Research Team

Senior Research Fellow, PIDS

Acknowledgment

In 2003, the Department of Trade and Industry (DTI), through then Undersecretary Thomas G. Aquino, approached the Philippine Institute for Development Studies (PIDS) to provide research support and come up with studies that would help the Philippine government identify negotiating points for the Philippines-Japan Economic Partnership Agreement (PJEPA). Considering that PJEPA was to be the first bilateral free trade agreement to be signed by the Philippines, both DTI and PIDS agreed to tap researchers from different institutions and disciplines to come up with a more objective assessment of the PJEPA. After a series of meetings and consultations, it was agreed that this huge task would be undertaken by the Philippine APEC Study Center Network (PASCN), which is based in PIDS. PASCN was deemed the ideal institution to conduct the studies given its network of top public and private universities and research institutions in the Philippines, and therefore able to provide an independent and scholarly assessment of the benefits and costs of an economic partnership agreement with Japan.

Immediately, PIDS Senior Research Fellow and PASCN Project Director Erlinda Medalla came up with an overall framework and presented the same to a group of researchers from the following institutions and network members of PASCN: the University of the Philippines, Ateneo de Manila University, De La Salle University, the University of Asia and the Pacific, University of San Carlos, the Foreign Service Institute, and the Asian Institute of Management. A series of brainstorming sessions followed to identify research areas and the researchers who will conduct the studies.

The researchers were given six to nine months to finish their research. Outputs at various stages were closely reviewed by PASCN's Review, Evaluation, and Dissemination Committee (REDC), with the PASCN project director as chairman, and REDC members coming from Silliman University, De La Salle University, the Foreign Service Institute, and Ateneo de Manila University as members. After the research outputs passed the review, they were submitted to the PASCN Steering Committee, chaired by then President Dr. Mario Lamberte, for approval. Copies of the research outputs were then submitted to the DTI. Meanwhile, the PIDS and PASCN embarked on a public information campaign to disseminate the results of the studies to as many audiences as possible. Conferences and seminars were held to present the studies and collect feedback, not just in Metro Manila, but also in the Visayas and Mindanao. Members of the research team were invited to present the studies personally and to answer questions from the audience. The studies were published online and in various formats.

These volumes are the result of hard work and collaboration among various individuals and institutions that contributed to and participated in all stages of the PJEPA research, information dissemination, and publication. Gratitude is extended to the following: the researchers, who bravely answered the call to do rigorous research despite time and budget constraints; the PASCN REDC and Steering Committee, which reviewed all 17 outputs meticulously to make sure that the researchers were able to answer the pressing issues of the PJEPA; the PIDS Management for unconditional support to the project; former and current PASCN staff: Atty. Dorothea Lazaro for providing excellent research assistance, Ms. Jenny Balboa, Mr. Michael Diza, and Ms. Eloisa Pamatmat-Isip, as well as Ms. Melalyn Mantaring, Ms. Mildred Belizario, and Ms. Susan Pizarro for the excellent administrative support; and the PIDS Research and Information Staff for helping with information dissemination and publication. Last but not the least, special thanks go to former PIDS President Josef Yap and Senior Research Fellow and Acting Vice-President Rafaelita Aldaba for their brilliant inputs in answering questions during the public debates that ensued amid Senate hearings on the PJEPA.

List of Acronyms

ACTETSME	- APEC Center for Technology Exchange and Training for SMEs
ADB	- Asian Development Bank
AFAS	- ASEAN Framework Agreement on Services
AFTA	- ASEAN Free Trade Area
APEC	- Asia-Pacific Economic Cooperation
AMS	- Aggregate Measure of Support
ARMM	- Autonomous Region for Muslim Mindanao
ASEAN	- Association of Southeast Asian Nations
AUV	- Asian utility vehicles
BAS	- Bureau of Agricultural Statistics
BETP	- Bureau of Export Trade Promotion
BITR	- Bureau of International Trade Relations
BPI	- Bureau of Product Standards
CAR	- Cordillera Administrative Region
CBBEs	- Countryside and Barangay Business Enterprises
CBUs	- completely built-up units
CEPT	- Common Effective Preferential Tariff
CEZ	- Cebu Economic Zone
CFIP	- Chamber of Furniture Industries of the Philippines
CGE	- computable general equilibrium
CIDA	- Canadian International Development Agency
CPC	- Centralized Product Classification
DBP	- Development Bank of the Philippines
DENR	- Department of Environment and Natural Resources
DFA	- Department of Foreign Affairs
DOT	- Department of Tourism
DTI	- Department of Trade and Industry
EAFTA	- East Asian Free Trade Area
EC	- European Community
EDC	- Export Development Council
EDP	- Electronic Data Processing
ELCP	- Electronic Local Content Program
ELSA	- Extended Leisure Stay Abroad
EOS	- economies of scale
EPA	- economic partnership agreement

EU	- European Union
EZs	- economic zones
EXPONET	- Export Information Assistance Center
FAINS	- Food Automated Import Inspection and Notification Process
FDI	- foreign direct investment
FEME	- Full Examination, Microscopic Examination
FG	- Flying Geese
FGDs	- focused group discussions
FOB	- free-on-board
FTA	- free trade area
FTAs	- free trade agreements
GATS	- General Agreement on Trade in Services
GATT	- General Agreement on Tariffs and Trade
GDP	- gross domestic product
GFI	- government financing institutions
GNI	- gross national income
GNP	- gross national product
GNS	- Group of Negotiations in Services
GRDP	- gross regional domestic product
GSP	- Generalized System of Preferences
GTAP	- Global Trade Analysis Project
GVA	- gross value added
HACCP	- Hazard Analysis and Critical Control Point
HICs	- highly indebted countries
HK SAR	- Hongkong Special Administrative Region
HLURB	- Housing and Land Use Regulatory Board
HO	- Heckscher-Ohlin
HRD	- human resource development
HS	- Harmonized System
IBRD	- World Bank-International Bank for Reconstruction and Development
ICs	- integrated circuits
ICC	- International Competitive Coefficient
ICT	- information and communication technology
IDC	- Industry Development Council
IGLF	- Industrial Guarantee and Loan Fund
ILO	- International Labor Organization
IMF	- International Monetary Fund
IO	- Input-Output

IP	- intellectual property
IPPs	- independent power producers
IPRs	- intellectual property rights
ISIC	- International Standard Industrial Classification
ISPs	- Internet service providers
IT	- information technology
ITC	- International Trade Center
JACE	- Japan Association of Corporate Executives
JACEP	- Japan-ASEAN Comprehensive Economic Partnership
JAL	- Japan Airlines
JAPA	- Japan Automobile Products Association
JATA	- Japan Association of Travel Agents
JDIs	- Japanese direct investments
JETRO	- Japan External Trade Organization
JI	- Japan's import index
JICA	- Japan International Cooperation Agency
JITSE	- Japan Information Technology Standards Examination
JITSE-Phil	- Japan Information Technology Standards Examination in the Philippines
JPEPA	- Japan-Philippines Economic Partnership Agreement
JRCA	- Japan's revealed comparative advantage
JSEPA	- Japan-Singapore Economic Partnership Agreement
LBP	- Land Bank of the Philippines
LGU	- local government unit
MA	- market access
MASICAP	- Medium and Small Industries Coordinated Action Program
METI	- Ministry of Economics, Trade, and Industry
MFN	- most favored nation
MIP	- major industrial projects
MNC	- multinational corporation
MT	- metric ton
MW	- megawatts
NACIDA	- National Cottage Industries Development Authority
NAFTA	- North America Free Trade Area

NAPES	- National Asia Pacific Economic and Scientific Database
NCR	- National Capital Region
NCSO	- National Census and Statistics Office
NEAT	- National Elementary Assessment Test
NES	- not elsewhere specified
NIC	- newly industrializing country
NSAT	- National Secondary Assessment Test
NSO	- National Statistics Office
NT	- national treatment
O&G	- Obstetric & Gynecologic
OCWs	- overseas contract workers
ODA	- official development assistance
OECD	- Organisation for Economic Co-operation and Development
OEM	- original equipment manufacturing
OFW	- overseas Filipino worker
OJT	- on-the-job
OLS	- ordinary least squares
PAL	- Philippine Airlines
PASCN	- Philippine APEC Study Center Network
PATA	- Pacific Asia Travel Association
PCBs	- printed circuit boards
PC-TAS	- Personal Computer Trade Analysis System
PEDP	- Philippine Export Development Plan
PEZA	- Philippine Economic Zone Authority
PHILCEMCOR	- Philippine Cement Manufacturers Corporation
PHILFOODEX	- Philippine Food Exporters Association
PHILTINS	- Philippine Trade Information and Network Systems
PIDS	- Philippine Institute for Development Studies
PJEPA	- Philippines-Japan Economic Partnership Agreement
PLRA	- Philippine Leisure and Retirement Authority
PNS	- Philippine National Standards
PRA	- Philippine Retirement Authority
PRCA	- Philippine's revealed comparative advantage
PSA	- Prostate Specific Antigen Test
PSIC	- Philippine Standard Industrial Classification
PTA	- preferential trade agreement

QCDDM	- Quality, Cost, Development, Delivery, and Management
R&D	- research and development
RA	- Republic Act
RCA	- revealed comparative advantage
ROO	- rules of origin
RTAs	- regional trade arrangements
S&T	- science and technology
SBAC	- Small Business Assistance Centers
SCCC	- Southern Cross Cement Corporation
SEARCA	- Southeast Asian Regional Center for Graduate Study and Research in Agriculture
SEZs	- Special Economic Zones
SITC	- Standard International Trade Classification
SMEs	- small and medium enterprises
SMEA	- Small and Medium Enterprise Agency
SMEDC	- Small and Medium Enterprise Development Council
SPS	- sanitary and phytosanitary standards
SSS	- Social Security System
TAA	- Trade Adjustment Assistance
TAT	- Tourism Authority of Thailand
TFP	- total factor productivity
TNCs	- transnational corporations
TRIMs	- Trade-Related Investment Measures
UK	- United Kingdom
UN	- United Nations
UNCTAD	- United Nations Conference on Trade and Development
US	- United States
USAID	- United States Agency for International Development
VAT	- value-added tax
VERs	- Voluntary Export Restraints
VHT	- Vapor heat treatment
WB	- World Bank
WTO	- World Trade Organization
WTO-GPA	- World Trade Organization-Government Procurement Agreement

1 Toward a Philippine-Japan Economic Cooperation in Agriculture

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Introduction

The Philippine economic outlook will always be affected by the performance of the agricultural sector given its relative share in the whole economy. On average, agriculture accounts for one-fifth of the country's gross domestic product (GDP). It also employs a sizeable proportion of the labor force and contributes to the country's foreign exchange earnings.

Japan plays an important role in the performance of the Philippine agricultural sector. Japan is the second major trade partner of the Philippines, next to the United States (US). Japan is the country's top market for bananas, pineapples, mangoes, and fresh tuna and shrimps. The Economic Cooperation in Agriculture contained in the Philippines-Japan Economic Partnership Agreement (PJEPA) explores collaborative endeavors in the agriculture sector toward expanding trade.

This paper (1) provides a background on the agricultural trade between the Philippines and Japan, and on their existing trade agreements; (2) presents a brief picture of the Japanese food market; (3) identifies salient points, opportunities, and constraints to improved agricultural trade between the two countries; and (4) highlights the key elements of the bilateral trade agreement with Japan. These salient points need to be assessed given the country's capability to deliver the output and the necessary institutional and public infrastructure.

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Philippine Agricultural Performance

David (2003) describes Philippine agricultural growth since the 1980s as erratic and slow. Over the last two decades, the country has had one of the lowest average growth rates in gross value added (GVA) in agriculture and agricultural exports. The GVA growth rate for crops exhibited a slowdown across commodities. The major export crops, namely coconut, sugar, and bananas were the poorest performers. Mango, a nontraditional export crop, exhibited a high growth rate but could not offset the decline and sometimes negative rates of many other crops.

Meanwhile, the fishery subsector's GVA share in agriculture was 20 percent in 2000. This share prevailed for two decades. Aquaculture and commercial fisheries led the growth, which was propelled by the higher catches of tuna for export. Forestry's GVA share in agriculture on the average was 4 percent.

Agriculture ceased to be a net earner of foreign exchange since the early 1990s. Its share in total exports declined from 35 percent in 1980 to a mere 5 percent in 2000. The composition of agricultural exports also changed. Fruits and vegetables now account for a fifth of agricultural exports, while fishery products contribute almost as much due to the growth in tuna exports. At the same time, agricultural imports grew rapidly due to (1) increased demand for food products with high income elasticities like milk and other dairy products, (2) declining competitive advantage in the domestic production of food, (3) greater reliance on imported manufactured inputs, and (4) trade liberalization.

David (2003) further notes that the slower growth of Philippine agriculture and the stagnation of agricultural exports suggest that the country has been losing its comparative advantage in the sector. From a recorded comparative advantage ratio of 2.9 in 1980, it went down to 0.8 in 1998. Table 1 shows the trends in revealed comparative advantage (RCA) for the sector and for selected agricultural exports.

Table 1. Revealed comparative advantage in agriculture and selected export crops, 1980–1998

Year	Agriculture	Coconut	Bananas	Canned Pineapple	Fresh Pineapple
1980	2.9	224.1	30.4	82.2	48.9
1985	2.4	212.3	31.2	91.6	59.7
1990	1.6	212.4	23.4	70.2	54.6
1995	1.1	153.5	14.1	41.5	23.6
1998	0.8	105.3	8.8	33.2	11.5

Source: David (2003)

RCA is defined as the ratio between the share of a commodity group to a country's exports and to world exports. In the early 1980s, agriculture's share in total exports was over a third of the country's total exports, but this share continuously slipped to mere 5 percent in 2000. Banana and pineapples used to dominate agricultural exports, but were eventually replaced by electrical and electrical equipment and parts, and garments. Export of fruits, vegetables, coconut, and sugar products, as a ratio of electric and electrical equipment plus garments, was a mere 5.65 percent in 1998—a considerable drop from 28 percent a decade earlier. This decline in agricultural exports can be partly explained by the increasing costs of production that pushed prices up and narrowed the market for Philippine agricultural products. The low value added in agricultural production also prevented the abovementioned commodities from commanding relatively high prices. These commodities generally went to the United States and Japan. Exports to these two countries accounted for half of the country's agricultural exports.

Trends in labor and land productivity contributed to the above trends. The crop subsector's labor productivity stagnated during the last two decades while growth in land productivity also leveled off. Yield per hectare of traditional exports either remained constant or declined due to the absence of major technological breakthroughs, although relatively higher growth was observed among the nontraditional exports. Larger plantations with access to international know-how registered improvements in yields of bananas and pineapples while the introduction of commercial spraying to induce flowering helped in the expansion of the mango industry (David 2003).

Agricultural Trade Patterns

The Philippine economy experienced constant setbacks due to the various political, socioeconomic, and natural disasters. The government exerted efforts to improve the economy through combined domestic and international actions, including focused efforts to improve international trade relations.

In the past decade, the total amount of agricultural exports has continuously declined. On average, the share of agricultural exports in the country's total exports equaled to 14 percent (Table 2). The most important implication of this decline in agricultural performance is the accompanying decline in people's income whose livelihood depends on it. In 2001, 37 percent of the population depended on agriculture for their livelihood and an average of 10.72 million Filipinos were employed in the sector (Bureau of Agricultural Statistics 2003).

Table 2. Philippine agricultural exports to Japan and the US, 1990–2000
(Value in FOB million USD, share in %)

Year	Total Agricultural Exports	Agricultural Exports as % of Total Exports	Agricultural Exports		% Share of Agricultural Exports to Total Agricultural Exports		
			Japan	US	Japan	US	Japan and US
1990	1,781.13	20.78	na	na	na	na	na
1991	1,844.67	20.87	489.72	520.70	26.55	28.23	54.78
1992	1,854.18	18.87	444.40	598.15	23.97	32.26	56.23
1993	1,918.25	16.86	564.32	494.76	29.42	25.79	55.21
1994	2,072.02	15.37	575.56	508.40	27.78	24.54	52.31
1995	2,499.06	14.32	543.94	641.88	21.77	25.68	47.45
1996	2,306.64	11.23	460.72	704.17	19.97	30.53	50.50
1997	2,337.51	9.27	433.60	686.34	18.55	29.36	47.91
1998	2,224.67	7.54	420.08	604.38	18.88	27.17	46.05
2000	1,982.73	5.21	464.30	539.21	23.42	27.20	50.61
Average	2,082.09	14.03	488.52	588.67	23.37	27.86	51.23

Note: 1999 figures are incomplete. na – not available

Source: National Statistics Office (NSO), various publications

Philippine Agricultural Exports to Japan

Earnings from agricultural exports amounted to USD 1.79 billion in 2001, albeit there was a 6.5 percent decline from the previous year. The top Philippine agricultural exports included coconut oil, bananas, pineapple and pineapple products, mango, shrimps and prawns, and tuna (Table 3). These agricultural exports comprised 71 percent of the total agricultural exports of the country. Agricultural exports made up a fifth of the Philippines' exports to Japan, averaging USD 488.52 million for the decade 1990–2000 (Table 4).

Among the top agricultural exports of the Philippines, the average quantity and value of bananas, shrimps, and prawns exported to Japan was the biggest, compared to other trading countries. The average quantity and value of pineapple and pineapple products exported to Japan also proved to be one of the largest, ranking second to the US. The average quantity and value of tuna exported to Japan and to other countries ranked a close third to exports to Germany and the US.

Table 3. Top 10 Philippine agricultural exports, 1991–2000

Commodity	1991		1992		1993		1994		1995	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Coconut oil (crude and refined)	298.53	16.18	481.16	25.95	357.61	18.64	475.16	22.93	826.09	33.06
Shrimps and prawns*	269.46	14.61	207.92	11.21	224.70	11.71	246.32	11.89	218.57	8.75
Banana, fresh	173.00	9.38	157.73	8.51	226.07	11.79	215.27	10.39	223.74	8.95
Pineapple and pineapple products	128.21	6.95	149.75	8.08	147.35	7.68	145.32	7.01	140.01	5.60
Tuna	115.24	6.25	102.32	5.52	149.92	7.82	163.95	7.91	154.09	6.17
Fertilizer (manufactured)	115.86	6.28	88.21	4.76	85.45	4.45	101.25	4.89	119.92	4.80
Desiccated coconuts	66.24	3.59	87.56	4.72	83.74	4.37	70.15	3.39	68.18	2.73
Sugar (centrifugal)	114.62	6.21	87.50	4.72	101.71	5.30	60.62	2.93	65.88	2.64
Copra oil cake/meal	54.88	2.98	52.54	2.83	45.30	2.36	53.01	2.56	66.87	2.68
Tobacco (unmanufactured)	42.52	2.31	33.83	1.82	25.67	1.34	23.46	1.13		
Seaweeds and carageenan									82.83	3.31
Mango, fresh										
Share of the top 10 exports	74.73		78.12		75.46		75.02		78.68	
Total agricultural exports	1,844.67		1,854.18		1,918.25		2,072.02		2,499.06	

Table 3. (continued)

Commodity	1996		1997		1998		1999		2000	
	Value	Share	Value	Share	Value	Share	Value	Share	Value	Share
Coconut oil (crude and refined)	570.64	24.74	673.33	28.81	705.66	31.72	342.28	19.44	464.94	23.40
Shrimps and prawns*	153.35	6.65	126.43	5.41	129.34	5.81	127.61	7.25	144.65	7.30
Banana, fresh	236.42	10.25	216.56	9.26	217.04	9.76	240.70	13.67	291.65	14.71
Pineapple and pineapple products	156.27	6.77	149.55	6.40	140.35	6.31	137.32	7.80	155.95	7.87
Tuna	162.64	7.05	164.61	7.04	183.25	8.24	129.65	7.37	118.26	5.96
Fertilizer (manufactured)	114.54	4.97	98.95	4.23	91.59	4.12	44.10	2.51	43.63	2.20
Desiccated coconuts	84.89	3.68	88.29	3.78	72.76	3.27	89.18	5.07	73.25	3.69
Sugar (centrifugal)	136.2	5.90	82.71	3.54	80.00	3.60	62.62	3.56	51.71	2.61
Copra oil cake/meal	56.31	2.44	52.51	2.25						
Tobacco (unmanufactured)										
Seaweeds and carageenan	94.07	4.08	94.72	4.05	64.71	2.91	85.59	4.86	84.87	4.28
Mango, fresh					41.74	1.88	35.16	2.00	34.33	1.73
Share of the top 10 exports	76.53		74.77		77.60		73.52		73.75	
Total agricultural exports	2,306.64		2,337.51		2,224.67		1,760.35		1,982.73	

Note: * Fresh, chilled, or frozen

Source: NSO, various publications

Table 4. Philippine agricultural exports to Japan, 1991–2000

Year	Agricultural Exports to Japan (in FOB million \$)	Total Exports to Japan	% Share Agricultural Exports to Total Exports to Japan
1991	489.72	1,763.19	27.77
1992	444.40	1,738.36	25.56
1993	564.32	1,817.42	31.05
1994	575.56	2,024.14	28.43
1995	543.94	2,741.53	19.84
1996	460.72	3,667.87	12.56
1997	433.60	4,192.24	10.34
1998	420.08	4,231.68	9.93
2000	464.30	5,606.02	8.28
Average	488.52	3,086.94	19.31

Note: 1999 figures are incomplete.

Source: NSO, various publications

Table 5. Philippine agricultural imports from Japan and the United States, 1991–2000

Year	Total Agricultural Imports	Agricultural Imports as % of Total Imports	Agricultural Imports		% Share of Agricultural Imports to Total Agricultural Imports		
			Japan	US	Japan	US	Japan and US
1991	1,259.17	10.45	65.07	364.28	5.17	28.93	34.10
1992	1,559.71	10.74	47.01	486.06	3.01	31.16	34.18
1993	1,626.20	9.24	58.90	508.46	3.62	31.27	34.89
1994	2,114.26	9.91	60.97	612.82	2.88	28.99	31.87
1995	2,648.65	9.98	60.06	742.04	2.27	28.02	30.28
1996	3,095.85	9.55	50.53	789.57	1.63	25.50	27.14
1997	3,101.78	8.63	75.68	804.19	2.44	25.93	28.37
1998	2,894.57	9.76	61.32	704.30	2.12	24.33	26.45
1999	2,878.13	9.36	59.80	662.10	2.08	23.00	25.08
2000	2,776.93	8.85	63.10	736.71	2.27	26.53	28.80
Average	2,395.53	9.65	60.24	641.05	2.75	27.37	30.12

Source: NSO, various publications

Philippine Agricultural Imports from Japan

For the period 1990-2000, the Philippines' agricultural imports from Japan averaged USD 60.24 million, representing 2.75 percent of total agricultural imports. The country's import bill with Japan averaged USD 5373.37 million, making up a miniscule 1.25 percent of the sector's agricultural requirements for the same period (Table 6).

For the past decade, agricultural goods imported from Japan comprised mainly of manufactured fertilizer, agricultural chemicals and materials, and agricultural machinery. Their share grew from a low of 29.78 percent in 1993 to 70 percent in 2001, heavily outweighing food and semi-processed agricultural commodities (*e.g.*, food and live animals, tobacco and tobacco manufactures, crude materials, and animal and vegetable oils and fats) in 2001. They represented 32.33 percent, 18.90 percent, and 18.89 percent, respectively, of the total agricultural imports from Japan (Table 7).

The composition of these agricultural imports reflects how technology in the domestic agricultural sector has lagged behind and/or how it has remained import-dependent. Unlike other agricultural imports from Japan, which are classified as consumer goods, the three agricultural imports cited above are classified as inputs used for the production of agricultural goods.

The value of imported agricultural imports from Japan fluctuated over the period 1991-2001; the value reached its lowest in 1992 at USD 47.01 million (in FOB) and its highest in 1997 at USD 75.68 million (in FOB). Agricultural imports from Japan exhibited a growth rate of 1.51 percent within this same period.

Agricultural Import Trends of Japan

Historically, Japan has been regarded as a major importer of agricultural food commodities from world markets. To illustrate, Japan imported food products amounting to USD 46.05 billion, which accounted for 12.17 percent of total imports. Agricultural imports included fish and prepared fish products, meat and prepared meat products, and vegetables, the volume of which has been increasing through the years.

The major suppliers of these food imports were the US, China, Australia, Canada, Thailand, and the Republic of Korea, in order of volume supplied from 1999 to 2001. Denmark and Chile occupied the seventh and eighth places in 1999, but were replaced by Taiwan and Russia through 2001. Indonesia and France were in the ninth and tenth places. Food imports from these suppliers accounted for 73.4 percent of Japan's total food imports.

Table 6. Philippine agricultural imports from Japan, 1991–2000

Year	Agricultural Imports from Japan (in FOB million US\$)	Total Imports from Japan	% Share Agricultural Imports to Total Imports from Japan
1991	65.07	2,347.08	2.77
1992	47.01	3,475.82	1.35
1993	58.90	4,029.96	1.46
1994	60.97	5,188.15	1.18
1995	60.06	5,956.65	1.01
1996	50.53	7,128.89	0.71
1997	75.68	7,414.22	1.02
1998	61.32	6,029.92	1.02
1999	59.80	6,135.87	0.97
2000	63.10	6,027.10	1.05
Average	60.24	5,373.37	1.25

Source: NSO, various publications

**Table 7. Average percentage of top three
agricultural imports to total agricultural
imports from Japan, 1991–2001**

Year	Percent (%)
1991	47.19
1992	39.78
1993	29.78
1994	36.62
1995	54.02
1996	58.56
1997	55.77
1998	55.03
1999	63.13
2000	64.45
2001	70.13
Average	52.22

Source: Bureau of Agricultural Statistics, Agricultural Foreign Trade Development Annual Report, various years.

The Philippines' Share in the Japanese Agricultural Food Market

The Philippines ranked 16th among the top food suppliers to Japan in 1999-2000, exporting mainly bananas, shrimps and prawns, tuna, pineapple, and asparagus as shown in Tables 8 and 9. Although importation of fresh fruits is limited by plant quarantine regulations, the Philippines has remained the second largest exporter of fresh and prepared fruits, next to the US. Japan typically imports the bulk of a particular food commodity from a single country or region. The Philippines, for instance, is the top supplier of tropical fresh fruits like bananas (78.9%), pineapples (97.9%), and mangoes (60.7%). Even the share of papayas increased to 48.4 percent since the ban on imports from the country was lifted in 2001.

In contrast, the Philippines has not yet positioned itself in the export of vegetables and other agricultural commodities to the Japanese market. It is only in the export of asparagus that it has a decent standing as fourth largest supplier. The Philippines' exports of shrimps, prawns, and tuna make up a small percent of the Japanese market.

Palanca-Tan (2003) revealed that RCA indices for Japan and the Philippines could offer a wide scope for complementation in trade between the two countries. Postwar figures show that the country's strongest advantage remained in labor-intensive goods, followed by fresh and processed foods. However, Japan's trade with Thailand, Indonesia, and Malaysia dwarfs that of the Philippines.

Japan's Agricultural Food Imports from other Countries

Japan imports food commodities from various countries. By far, the US is the largest supplier of food to Japan. It supplies huge bulks of corn, beef,

Table 8. Japan's top imports from the Philippines

Item	Value (USD '000)		Volume (metric ton)	
	1999	2000	1999	2000
Total	746,643	739,047	--	--
Bananas	379,743	390,282	727,071	811,000
Shrimps and prawns	91,047	103,447	8,028	8,530
Tuna and bonito	86,931	66,668	39,081	26,789
Pineapples	42,320	48,135	88,329	98,378
Asparagus	20,141	17,307	5,243	4,294

Source: Statistics of Japan's Food Imports in 2000

Table 9. Top 10 exporters, by country

Country	2000 (USD 1000)	Growth rate %	1999 (USD 1000)	Top Items
1 US	12,310,242	3.4	11,902,958	Corn Beef Pork
2 China	6,096,972	12.6	5,412,555	Eels (processed) Chicken Shrimps and prawns
3 Australia	3,218,712	7.5	2,993,262	Beef Shrimps and prawns Wheat
4 Canada	2,585,697	5.9	2,442,116	Pork Canora Wheat
5 Thailand	2,261,346	4.5	2,164,519	Shrimps and prawns Prepared shrimps and prawns Chicken
6 Korea, Republic of	1,797,187	-11.3	2,026,507	Tuna Clams and oysters Pork
7 Russia	1,312,623	9.4	1,199,760	Crabs Cod roe Salmon roe
8 Denmark	1,236,765	21.5	1,018,169	Pork Cheese and curd Salmon roe
9 France	1,210,924	1	1,198,482	Wine Brandy Pork
10 Indonesia	1,143,008	2.1	1,119,740	Shrimps and prawns Tuna Coffee bean
16 Philippines	739,047	-1.0	746,643	Bananas Shrimps and prawns Tuna, bonito

Source: Statistics of Japan's Food Imports in 2000

and pork. China follows the US, supplying processed eels and chicken to the Japanese market. Australia is another large supplier of food to Japan. Beef, shrimps and prawns are its major products. Japanese importation from these suppliers is growing, with the exception of South Korea, whose imports to Japan contracted by -11.3 percent.

Since 1993, the major vegetable exporters to Japan were the US, China, and New Zealand, which accounted for almost 80 percent of total imports. In 1999, Japan External Trade Organization (JETRO) reported that the US exported 225,000 tons of vegetables, consisting mostly of onions (53.6%) and broccoli (31.3%). China shipped 131,000 tons consisting of ginger (23.8%), mushrooms (19.9%), garlic (19.2%), and peas (11.1%), among others. On the other hand, New Zealand exported 114,000 tons, mainly pumpkins (69.4%) and onions (25.6%) (JETRO 1999).

For fruits and prepared fruit products, the top suppliers in 2000 were the US, the Philippines, China, New Zealand, and Brazil, ranked accordingly. Of the citrus fruits (lemons, oranges, and grapefruit), 90 percent came from the US. However, in recent years, South Africa has also been supplying remarkable amounts of oranges (7.4%) and grapefruits (18%) to Japan. Other primary exporters to Japan are Chile for grapes, Mexico for melons/watermelons, and South Korea for apples.

Shrimps and prawns are leading imported products in Japan in terms of value and are ranked second to pork among overall agricultural imports. Thailand has been the main source of shrimps and prawns until the 1990s but due to pollution problems, Indonesia has taken the lead. In 2001, Indonesia ranked first, with a share of 22.7 percent of Japan's market, followed by India (17.5%), and Vietnam (14.6%).

Japan's imports of tuna are about 360,000–380,000 tons and reached 400,540 tons in 2001. Taiwan was the top tuna exporter, having an import share of 26.3 percent, followed by South Korea (16.1%), Thailand (11.1%), Indonesia (6.7%), and China (5.6%). The Philippines ranked as 16th among the exporters to Japan.

The Japanese Vegetable and Fruit Market

Fresh produce is an essential component of Japanese diet. A Japanese individual typically consumes around 59 different produce each year. Fresh produce accounts for 7-8 percent of the average household expenditure. This translates to an annual per capita consumption of 50-60 kilograms (kg) or 163 grams of produce per day (based on the 1997 Survey on Household Expenditures).

As fresh produce is an important component of daily nutrition, a Japanese consumer has become selective and conscious of safety considerations in exercising his or her preferences. Three in four Japanese consumers buy produce every two or three days. The most popular locations are supermarkets (55%), fruits and vegetable stores (24%), and cooperative stores (12%). These sources are followed by direct buying from producers

and organic growers. Consumers want sellers to provide fresh produce (44%), a wide selection with unusual size items (41%), less packaging and wrapping materials such as styrofoam trays (27%), good quality (22%), and low prices (19%).

Thus, imports of fresh produce are projected to rise for a number of reasons: declining number of domestic producers due to ageing Japanese population, technological advances that have the potential to extend the freshness period of most products, expanding variety of imported produce, and popularity of direct commercial importing.

Distribution Routes

There are two distribution channels for imported produce. The general route involves the Japanese importers (trading companies and produce packers) and the wholesale market. The second route or the direct route was developed by major supermarkets that distribute produce directly to processors and retailers. About 70 percent of the imported produce in Japan is distributed through the first route, as in the case of pumpkins, broccoli, and asparagus. Wholesalers may conduct a type of auction where multiple buyers put prices on commodities. "Seri" trading is conducted six times a week at the wholesale markets.

The direct route bypasses the wholesale markets. Its main purpose is to develop and import products that match Japanese consumers' tastes. Produce seeds are taken from Japan together with Japanese growing technologies and are introduced in other countries. Partnerships among large Japanese supermarkets like JASCO and Daiei, food processing companies, and import traders are forged. Produce distributed in this manner are white spring onions, shiitake mushrooms, and asparagus, among others.

Market Access

JETRO, through its Japanese Market Report on Regulations and Practices, provides advice on access to Japanese market. One of the methods to gain such access is by establishing a local company or office in Japan to market products independently or by seeking a business relationship with a Japanese company. JETRO emphasizes the necessity of studying Japanese consumer tastes, and paying careful attention to the freshness and taste of the produce. Knowledge of the Epidemic Prevention and Food Sanitation Laws of Japan is equally crucial in any effort to penetrate the Japanese market, which places a very high premium on food quality and safety.

Plant Quarantine Law

Japan imposes one of the strictest plant quarantine practices in the world. Produce importers must submit several quarantine documents before a shipment is cleared or in case pests are found. In which case, a produce could be sterilized through fumigation, destroyed by burning, or returned to source. In addition, there are certain produce whose import from certain regions is prohibited due to pests or their larvae, as in the case of grapes, cayenne pepper, and kidney beans from Asia and Hawaii, which are plagued by melon fly or Oriental fruit fly. A Phytosanitary Certificate issued by the designated government agency of the exporting country is a mandatory document before the entry of produce to Japan.

Food Sanitation Law

In addition to the plant quarantine clearance, the importer must likewise submit a Food Import Information to the Ministry of Health and Welfare for examination. An administrative examination is conducted, including examination of proof of sanitation documents and of ingredient data tables or description documents. The Japanese examiners have set up an information system to facilitate investigation of past import history or possible violations. Actual inspection of products may follow depending on the results of the administrative examination. Sampling may likewise be done for chemical analysis and bacteria counts, levels of residual pesticide, additives, and residual radiation in order to establish the integrity of products.

Rules on Labeling and Packaging

The Produce Quality Labeling Guidelines instructs all importers to use labels for their produce. The product name, country of origin, distributor or importer, and volume must be contained in the label. In addition, guidelines are also provided for size standards for 27 widely distributed items. For instance, onions of diameter more than 8 centimeters (cm) are labeled 2L, 7–8 cm are called L, and onions 6–7 cm are labeled M. Broccoli is packed 38 heads to a container following a practice that Dole initiated and which later became the standard.

Expanding Economic Cooperation

In examining the importance of economic cooperation in the field of agriculture, it is important to put in context the state of agricultural development in the country.

- Agriculture's importance to the Philippine economy in terms of its contribution to exports has been on the wane, averaging 14.03 percent for the period 1990-2000. Beginning 1997, the sector's share

has fallen below the double digit (9.27% in 1997 to 5.21% in 2000). This trend is supported by the declining RCA in agriculture.

- Roughly one-fourth of the country's agricultural exports are shipped to Japan and another quarter to the US. This highlights the vulnerability of the agricultural sector and its high degree of market dependence on mere two trading partners.
- For the period 1991-2000, the composition of the country's major agricultural exports has remained almost the same. Crude and refined coconut oil remains the top export commodity. Seaweeds/carageenan and fresh mangoes came into the picture only in the later part of the decade, displacing copra oil cake/meal and unmanufactured tobacco.
- The Philippines' agricultural exports to Japan make up one-fifth of its total exports to the country. Fresh fruits (bananas and pineapples), shrimp and prawns, tuna, and vegetable comprise the bulk of exports.
- The country's agricultural imports from Japan averaged USD 60.24 million or just 2.75 percent of total agricultural imports. This value represents, in turn, a mere 1.25 percent of the country's total import bill from Japan.
- Only three commodities in 2000 made up close to 70 percent of the country's imported agricultural commodities from Japan. These are manufactured fertilizer, agricultural chemicals and materials, and agricultural machinery. From 1991 to 2001, these commodities made up over half of the imported agricultural goods from Japan on average. Food and live animals, tobacco and tobacco manufactures, crude materials, and animal and vegetable oils and fats made up another 30 percent.
- Japan is historically regarded as a major importer of agricultural food commodities.
- The Philippines is ranked 16th among the top food suppliers to Japan. Bananas, shrimp and prawns, tuna and bonito, pineapples, and asparagus comprise the bulk of the country's food exports to Japan.
- Japan typically imports fresh fruit from a single country/region. This makes the Philippines the top supplier of tropical fresh fruits, e.g., bananas, pineapples, and mangoes.
- Fresh produce is an integral component of the Japanese diet. To enable the entry of food products in Japan, quality and safety considerations and elaborate requirements on labeling and packaging must be met.

Facilitating Existing Trade

As the Philippines enjoys being the top supplier of tropical fruits to Japan, the challenge for the Philippines is to maintain this position. Continuous improvements to meet the high standards of a selective Japanese market must be met in the face of an aggressive competition that seeks to capture a bigger share of the market (e.g., Hawaii, US for papayas; and Thailand for canned pineapple/pineapple products).

The Philippine government should continue to facilitate existing trade. One way of doing this is to expedite the quarantine clearance process of imported goods by submitting a sample of forthcoming imports to official laboratories designated by the Japanese government. The test results may be substituted for the corresponding inspection at the port of entry. In addition, importers may submit notification by making use of the Food Automated Import Inspection and Notification Process (FAINS), a digital system of processing import-related documentation. These and other related trade information may be accessed at the JETRO website.²

Potential Agricultural Commodities that Can be Exported

In addition to Philippine traditional exports, other products can be exported to Japan since their specifications meet the requirements of the Japanese consumer market. These include

- 1) crabs (although most produce are mud crabs, some farms are starting to grow king crabs),
- 2) seaweeds,
- 3) onions (Japan imports the Welsh variety),
- 4) pumpkins,*
- 5) potatoes,
- 6) ginger,
- 7) garlic,
- 8) carrots and turnips,
- 9) watermelons/melons,*
- 10) tomatoes,*
- 11) eggplants,
- 12) avocados, and
- 13) rice straw.

* Imports from Asia is currently prohibited because of Melon fly and Oriental fruit fly but representations may be made with the concerned Japanese agency.

² <http://www.jetro.go.jp>

This is a preliminary listing of agricultural products, composed of two fisheries products and 11 vegetables/fruits, which have high prospects in the Japanese market. Exploring the export potential of these 13 produce can be beneficial, considering that Japan imports them from as far as Mexico and Portugal. Specifications of the Japanese consumer market must be checked to ensure compliance of Philippine products. It would also help knowing beforehand if the agricultural chemical usage patterns in the Philippines meet those of Japan since this information is readily available.

In addition to this initial list, other Philippine products can be analyzed for their marketability in Japan, such as *pili* nuts and its derivatives, dried shiitake mushrooms, okra, papayas, soybeans, other beans and peas, leaf tobacco, crude honey, special forest products, vegetable wax, and charcoal. Palanca-Tan (2003) demonstrated, by using a two-digit commodity classification, that the Philippines has strong comparative advantage in sugar preparations and honey, fruit vegetable oil and fats, processed animal and vegetable oil, in addition to the fruits, vegetables, fish, and other fish preparations that are being exported to Japan.

In 1998, the APEC Study Center Institute of Developing Economies in Tokyo came out with a report that aimed to quantify impediments to trade in commodities in Japan (Yoshino 1998). The section on commodity trade looked at 20 items and tried to clarify how closely the difference between domestic and import prices reflect impediments to commodity trade. Some of the key findings are as follows:

- Corn—The ratio of the domestic price to its imported price is 4.60; almost all corn are used for feedstuff production; tariffs are not levied on corn imports; domestic producers are not protected.
- Soybean—The ratio of the domestic price to its imported price is 5.95; no tariff is set for soybean and no special subsidy is given to farmers; the price differential is seen as due to differences in the characteristics of domestically grown soybean.
- Other beans and peas—These include green peas, kidney beans, and Azuki beans; Japanese consumer preference significantly affect the ratio of the domestic price to the imported price; beans and peas are used to make Japanese confections; import quotas used to be imposed depending on domestic production; since April 1995, a tariff quota system was implemented.
- Garlic—Price differential is greater than two; consumer tastes change rapidly and consumers require increased variety (weak-smelling garlic and strong-smelling garlic).

- Tobacco leaf—The ratio of the domestic price to its imported price is 2.25; tobacco made of tobacco leaf is an expensive commodity and quality is important to consumers; the tariff rate for tobacco is zero.
- Crude honey—The ratio of the domestic price to its imported price is 4.20; price differentials are traced to quality and consumer's preferences.
- Dry shiitake mushroom—The ratio of the domestic price to its imported price is 2.09; mainly due to differences in production costs; since dry shiitake is not regarded as a plant, imports do not need quarantine examinations but Japanese consumers are wary of postharvest pesticides that may have been used on the product.
- Crude Japanese lacquer—The price differential is 14.96; imports are tariff free; no protectionist measures are taken to promote domestic production.
- Charcoal—The ratio of the domestic price to its imported price is 3.69; no tariff is levied on imported charcoal; the high price differential may be due to differences in production; in Japan, a kiln is used to make charcoal.

These findings served as inputs to the Aggregate Measure of Support (AMS). The AMS, as a concept, measures certain aspects of the support provided by agricultural policies. The AMS calculation includes all domestic support policies considered to have a significant effect on the volume of production, both at the product level and at the level of the agricultural sector as a whole. Policies are classified depending on their potential impacts on trading. Policies that have a substantial impact are classified into the amber box; policies that are not deemed to have a major impact are placed in the green box; and policies that fall into neither of the two categories are known as blue box policies and are not included in the AMS calculations.

Green box policies include direct payment schemes that subsidize farmers' incomes but in a manner that is deemed not to influence production decisions. They include assistance provided through environmental protection programs, regional assistance programs and general services that provide research, training and extension, and marketing information. Blue box policies, on the other hand, include the compensatory payments and land set-aside program of the European Union's Common Agricultural Policy and the US' deficiency payment schemes. The Philippines, however, does not have any export subsidies. In the case of World Trade Organization (WTO) production subsidies, the Philippines maintains less than a 10 percent subsidy rate (Balisacan 2003).

In 2003, Japan expanded the coverage of its Generalized System of Preferences (GSP) that cuts existing tariff rates. Topping the list of products

are coconut oil (from 4.5% to zero), papayas (from 2% to zero), fruit stones, kernels, and other vegetable products (from 3% to zero), vegetable planting materials (from 3% to zero), and yeast (from 3.8% to zero). Tariff on prepared bananas, avocados, and mangoes other than those packaged in airtight containers was trimmed to 4.8 percent, prepared mangoes and guavas to 7.5 percent, preserved papayas to 6 percent, prepared papayas to 3.8 percent, vegetable and fruit nuts prepared in sugar to 9 percent, and prepared cashew nuts to 5 percent.

One of the criteria used to determine whether a specific agricultural commodity is qualified for inclusion in the list that will receive preferential treatment is that it should not compete with products being grown by Japanese growers. Otherwise, Japan will suspend the GSP privilege.

Other Means for Expanding Trade

A large portion of the produce brought into Japan is imported directly. The main purpose of this distribution route is to develop and import products that match the Japanese consumers' tastes. Tie-ups with large supermarkets, food processing companies, and import traders thus become vital. For direct imports, it may be initially necessary to produce commodities using Japanese seeds to eliminate the risk of "taste failure." However, it may also pay to develop new products using modified seeds³ since trading companies are always eager to introduce new items that help differentiate them from their competitors. Some fruits that cannot be imported fresh can be imported as juice, jam, diced fruit, or frozen fruit. Thus, there is a need for exporters to be innovative. The bulk of the Philippine exports are low-value crops and it is imperative to increase their value added. Table 14 shows that the country ranks 16th in the list of top suppliers of food to the Japanese market. Apart from tropical fruit, however, the rest of exported products, such as high-value commodities like shrimps, prawns, and tuna, comprise a small share compared to top suppliers like China, Australia, Thailand, and Indonesia.⁴

The Japanese consumer is also very particular about the packaging of the product. It must be functional yet attractive without sacrificing product quality. Assistance to exporters is urged to meet Japanese standards.

To illustrate a possible partnership, a Department of Trade and Industry (DTI) desk officer interviewed for this study mentioned the case of a farmer in Bulacan who is raising okra for export to Japan using Japanese seeds.

³ Subject to the stipulations of the Plant Protection Law.

⁴ Some industry observers claim that the seafood imports of some countries actually come from Philippine waters.

A Japanese nongovernment organization based in Nueva Vizcaya has also introduced the mushroom species shiitake to local farmers in the area. This mushroom could be cultivated in some parts of the Cordillera and Nueva Vizcaya where temperatures range from 5 to 32 degrees Celsius. The same trade desk officer also related the case of a businessperson who wanted to export rice straw to Japan but got impatient with the stringent Japanese import rules.

In another instance, the secretary-general of the Japanese Chamber of Commerce and Industry in Manila, Tetsuya Matsuoka, related the story of a Filipino farmer based in Baguio who regularly provides vegetables to Japanese nationals in Makati. These vegetables are exactly similar to those found in Japan.

Earning the trust of the Japanese consumers is vital in the effort to develop a long-term relationship since the Japanese consumer focuses on the supplier's credibility, *e.g.*, Dole or Del Monte. In the case of seafood produce, long-term relationships already exist between the Japanese importer and exporter and penetrating the market would be more difficult.

In improving the quality of Philippine products, programs supported by official development assistance could be explored. Technical assistance (to meet the strict and discriminating Japanese consumer market) with regards to phytosanitary measures, market fairs to bring together the Filipino farmer/exporter and the Japanese trader, and capacity building to develop human resource in agriculture may be sought.

Specific Plans of Action

- 1) If the Philippines wants to negotiate a trade agreement in agriculture with Japan, without touching on the sensitive issues of tariffs and export subsidies, and given that the agreement should promote agricultural trade, then greater market access should be explored via other means. Since the exchange, as earlier mentioned, cannot be crop for crop, it would be better to include agriculture along with other components of the economic cooperation. By so doing, the country would have a better bargaining position, through a healthy compromise between the two countries.
- 2) An Agricultural Trade Attaché Office in Japan could be appointed to undertake an in-depth review of the Japanese food market. Information on notable and persistent market trends and consumer preferences could help address the limited product varieties and their potential in the Japanese market. Both short-run and long-run frameworks could be laid out for this purpose.

- 3) An inventory of agricultural product exporters to Japan could likewise be done. This could pave the way for documenting their problems, including all other information such as skills that need to be improved and/or are lacking.
- 4) A review and assessment of technical assistance given by Japan to the Philippines is also necessary.
- 5) The Philippine government should lead in facilitating trade. This can be done by bringing together the private stakeholders involved, but should not dictate what products must be planted. Instead, it should ensure that the necessary institutional and public goods are in place, and that identified actions are taken in an immediate fashion.

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2 Prospects and Problems of Expanding Trade with Japan: A Survey of Philippine Exporters

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Rosalina Palanca-Tan¹

Introduction

The Philippines-Japan trade relations have been limited in several respects. Philippine exports to Japan continue to lag much far behind its imports from Japan. This has resulted in huge trade deficits for the Philippines. As a consequence, Philippine trade with Japan accounts for the bulk of our trade deficits. In 1999, for instance, Philippine trade deficit with Japan of USD 3.348 billion even exceeded the country's overall deficit of USD 2.751 billion.

Another concern is the weaker Philippines-Japan trade links relative to trade links of Japan with other Association of Southeast Asian Nations (ASEAN) member countries and China, the close competitors of the Philippines. In 2001, Japan's imports from the Philippines accounted for just 1.8 percent of Japan's total imports, much lower than Indonesia's 4.3 percent, Malaysia's 3.7 percent, Thailand's 3.0 percent, and China's 16.6 percent.

What is preventing the Philippines to partake of a larger slice of the Japanese market? This is the key question this paper aims to address.

Objectives of the Study

This study looks into the prospects of expanding trade, particularly Philippine exports to Japan. The specific tasks to be accomplished by this research are as follows:

- (1) To identify specific product categories with export potential in Japan,
- (2) To present the industry profile, with emphasis on the export strengths and weaknesses of the production sectors identified above,

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- (3) To identify problem areas and opportunities with respect to exporting to Japan, and
- (4) To identify and recommend provisions for the proposed Japan-Philippines Economic Partnership Agreement (JPEPA) to enable existing and prospective Philippine exporters to exploit fully the potential of the Japanese market.

There is a dearth of studies dealing particularly with PH-Japan trade. Many of the available studies are on Japan's trade with ASEAN countries and PH-Japan economic relations in general. These include papers by Valdepeñas in "Japan in the Post-War Philippine Economy, in *Philippine Studies* (1979); Ng, et al.'s *Industrial Restructuring in ASEAN and Japan* (1987); and Tecson's "Desiderata for Future Philippines-Japan Economic Relations," in *Towards a Shared Future through Mutual Understanding: Proceedings of the First International Conference on Philippines-Japan Relations* (1996). The study by Palanca-Tan, "Postwar Trade" in *Philippines-Japan Relations* (2003), focuses on PH-Japan trade relations in the entire postwar period and makes an in-depth analysis of the relevant and critical features and characteristics of these trade relations, particularly in the decades of the 1980s and 1990s.

As of this writing, research on trade relations between the Philippines and Japan has been limited to macroeconomic analysis and use of secondary data. This research contributes to existing primary data literature and to firm-level analysis of the factors that affect Philippine exports to Japan.

Methodology

The analysis on Philippine export niches in Japan adopts Balassa's RCA framework and the World Bank's Market Position Matrix. To identify the products that Japan needs and imports relatively more extensively, an index for imports parallel to exports RCA is defined. To determine which Philippine products have export prospects in Japan, Japan's import index and the RCAs of Japan and the Philippines are analyzed and compared.

The World Bank approach, on the other hand, enables this study to assess the position of a Philippine export good in the Japanese market by considering the share of the Philippine product in Japan's imports and how this is changing vis-a-vis the product's share in Japan's overall imports.

Objectives 2 and 3 of this study are achieved through focused group discussions (FGD) and interviews with past, existing, and prospective exporters to Japan, as well as interviews with industry leaders and officials of both the Philippine and Japanese governments.

Summary Data on Philippine Exports to Japan

Export products

About a third (33%) of Philippine exports to Japan in 1998–2002 were generated by semiconductors exports. The second largest was electronic data processing, making up for more than a fifth (22%) of Philippine exports. All electronic products combined accounted for 60 percent. Machineries and transport equipment parts comprised 8 percent of Philippine exports to Japan, the bulk of which were automotive parts (6%).

Food and food preparations contributed 8 percent to merchandise trade earnings from Japan. More than half (4%) of these came from exports of fresh fruits (bananas, pineapples, mangoes, papayas) and vegetables (asparagus, okra, taro). Marine products, mainly shrimps and prawn, accounted for 3 percent. Tuna exports to Japan have been dwindling in recent years. Nonfood consumer products (e.g., house products, footwear, fashion goods, decorative goods, garments, etc.) and resource-based products (e.g., mineral, coconut, etc.) each contributed 6 percent.

It must be noted that electronic product exporters declare their export earnings in two ways. Some declare gross earnings inclusive of the costs of imported raw materials, which account for the substantial portion (more than 90%) of the value of the finished product. Others declare net foreign exchange earnings, which reflect the true value added of the product in the Philippines. Based on industry employment data, industry leaders estimate electronics value added to be roughly equivalent to only 15 percent of export earnings. This would then make the net foreign exchange contribution of electronics in 2002 to be only about USD 500 million, a figure not so much higher than the USD 381 million contribution of food products and USD 268 million contribution of nonfood consumer products.

Export growth

Philippine exports to Japan have grown much less than total Philippine exports. While overall Philippine exports grew by an average of 8 percent per year in the past five years, 1998–2002, exports to Japan grew by only 5 percent, which is 3 percent points less.

The growth of Philippine exports during the period was pulled mainly by industrial manufactures. The growth of industrial exports more than offset the contraction in nonfood consumer goods (-1%) and resource-based exports (-5%). Food exports, however, managed only a modest annual growth of 1 percent in 1998–2002. This growth was made possible by fresh fruits and seafood exports, which increased by 5 percent and 2 percent, respectively.

Table 1. Export product shares, annual average, 1998–2002

Product Category	Share
Consumer manufactures	6.38
Food and food preparations	8.00
Processed foods	0.76
Fresh foods	4.34
Marine products	2.91
Tuna	0.52
Shrimps and prawns	1.93
Resourced-based products	6.52
Industrial manufactures	73.36
Electronics	60.24
Components/devices (semiconductors)	33.19
Electronic data processing	21.51
Telecommunications	1.44
Automotive electronics	1.76
Consumer electronics	1.40
Machineries/transport equipment/apparatus and parts	8.18
Transport equipment	7.07
Automotive parts	6.41
Special transactions	5.73

Source of data: Department of Trade and Industry (DTI) Database

The growth rates of industrial exports to Japan were smaller except for telecommunications and automotive electronics, which posted impressive average annual increases of 39 percent and 32 percent, respectively. The contractions in the consumer manufactures and resource-based products were also more pronounced. Further, overall food exports to Japan dropped by 1 percent. The moderate growth of 3 percent in the fresh fruits exports was not sufficient to buoy up the whole sector. Exports of processed foods and marine products suffered average annual decreases of 3 percent and 5 percent, respectively.

How Important is the Japanese Market to Philippine Exporters?

Japan absorbed about 15 percent of Philippine exports in 1998–2002. Japan is the single biggest buyer of Philippine shrimps and prawns (71%) and fresh fruits and vegetables (60%). A fourth to a third of Philippine exports of transport

Table 2. Export growth rates, annual average, 1998–2002

	Total PH Exports	Exports to Japan
Total	7.67	5.25
Consumer manufactures	-1.21	-2.21
Food and food preparations	1.01	-0.82
Processed foods	0.25	-2.78
Fresh foods	4.66	2.97
Marine products	-0.43	-5.11
Tuna	-0.97	-0.10
Shrimps and prawns	2.23	-1.87
Resourced-based products	-4.92	-8.32
Industrial manufactures	11.54	8.32
Electronics	14.68	11.51
Components/devices (semiconductors)	13.92	8.30
Electronic data processing	24.33	18.78
Telecommunications	-15.49	38.63
Automotive electronics	9.26	31.55
Consumer electronics	8.30	-11.31
Machineries/transport equipment/apparatus and parts	12.15	3.84
Transport equipment	11.78	2.65
Automotive parts	11.53	3.18
Special transactions	10.98	9.28

Source of data: DTI Database

equipment and automotive parts and electronic products, such as data processing, telecommunications, and automotive electronics, are destined for Japan. Japan has a remarkably lower share of about 10 percent in Philippine semiconductor exports. Even smaller are the shares of Japan in Philippine processed food (7%) and consumer goods (8%) exports.

Japan's import index ($JI > 1$) is used to identify the product needs and wants of the Japanese market that are sourced externally. Philippine products that have high export potential in Japan are those products for which JI is greater than 1, as well as Philippine RCA (PRCA) is greater than 1 and greater than Japan's RCA (JRCA).

Of the 69 commodities (3-digit SITC classification) for which Japan's import index (JI) is greater than 1, there are 16 commodities for which PRCA is

Table 3. Japan's share in Philippine exports, annual average, 1998–2002

Product Category	Shares
Total	14.63
Consumer manufactures	8.22
Food and food preparations	30.70
Processed foods	7.04
Fresh foods	60.35
Marine products	35.71
Tuna	16.74
Shrimps and prawns	71.27
Resourced-based products	18.02
Industrial manufactures	14.29
Electronics	13.26
Components/devices (semiconductors)	9.91
Electronic data processing	24.11
Telecommunications	33.06
Automotive electronics	28.29
Consumer electronics	15.98
Machineries/transport equipment/ apparatus and parts	34.40
Transport equipment	34.67
Automotive parts	35.43
Special transactions	19.73

Source of data: DTI Database

greater than 1 and significantly greater than Japan's RCA. Sixteen is remarkably a big portion of the 25 commodities for which the Philippines has a comparative advantage. Of these 16, there are only two commodities for which Japan also has a comparative advantage. Nevertheless, the JRCA for these two is significantly less than the PRCA.

Other markets in Japan, which the Philippines may develop, include commodities that Japan imports extensively and for which PRCA, though less than 1, is greater than JRCA. Of the 19 commodities in this list, unmanufactured tobacco, non-ferrous base metal ore concentrates, textile products, and footwear appear to be the most promising.

Finally, there are a number of commodities that Japan may not yet be importing as much ($0.5 < JI < 1$) but with PRCA that is greater than 1 and significantly greater than JRCA. Note that of the remaining 10 commodities for which the Philippines has a comparative advantage but are excluded

Table 4. Products for which: $JI > 1$, $PRCA > 1$, $PRCA > JRCA$

Commodity	JI	JRCA	PRCA
031 Fish, fresh, simply preserved	5.02	0.15	1.37
032 Fish, etc., tinned prepared	4.06	0.33	3.49
051 Fruit fresh, nuts fresh, dry	1.06	0.01	4.02
053 Fruit preserved prepared	1.64	0.02	3.28
241 Fuel wood, charcoal	2.29	0.03	2.68
281 Iron ore concentrate	4.78	0.00	2.42
284 Non-ferrous metal scrap	1.38	0.12	1.36
285 Silver platinum ores	2.09	0.34	2.03
292 Crude vegetable materials, nes	1.21	0.12	1.16
632 Wood manufactures, nes	1.33	0.04	1.26
714 Office machine	1.09	1.14	4.45
831 Travel goods, handbags	2.64	0.04	3.98
841 Cloth, not fur	1.51	0.03	2.02
864 Watches, clocks	1.64	1.30	2.12
899 Other manufacturing goods	1.28	0.36	1.06
941 Zoo animals, pets	1.21	0.07	1.04

JI = Japan's import index, JRCA = Japan's revealed comparative advantage, nes = not elsewhere specified, PRCA = Philippine's revealed comparative advantage.

Source of data: National Asia Pacific Economic and Scientific (NAPES) Database (1999 figures).

in category 1, eight are in this third list. Hence, 24 of the 26 commodities in which the Philippines has a comparative advantage are potentially importable in Japan. Note also that Japan's RCA is greater than 1 for only three (namely, office machine, watches and clocks, and electric machines) of these 24.

Philippines' Position in Japan's Markets

The RCA focuses on the supply side. It tells us what the Philippines can export to Japan. To complete the demand side of the equation, we have to look at the share of Philippine products in Japan imports and how this is growing vis-a-vis Japan's imports. Adopting the approach used by the World Bank (1997), Philippine export products to Japan will be classified into the following four quadrants in a Market Position Matrix: Optimal Quadrant (I), Lost Opportunity Quadrant (II), Vulnerable Quadrant (III), and Retreat Quadrant (IV). A product is considered dynamic (stagnant) if its share in total imports of Japan is increasing (decreasing). On the other hand, a Philippine export product in

Table 5.:Products for which: $JI>1$, $0.1<PRCA<1$, $PRCA>JRCA$

Commodity	JI	JRCA	PRCA
054 Vegetable, etc. fresh, simply preserved	1.63	0.01	0.20
055 Vegetable, etc. preserved prepared	2.18	0.07	0.21
081 Animal feedstuff	1.74	0.05	0.24
099 Food preparations, nes	1.05	0.29	0.33
112 Alcoholic beverage	1.12	0.06	0.21
121 Tobacco unmanufactured	1.36	0.00	0.87
243 Wood, shaped	2.06	0.01	0.13
251 Pulp waste paper	1.42	0.05	0.31
276 Other crude minerals	2.31	0.18	0.24
283 Non-ferrous base material ore concentrates	4.47	0.04	0.99
291 Crude animal matter, nes	2.98	0.06	0.35
332 Petroleum products	1.10	0.16	0.23
341 Gas natural manufactured	4.10	0.00	0.12
521 Coal petroleum, etc. chemicals	2.05	0.12	0.17
656 Textile, etc. products, nes	1.58	0.06	0.81
657 Floor cover, tapestry, etc.	1.14	0.02	0.15
661 Cement, etc., building products	1.24	0.20	0.57
851 Foot wear	1.05	0.01	0.52
897 Gold silver jewelry	1.06	0.14	0.24

nes = not elsewhere specified, JI = Japan's import index, JRCA = Japan's revealed comparative advantage, PRCA = Philippine's revealed comparative advantage

Source of data: NAPES Database (1999 figures).

Japan is considered competitive (noncompetitive) if the Philippine share in Japan's market is growing (falling). An optimal market position is where the Philippines is increasing its market share in Japan's dynamic import goods. The quadrant of "lost opportunity" is where the Philippines loses market share in Japan's dynamic exports. In quadrant III, the Philippine position is vulnerable because it is increasing its share in Japan's stagnant import products. Finally, in quadrant IV are Japan's stagnant import goods for which the Philippines is not competitive and, hence, called the "retreat" quadrant.

Tables 7 and 8 list the Philippine export products to Japan in the "optimal" quadrant and "lost opportunity" quadrant, respectively.²

² The other quadrants, Vulnerable Quadrant and Retreat Quadrant, are included as Appendices 1 and 2.

Table 6. Products for which: $JI < 1$, $PRCA > 1$, $PRCA > JRCA$

Commodity	JI	JRCA	PRCA
061 Sugar honey	0.59	0.01	1.04
265 Vegetable fiber, excluding cotton jute	0.96	0.00	7.32
273 Stone sand gravel	0.94	0.11	1.05
422 Fixed vegetable oil, nonsoft	0.64	0.04	7.27
666 Pottery	0.83	0.42	1.65
723 Electric distributor machine	0.80	0.72	3.07
729 Electric machine, nes	0.94	2.01	5.76
821 Furniture	0.94	0.10	1.19

JI = Japan's import index, JRCA = Japan's revealed comparative advantage, nes = not elsewhere specified, PRCA = Philippine's revealed comparative advantage.

Source of data: NAPES Database (1999 figures).

Figure 1. World Bank's market positioning classification

Share of Philippine Exports in Japan's Imports	Share of Product in Japan's Imports	
	Increasing (Dynamic)	Decreasing (Stagnant)
Increasing (Competitive)	I Optimal	III Vulnerable
Decreasing (Non-Competitive)	II Lost Opportunity	IV Retreat

Source: World Bank (1997)

There are 76 product items in the optimal quadrant of the Philippines' Japan Market Position matrix. The majority of these—almost three-fourths—are electronics and automotive, and other industrial manufactures (circuits, resistors, capacitors, switches, radio receivers, input-output units, etc.). Only a few agricultural products (fresh and dried bananas, dried and salted fish), and consumer manufactures (curtains and other furnishings, babies' garments and clothes, knitted garments, wood furniture, trousers, t-shirts, and vests) can be found in the list.

Table 7. Philippines' exports to Japan market position matrix: optimal quadrant

SITC Code	Product Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
4223	Coconut oil, fractions	100.252	19.68	0.13
8122	Ceramic plumbing fixtures	47.494	1,272.67	4.11
0573	Bananas, fresh or dried	32.216	3.33	5,633.16
7722	Printed circuits	31.398	269.38	251.04
7526	Input or output units	29.008	79.88	34.78
7621	Motor vehicle radio receiver	26.563	127.46	28.93
7831	Public transport passenger vehicle	21.669	211.60	22.69
7768	Electronic component parts, crystals	20.158	97.92	35.47
7723	Electric resistors, parts	15.310	130.30	142.29
3343	Gas oils	13.832	1,415.71	39.57
5799	Other plastic waste, scrap	11.944	2,293.49	5.92
8713	Non-optical microscope, etc.	10.922	37,643.55	43.97
7786	Electrical capacitors	10.892	521.56	13.90
6585	Curtains, other furnishings	9.659	5.35	3.75
8932	Builders' ware, plastics	9.487	19.51	1.10
6899	Base metal, nes, waste, scrap	9.486	1,150.26	5.56
7764	Electronic microcircuits	6.664	51.49	1,617.32
6649	Glass, nes	5.260	213.93	85.51
7843	Other parts, motor vehicles	5.236	82.64	151.83
8999	Manufactured goods, nes	4.797	29.81	0.41
7489	Parts, nes, shafts, etc.	4.174	3.31	12.61
0351	Fish, dried, salted	4.074	48.15	7.53
5817	Fittings for tube, plastic	3.983	393.70	1.97
8931	Plastic containers, etc.	3.806	178.90	191.44
7725	Switch apparatus,<1000v	3.552	88.42	207.24
2882	Other non-ferrous metal waste	2.865	3.36	4.75
6214	Vulcanized rubber tubes, pipes	2.760	414.05	1.11
6996	Articles iron, steel, nes	2.652	288.57	6.22
6931	Stranded wire, cable, etc.	2.555	304.79	3,576.11

Table 7. (continued)

SITC Code	Product Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
7249	Parts, textile, dom. washing machine	2.434	28.30	38.19
7413	Industrial furnaces, etc., parts	2.332	113.76	10.09
8714	Compound optical microscopes	2.158	4,271.74	7.30
8732	Revolution counters, meters, etc.	1.963	873.21	0.15
7169	Parts, nes, rotating electric plant	1.529	1,166.84	387.63
8841	Optical fiber lens, etc., unmounted	1.457	28.73	203.00
7712	Other electric power machine, parts	1.446	17.33	252.87
6211	Compounded rubber, unvulcanized	1.283	687.91	3,335.43
7479	Parts for taps, cocks, etc.	1.178	65.07	14.45
7783	Automotive electric equipment	1.153	73.52	107.78
5822	Other plate, sheet, etc.	1.081	10,816.43	84.66
8451	Babies' garments, cloths, accessories	0.963	98.55	15.45
6359	Manufactured articles, wood, nes	0.890	487.03	7.95
7782	Electric lamps, bulbs, etc.	0.741	305.20	43.63
8459	Other garments, knitted	0.647	401.65	2.06
6795	Tube, pipe fittings, iron, steel	0.613	897.71	9.43
8215	Furniture, nes, of wood	0.598	3.31	21.14
8746	Automatic control instruments	0.569	32,983.18	9.29
5821	Plastic sheet, etc., self-adhesives	0.557	182.79	6.12
6991	Locks, safes, strong boxes	0.549	11.21	254.70
8426	Trousers, breeches, etc.	0.545	72.20	15.99
5541	Soap	0.523	869.86	0.30
8454	T-shirts, other vests knit	0.387	498.52	25.13
7641	Line telephone, etc., equipment	0.370	121.07	88.03

Table 7. (continued)

SITC Code	Product Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
5163	Esters, inorganic acid, etc.	0.276	1,097.22	6.24
8813	Photo, cinema equipment, nes	0.226	21.25	19.45
5225	Zinc, chromium, iron, etc., oxides	0.208	4,924.14	1.62
7281	Machine-tools, special industrial	0.204	1,362.58	120.02
8744	Instruments, analysis, etc.	0.179	1,361.18	12.34
7161	Electric motors<=37.5w	0.154	1,076.87	117.25
6581	Sacks, bags, textile material	0.153	601.33	9.91
6644	Float, ground, polished glass	0.137	159.55	310.95
6624	Non-refractory brick, etc.	0.125	41.66	30.88
7788	Electrical machinery, equipment, nes	0.119	1,121.27	254.69
6935	Metal fencing, gauze, etc.	0.115	46.38	8.34
7373	Welding, brazing, etc. machines	0.096	754.57	131.53
6942	Screws, bolts, nuts, iron, steel	0.096	347.36	525.87
6421	Containers, etc., of paper	0.077	12.44	298.65
7522	Digital computers	0.075	663.85	23.68
8742	Drawing, measuring instrument	0.072	410.04	197.94
8843	Lenses, prisms, etc. mounted	0.048	5.04	13.11
5989	Chemical products, etc., nes	0.043	3,415.36	441.17
7259	Parts, paper mill, etc., machines	0.013	76.26	4.48
7311	Machine tools, metal removal	0.012	4,964.37	1,389.26
7929	Parts, nes, aircraft, equipment	0.008	203.34	269.28
5429	Medicaments, nes	0.006	209.38	300.74
5985	Chemical elements for electronics	0.001	8.25	156.12

nes = not elsewhere specified; SITC = Standard International Trade Classification

Source of data: Personal Computer Trade Analysis System (PC-TAS)

Table 8. Philippine exports to Japan market position matrix: lost opportunity quadrant

SITC Code	Product Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
2841	Nickel ores, concentrates	14.551	-15.351	2.89
2519	Semi-chemical pulps	13.609	-18.454	2.52
7731	Insulated wire, etc. conductor	10.234	-39.926	1,455.73
7763	Diodes, transistors, etc.	9.515	-47.668	3.16
0579	Fruit, fresh, dried, nes	7.234	-15.167	159.80
8944	Festive articles, etc., nes	6.992	-21.977	21.02
7853	Invalid carriages, parts	6.844	-12.516	37.16
7751	Household laundry equipment	5.915	-69.929	6.72
2450	Fuel wood, wood charcoal	5.872	-59.070	0.87
7599	Parts, accessories, data processing machines	4.751	-12.255	160.79
6299	Hard rubber, etc., nes	4.540	-11.685	389.17
7491	Moldings for metal foundry	4.329	-43.284	290.63
7359	Parts, nes, machine-tool w/ metal	3.980	-9.051	260.59
8412	Suits and ensembles	2.953	-14.188	45.31
7529	Data processing equipment, nes	2.703	-38.832	235.58
6978	Household appliances, etc., nes	2.403	-56.530	1.22
2462	Sawdust, wood waste, scrap	2.291	-37.419	369.31
0545	Other fresh, chilled vegetables	2.261	-12.191	0.87
7649	Parts, telecommunication equipment	2.208	-47.901	298.68
5986	Organic chemical products, nes	2.144	-28.756	13.01
8469	Other made-up clothing accessories	1.687	-69.644	9.48
6122	Saddlery and harness	1.610	-87.769	3.87
7758	Electro-thermic appliances, nes	1.537	-24.632	40.07
6997	Articles nes, copper, etc.	1.529	-23.008	4.05
7611	Color television receiver	1.355	-61.355	1,434.59
7642	Microphone loudspeakers, amplifiers	1.120	-10.369	13.38
8939	Plastic articles, nes	0.882	-43.539	555.87

Table 8. (continued)

SITC Code	Product Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
7374	Soldering machines, etc.	0.788	-34.467	33.69
8432	Suits, jackets, trousers, etc.	0.762	-61.125	4.23
7732	Electric insulating equipment	0.739	-64.212	1.59
7492	Gaskets, etc.	0.728	-76.429	2.06
6429	Articles, pulp, paperboard, nes	0.668	-42.877	40.82
7427	Pumps, liquid elevators, etc.	0.607	-42.670	10.29
8933	Plastic flooring, wall covering	0.603	-47.477	4.58
0819	Food waste, animal feeds	0.579	-54.712	503.87
2822	Waste, scrap, alloy steel	0.540	-56.506	68.02
6924	Tanks, casks, drums, etc.	0.527	-81.011	1.25
0622	Sugar confectionery	0.499	-44.235	0.77
8482	Plastic, rubber, apparel, etc.	0.471	-54.648	3.93
1122	Fermented beverages, nes	0.384	-79.771	21.30
0344	Fish fillets, frozen	0.370	-77.224	9.87
5542	Detergents, except soap	0.370	-83.657	50.63
8942	Children's toys	0.332	-73.434	39.56
8213	Metal furniture, nes	0.321	-62.201	11.69
7842	Motor vehicle bodies	0.294	-76.522	0.11
1212	Tobacco, stemmed, stripped	0.286	-35.029	179.87
7868	Other nonmotor vehicles, trailer parts	0.275	-12.752	506.00
6659	Glass articles, nes	0.262	-12.727	22.85
6344	Other plywood, veneered panels	0.245	-89.299	27.78
8425	Skirts and divided skirts	0.209	-69.351	24.66
7638	Sound, video recording, etc.	0.202	-83.440	14.29
6589	Made-up articles, textile, nes	0.186	-3.693	1,015.77
5221	Carbon, nes, carbon black	0.171	-92.002	0.52
7628	Other radio receivers	0.151	-87.035	2,405.06
5754	Amino, phenolic resin, etc.	0.148	-21.664	5.53
8438	Underwear, nightwear, etc.	0.127	-77.711	3.68
0372	Crustacea, mollusks, prepared, nes	0.102	-70.906	117.36

Table 8. (continued)

SITC Code	Product Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
0984	Sauce, seasoning, condiment	0.099	-50.242	53.17
8448	Underwear, nightwear, etc.	0.097	-88.186	8.85
6584	Household linens	0.095	-29.419	8.15
7139	Parts, nes, internal combustion piston engines	0.091	-4.256	0.47
5816	Other tubes, pipes, hoses	0.085	-89.494	9.78
8831	Cinematographic film, 35mm+, developed	0.075	-97.844	443.08
2733	Sands, natural not metal-bearing	0.071	-77.289	270.05
0583	Fruit, nuts, frozen	0.037	-55.534	2.37
8743	Gas, liquid measuring, checking, instrument	0.035	-59.457	0.69
6995	Miscellaneous articles, base metal	0.029	-83.406	1.01
7189	Engines, motors, nes, parts	0.028	-53.924	59.82
8212	Mattresses, etc.	0.025	-87.357	10.93
8462	Hosiery, etc., knitted	0.019	-88.988	38.49
8996	Artificial aids, disabled	0.019	-28.312	25.72
8981	String musical instruments	0.019	-68.582	6.40
8722	Other medical instruments	0.013	-31.728	118.56
8719	Liquid crystal devices; lasers	0.013	-87.944	647.86
8961	Hand paintings, drawings, etc.	0.009	-45.810	16.37
7165	Generating sets	0.008	-79.702	22.53
7132	Internal combustion piston engine, vehicle	0.008	-76.776	937.87
0566	Vegetable, unpickled, frozen	0.004	-91.602	1.98
8723	Therapeutic apparatus	0.001	-99.805	196.29
7752	Domestic refrigerators, freezers	0.000	-65.653	2,117.33
6812	Platinum	0.000	-94.066	167.25
0172	Sausage of meat, offal, etc.	0.000	-100.000	90.33
0546	Vegetables, frozen	0.000	-100.000	16.28
3341	Motor gasoline, light oil	0.000	-100.000	74.49

Table 8. (continued)

SITC Code	Product Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
3442	Gas, hydrocarbon, liquid, nes	0.000	-100.000	0.87
6252	Tires, pneumatic, new, bus	0.000	-100.000	656.47
7111	Steam, super-heat boilers	0.000	-100.000	29.37
7919	Railroad track fixtures, parts	0.000	-100.000	2.80

Nes = Not elsewhere specified; SITC = Standard International Trade Classification

Source of data: Personal Computer Trade Analysis System (PC-TAS)

There is a preponderance, on the other hand, of agricultural and food products (e.g, other fresh and dried fruits, fresh and chilled vegetables, sugar confectionary, fermented beverages, frozen fish fillets, prepared crustaceans and mollusks, sauced/seasoning/condiments, frozen fruits and nuts, unpickled vegetables, sausage of meat, frozen vegetables), as well as consumer manufactures (e.g., festive articles, suits and ensembles, clothing accessories, plastic articles, suits/jackets/trousers, pulp/paper/board articles, plastic floor and wall covering, plastic and rubber apparel, children's toys, metal furniture, glass articles, skirts and divided skirts, textile articles, nightwear and underwear, household linens, mattresses, knitted hosiery, and hand paintings and drawings) in the "lost opportunity" quadrant.

Philippine Exporters to Japan: Strengths, Weaknesses, Opportunities, and Threats

Agricultural products and processed food

Strengths and opportunities

A clear advantage of the Philippines in its trade with Japan lies in its agricultural resources as shown in Tables 4-6.

Fruits. The Philippines grows the principal fruit items that Japan imports. Of the total fruit imports of Japan, 58 percent are bananas, 7 percent pineapple, 1 percent mango, 1 percent avocado, and 1 percent papaya—all of which are grown in the Philippines. The Philippines is Japan's major supplier of tropical fruits. The Philippines supplies Japan 79 percent of its bananas, 98 percent of its pineapples, 61 percent of its mangoes, and 48 percent of its papayas.

Most fresh fruit imports of Japan are fruits not grown at all or grown only in very small amounts in Japan. Since the suppliers of any particular kind of fresh fruit in Japan are generally limited due to the small number of producing areas and plant quarantine regulations, some 80 percent–90 percent of any one fresh fruit usually comes from a single country or region. The liberalization of fruit importation in the 1990s resulted in a significant increase in the share of imported fruit products in the Japanese market—from 34 percent in 1989 to 56 percent in 2000. The increase in imports of fruits and fruit products has further stimulated demand with the resulting shift from the traditionally ceremonial way of eating fruits to a more casual and ordinary way. Another factor that contributes to the continuing slide in Japan's self-sufficiency rate in fruits is the declining number of farm households raising fruit trees.

Fruit Juices. Fruit juices are imported in Japan in three forms—fruit juice extract, Japanese-finished fruit drinks processed in wholly owned or joint venture plant overseas, and foreign brand juice drinks. Of these three, the most common is the fruit juice extract. Pineapple juice imports of Japan had grown by 17 percent in volume and by 52 percent in value from 1997 to 2001. In 2001, pineapple accounted for 12 percent of Japan's import of fruit juices. The Philippines is the biggest exporter of pineapple juice in Japan with a 36 percent share, closely trailed by Thailand's 31 percent share.

Vegetables. In recent years, there had been quantitative increase in vegetable imports as well as a diversification in vegetable types imported in Japan for the following reasons: First, there is a downward trend in domestic production due to the aging of farmers as well as crop failures and disasters. Second, there has been a trend of sourcing out-of-season supply from countries with different growing seasons from Japan as in the case of pumpkin, asparagus, and broccoli. Third, Japanese culinary tastes are changing; and fourth, there is the growing use of reefer containers in marine transport and refrigerator trucks in overland transport making possible the import of fresh vegetables in large quantities.

Over 90 percent of Japan's supply of frozen vegetables is imported. For fresh vegetables, imports share reached 18 percent in 2000. Up until 2003, imports from the Philippines roughly accounts for only 1 percent of total Japanese vegetable imports.³ Okra and asparagus are the two major fresh vegetable exports of the Philippines to Japan. Demand for okra in Japan mainly comes from hotels and restaurants and, hence, is not price elastic.

³Notes from JETRO Workshop Series on Vegetable Production/Marketing for Japan, July 2003.

The Philippines also exports frozen taros to Japan. Its share of 0.2 percent in Japan's frozen taro imports is a far second to China's 99.8 percent.⁴

The Philippine advantage is that it can grow vegetables all year round. It can supply off-season vegetables in Japan. The top fresh vegetable imports of Japan are onions (28%), pumpkins (15%), and cabbage and broccoli (15%).⁵ Other major fresh vegetable imports of Japan include carrots, turnips, and ginger. According to Takusari, president of the Tropical Agriculture and Forestry Technical Development Association, onions and carrots are two vegetables that can be grown cheaply and easily without the use of chemicals in the Philippines.⁶ As the Japanese become increasingly health conscious, the traditional requirements for appearance and size of vegetables are being replaced by safety considerations, which are being equated to organic or chemical-free vegetables. According to JETRO consultants, there is a better chance for Filipinos to penetrate the Japanese vegetable markets with organic products. Farm debris and manure, which can be used as composted fertilizers, are plentiful in the Philippines. There is also a great diversity of sources of organic materials in the Philippines. Charcoal vinegar, for instance, can be extracted from several types of trees in the Philippines. In 2003, the share of the organic market in Japan was only 2 percent; however, it was expected to expand rapidly in the next few years.

Pumpkin is another potentially exportable vegetable to Japan. The Japan International Cooperation Agency (JICA) had once been interested in the small, green variety of squash that is easily grown in the Philippines and which has a long shelf life. Pumpkin, however, is classified as a restricted crop from the Philippines due to insect infestation. An opportunity, however, still exists for frozen pumpkin. Generally, exporting vegetables in frozen or processed form is a viable solution to the time frame problem for vegetable exports. The Japanese market only has a 4-day time frame for fresh vegetables—2 days for transporting and 2 days for display—which is difficult for Philippine exporters to meet as transport time already takes more than 2 days.

Seafood. The Philippines is nearer, relative to its Southeast Asian competitors, to the source of Japan's marine product imports, such as tuna and exotic seafood items. Japan is the world's largest market of raw tuna for sashimi. Since Japan's domestic catch of tuna is sluggish, the share of imported

⁴ JETRO Marketing Guidebook for Major Imported Products, p. 98.

⁵ Ibid., p. 95.

⁶ The Philippines used to export onions to Japan in the 1990s. Philippine onions satisfy the quality requirement, juicy and soft, of the Japanese market. However, they fail to meet the size requirement. Takusari, JETRO workshop, May 2003.

tuna in the Japanese market is gradually increasing. In 2000, 58 percent of tuna supply in Japan was imported.

Shrimps, lobsters, and crabs are the other leading imported seafood products in Japan. Farmed black tiger accounts for an overwhelming 96 percent share of the shrimp and lobster market. For medium and large-size shrimp, imports have a market volume share of more than 98 percent. For crabs, imports share is about 75 percent.

Canned Seafood. The Japanese production of canned seafood started to slow down after 1980 with the diminishing supply of mackerel and sardines and the increasing cost of raw materials due to intensified fishing restrictions, as well as the development of more sophisticated food production and packaging technologies. With the decline in domestic production, the share of imports in Japan's canned seafood market expanded from less than 1 percent in 1980 to 15 percent in 2000. In recent years, there has been a growing market for anchovies and oil-packed sardines. There has been a sudden surge in demand for DHA-rich blue-skinned fish products, such as sardines and mackerel, for health reasons. Canned tuna, however, remains the main import item, accounting for 81 percent of total canned seafood imports of Japan in terms of volume, and 50 percent in terms of value. About 40 percent of canned tuna in the Japanese market is imported.⁷ An advantage of Philippine tuna canners over that of Thailand, the biggest exporter of tuna to Japan and the world, is labor cost. All tuna canners in the Philippines have now relocated to General Santos in Mindanao where wages are lower than those in Bangkok, the site of Thai tuna canners. Another advantage is its greater proximity to Japan relative to Thailand, Indonesia, and Vietnam.

In general, Philippine exporters of agricultural and processed food products find three favorable and encouraging conditions in the Japanese market. *First* is the price premium paid by the Japanese market. Relative to other foreign buyers, the Japanese market is less price-conscious. They are willing to pay a higher price for as long as they get quality goods. *Second* is the assistance extended by Japanese buyers to enable exporters to meet the requirements of their market. This includes regular inspection of plants, developing tools and equipment to increase productivity (e.g., a banana-cutting devise was developed by the Japanese for the production of banana chips), and providing equipment and machineries on credit. *Third* is the loyalty of Japanese buyers. The Japanese buyers will not seek and will not accept offers from other suppliers for as long as their present suppliers satisfy all their requirements.

⁷ Please refer to JETRO Market Information, <http://jetro.go.jp/ec/e/market/jmr/063/1.html>.

Weaknesses and threats

Despite the Philippines' comparative advantage in agriculture, only a few agricultural and food products (bananas, and dried/salted fish) land in the optimal quadrant of the Philippines' Japan market position matrix. Many products fall into the quadrant of lost opportunity. While the import market in Japan for these products is expanding, the share of the Philippines in Japan's imports is contracting. Why is the Philippines unable to tap into these growing markets in Japan?

Protection, Regulation, and Closeness of the Japanese Market. Trade liberalization in Japan, especially for agricultural and food products, is yet very far from being complete. Japan persists to use the food self-sufficiency

Table 9. Japan's custom duties on selected agricultural and food products

HS No.	Product	General	WTO	Preferential
0803	Bananas	40%,50%	20%,25%	10%
0804.30	Pineapples	20%	17%	
0804.40	Avocados	6%	3%	3%
0804.50	Mangoes	6%	3%	Free
0807.20	Papayas	4%	2%	2%
0803.00	Bananas, dried	6%	3%	*Free
0804.30	Pineapples, dried	12%	7.2%	*Free
0804.50	Guavas, mangoes, and mangosteens, dried	6%	3%	Free
2009.20-90	Juice of any other fruit			
	1) containing added sugar not more than 10% by weight			
	of sucrose	27%	23%	
	others	35%	29.8%	
	2) other juice of any fruit not more than 10% by weight			
	of sucrose	22.5%	19.1%	
	(ii) others	30%	25.5%	
0709.30	Fresh asparagus	5%	3%	
0714.90	Taros	15%	9%	
2004.90	Frozen asparagus	20%	17%	
0306.11-3	Lobster, shrimps and prawns, live, fresh, chilled or frozen	4%	1%	
0306.19	Other crustaceans	4%	2%	
0302	Tuna	5%	3.5%	

*Applicable only to least developed countries

HS = (harmonized system), WTO = World Trade Organization

Source of data: Various tables from JETRO Marketing Guidebook for Major Imported Products

argument to justify the continuing protection and regulation of its agricultural and food sectors. Tariff peaks still exist for agricultural products. Even with the GSP, Japan's tariff rates on agricultural products are still high: 10 percent for fresh bananas, 17 percent for fresh pineapples, 5.5 percent for banana chips, and 15–21.2 percent for *nata de coco*.

Also, up until 2003, Japan imposes quantitative restrictions on fisheries products. Japan claims that this is necessary to ensure sustainable harvesting of the resource. Trading of the import quotas in the informal markets affects Philippine exporters as it results in increased costs for the importers, which are passed on to the exporters/sellers.

In addition to the tariff and import quota barriers, foreign firms' access to the Japanese market remains difficult and highly costly as the distribution system stays complex, multilayered, non-transparent, and dominated by exclusive relations among producers, wholesalers, and retailers. Most foreign suppliers export to Japan indirectly through Japanese importing firms. These Japanese importers source supplies through their branches all over the world. The route from producers to consumers has not one but about four layers of distribution agents—(1) importers, (2) wholesalers, (3) intermediate wholesalers, and (4) retailers (restaurants, food processing companies, and supermarkets). Efforts toward deregulation have now made possible "short-cuts." Not only can Japanese importers now go straight to intermediate wholesalers or even the final users, the foreign seller or exporters can also now go directly to the distribution channels in Japan without the Japanese importer. This development does not mean, however, that any exporter can easily export directly to Japan. Familiarity with the distribution networks and connections remain to be the determining factors. Not surprisingly, successful Philippine exporters of agricultural goods to Japan are limited to the big farming conglomerates such as Dole Philippines, and some Japanese-managed farms. Sadly, there is truth in the candid comment of a Japanese embassy official that it is almost impossible for the Filipino farmer to penetrate the Japanese market even with zero tariff.⁸

In a JETRO agricultural seminar and workshop series, a Japanese owning a farm in the Philippines and exporting his produce to the Japanese market served as a speaker. He advised an audience of Filipino farmers hoping to sell to Japan to "invite Japanese traders to visit (your farms) and showcase your products with all expenses paid. After the visit, negotiations can start if the products are exportable. Try and try until the negotiation becomes successful." Simple as it may sound, it is not hard to imagine how this

⁸ "And, hence, there is not much point in including the agricultural sector into the proposed economic partnership agreement," according to the Japanese Embassy Commercial Section official.

strategy can exhaust all the resources of even the biggest farmers and food processors in the country.

Furthermore, there are the nontariff barriers. The sanitary and phytosanitary (SPS) conditions and quarantine regulations of the Japanese market (e.g., standards on food additives and residual agricultural chemicals in the Food Sanitation Law) are said to be the most complex and most stringent in the world, and the biggest impediment for agricultural and foodstuff exporters to Japan. During the FGDs and interviews, participating exporters complained about the following requirements of the Japanese market, in particular,

- (1) Japan's metabisulfide⁹ standard of only 50 ppm (parts per million) is too low relative to Europe's 1000 ppm and United States' (US) 200 ppm;
- (2) Vapor heat treatment (VHT) for fresh fruits; and
- (3) Non-defined and subjective standards for food products, mostly qualitative factors that do not constitute health and safety risks as provided for in the WTO SPS agreement.

The Food Sanitation Law of Japan also provides that the Japanese importing company is liable for any harm caused by the imported food. This provision necessitates insurance coverage for the imported food, an added cost that raises the prices of the imports further.

At the very end of the obstacle course is the Japanese consumer. The number one concern of Japanese consumers is tractability of the product. In the case of agricultural and food products, they ask questions such as: "What types of seeds are used?," "From where are they sourced?," "When, where, and under what conditions are the plants grown and harvested?," "What, how, and how often are fertilizers and pesticides used?," and "What and how much chemicals are used in processing?" With the internet, tractability is rapidly becoming a standard requirement. A consumer will just have to type the lot number of the product and all available information on the product will appear on the computer screen. Hence, to gain the trust and patronage of the Japanese consumer, the producer will have to provide as much information as possible.

Finally, there are disappointing as there are encouraging circumstances in dealing with the Japanese market. Japanese importers/buyers behave like a cartel. For instance, in tuna auction, Japanese importers collude not to outbid each other. In general, when Japan dominates the world market, Japanese importers collude to dictate the world price. The close relations among players

⁹ Metabisulfide is a chemical preservative to prevent the growth of microorganisms and subsequent spoilage. It is also an anti-browning agent.

in the Japanese distribution system also mean that if you lose one customer, you lose the entire Japanese market. Moreover, Philippine exporters complain of the numerous claims that Japanese buyers make in terms of both number of cases and volume of claims, and the lack of a system to verify the validity of the claims. The decade-long recession in Japan in the 1990s has also shrunk the Japanese market, with the Japanese consumers increasingly becoming price conscious.

Competition. Although the Philippines has the dominant market share for the fruit items that it exports to Japan, it cannot be complacent with the competition posed by Ecuador and Taiwan for bananas, Mexico for mangoes, and Hawaii for papaya.

In trying to increase its vegetables exports to Japan, it has to contend with China, which has already dominated several of the Japanese vegetable markets and overtaken many of the long-time major suppliers of Japan, such as the United States. In 2003, China already accounted for about half of Japan's imports of vegetables. The rapid growth of Japanese vegetable imports is largely due to China. China can sell larger volumes at much lower prices than the Philippines. For instance, China can supply Japan with bigger onions of the same quality (i.e., juicy and soft) at a lower price. Further, that Japan is moving its secondary processing plants for food products¹⁰ to China is only indicative of a continuing expansion of agricultural and processed food trade from China to Japan.

For fresh and frozen seafood exports such as shrimp, prawns, and tuna, the Philippines has already lost the race to Thailand and Indonesia, despite the fact that the Philippines is nearer to both the source of the resource and Japan's market. Vietnam is catching up. While the Philippines at the time of this writing has none, Thailand and Indonesia and even the newest entrant, Vietnam, now has several long line fishing boats. Vietnamese firms, in partnership with the government, have even developed a boat building industry in support of the growing fishing industry in Vietnam.

The same story goes for canned seafood, specifically canned tuna. Thailand and Indonesia lead the world market for canned tuna as suppliers. Thailand's biggest tuna canner is bigger than all tuna canners in the Philippines combined. Therefore, because of scale, tuna canners in Thailand have lower unit costs. A major cost item that results in substantial scale savings is shipping. Indonesia, on the other hand, replaced the Philippines in second place in 1995. The jump in its share in Japan's canned tuna imports from only 12 percent in 1995 to 34 percent in 2001 is impressive.

¹⁰ Secondary processing plants are where food exports to Japan are unpacked, inspected, and then repacked for sale in the Japanese market.

Philippine Competitiveness and Readiness Issues. Philippine exporters are less able to hurdle the obstacles in the Japanese market and lose in the competition for Japan's market against its Asian neighbors—particularly China, Thailand, and Vietnam—due to three factors, namely, firm inefficiencies resulting in quality and price disadvantages, insufficient infrastructure, and lack of government support.

Both quality and price of Philippine food exports are noncompetitive. Directors and members of the Philippine Food Exporters Association (Philfoodex) themselves roughly estimate that only one out of 10 Philippine food exporters will pass the Hazard Analysis and Critical Control Point (HACCP). A quality problem area cited by Japanese food importers is the lack of tractability of Philippine food products. For banana chips, for instance, Philippines exporters are not able to provide the information the Japanese market requires, such as data on farms from which the bananas are sourced, their cultivation techniques, and their use of fertilizers and pesticides.

Sources of the cost disadvantage of Philippine agricultural and food exports are numerous. *First* is deficiency in technological know-how. Philippine tuna canners, for example, still speculate on how their Thai counterparts can produce with less raw material (tuna) use. Technical know-how as simple as heat insulation to conserve energy is still not applied in many of the small and medium food processing firms.¹¹

Second cost disadvantage is packaging—a major cost item for food exports. Domestically sourced packaging materials are more expensive than imported ones. Importation, however, would require volume. This is a constraint faced by the small and medium enterprises (SMEs), which dominate the food export sector.

Third is the absence of economies of scale, which has significant implications on certain cost items such as shipping/transportation costs and storage costs.

Fourth is the insufficiency of credit facilities for SMEs. Access to funds by SMEs is constrained by their lack of collateral. Until recently, most exporters avail of the short-term Packing Credit Line for both short-term and long-term capital needs. The problem of short-term credit used to finance long-term requirements for fixed capital acquisition surfaces when financial crisis, such as the 1997 Asian crisis, occurs. When supply of funds dry up, short-term loans are not rolled over and SMEs run out of money to service their loans and

¹¹ During the FGD with directors and members of Philfoodex, one food processor mentioned how her firm's monthly electricity bill had gone down by about PHP 25,000 after following an advise by a JICA consultant to install a heat insulation system that cost the firm only a one-time outlay of about PHP 9,000.

finance their daily operation, resulting in temporary or permanent closures. As a consequence, according to a Philfoodex director, there are exporters who rely on the informal financial markets where interest rates can be as high as 20 percent per month.

The *fifth* concerns government policies that raise the costs for exporters. One such policy is the government's regulation of sugar imports. The very high Philippine tariff on imported sugar of 65 percent results in a substantially higher price of sugar—a major ingredient in food exports. Another government policy that exporters claim to be impairing Philippine competitiveness is the minimum wage policy. Exporters claim that the automatic wage adjustments do not provide incentives for workers to increase their productivity.

Other constraints faced by Philippine food exporters include uncertainties and instability of the supply of raw materials and insufficiency of testing centers for food products. A major concern of food exporters is the sourcing of raw materials. Apart from shortages arising from seasonality and natural calamities (typhoons), other factors come into play. The banana chips case is an example. *Saba*, the type used for banana chips, is grown by backyard farmers, not by commercial farms, which have concentrated in the production of Cavendish bananas for exports. A number of problems arise in dealing with backyard farmers—no guarantee on volume, non-adherence to agreements, competition for supply even with the banana-cue vendors, and others.

Consumer manufactures

Strengths and opportunities

The strength of the Philippines' nonfood consumer exports—such as apparel and fashion goods, household products, and furniture—is the product quality particularly the product design and the unique indigenous materials that are available in the Philippines.

Garments. The slowdown of the Japanese economy that started in 1991 and the introduction of the consumption tax resulted in the slump in demand for the luxury-class, branded apparel products from Europe and the US and the increased popularity of lower-priced casual garment imports from China and Southeast Asian countries. The proliferation of "development imports"—goods manufactured according to Japanese buyers' specifications in overseas factories—have led to the growth of the Japanese market despite the decline in domestic production. Likewise, even the upscale European and US brands have put up factories in Asia and are shipping goods directly from their Asian branches to Japan.

Asian-made garments fall into the mass market and medium-quality categories in Japan's market. Mass-market items usually involve consignment processing and manufactured with the abundant materials available in China and Southeast Asian countries. Medium-quality items are imported in small-sized lots of a large variety of designs and require shorter delivery times. Considering the high costs of production in the Philippines relative to China, Vietnam, and Indonesia, Philippine exporters must focus on medium-quality items in which Philippine advantage exists—in terms of design and craftsmanship—to balance its cost disadvantage.

Footwear, Bags, Jewelry, and Timepieces. In general, the chronic recession in post-bubble Japan has led to a change in Japanese consumers' preference in favor of lower-priced quality goods sourced from Asian countries. The volume of imports of low-priced footwear, bags, jewelry, timepieces, and other fashion goods especially from China have increased with the decline in domestic production. On timepieces, Japan appears to be concentrating more on the production and export of movements resulting in lower domestic production, and hence, increasing reliance on imports for completed watches and clocks.

There are some fashion trends emerging in the Japanese market. For bags, there is a shift in demand away from leather bags to bags made of lighter-weight nylon fabric and similar materials. For jewelry, imports of higher-priced platinum and gold jewelry are down while silver jewelry is up. For timepieces, heavy-duty and multi-featured digital watches are popular among the young. The Japanese also tend to own a rather large number of inexpensive watches and mix-match them with different styles of clothing.

Household Products, Lifestyle Products, Novelty, and Gift Items.¹² Imports make up nearly half of the total market value of this product category.¹³ Prospects for import growth in Japan in this sector are good for a number of reasons. *First* is the extensive and continuing development of new sales channels in the sector. There are department stores in Japan entirely devoted to household goods; the pioneer in this area is the Seibu-owned Shibuya Loft. Further, the number of small specialty and lifestyle stores in Japan is still growing. Catalog-based mail order and e-commerce transactions are also picking up.¹⁴ *Second*, household goods stores' customer base is growing

¹² This product category includes a wide range of goods, such as tableware, kitchenware, bath and toilet items, stationery, and products for living room and dining room use. According to Ministry of Economy, Trade and Industry (METI), the following 11 products fall under household goods: light sheet metal products, glass products, ceramics and simple china, fine ceramics, enamelware, house furnishings, musical instruments, stationery, toys, leather products, and leather shoes. Household goods, however, also include products made from bamboo, cane, cloth, and plastics.

¹³ JETRO Japanese Market Report, No. 55, March 2001.

¹⁴ This is reflected in the remarkable sales performance of magazine type household goods catalogs (e.g.,

and diversifying. The traditional clientele of these stores are females who are 20-50 years old. This sector reaches out to male customers by offering unisex items and gift ideas for males. Consumption expenditures in Japan has also switched from overseas trips and shopping during the bubble years to domestic expenditures on family activities and goods that improve home comfort, warmth, and charm. *Third*, to reduce production costs and increase the low profit margins of the retailers, foreign manufacturers mainly in Asia are commissioned or contracted to produce the goods. Relative to Japan's food products market, the household goods sector has a fairly simple 3-level distribution channel: producer-wholesaler-retailer. In many cases, retailers bypass wholesalers and go directly to the importer or even exporter/ manufacturer of the goods. Finally and most importantly, a boom in Asian household products started in 2000 in Japan. This coincides with the "ecology" trend, which translates into the improved preference for natural and simple materials.

Furniture. Despite depressed consumer spending, furniture imports are also trending upward. As in other consumer manufactures, furniture imports from China and Southeast Asian countries are mostly "development imports" that strike a balance between quality and cost. Asian furniture exports, mostly made of wood, have advantages in terms of raw materials and labor costs. Wooden furniture accounts for more than half of Japan's furniture imports and more than a third of Japan's demand for wooden furniture is met with importation.

Weaknesses and threats

Selectivity of the Japanese Market. Japanese wholesalers and retailers usually find suppliers through trade fairs and exhibits and by visiting overseas shops. To tap Japan's market, products must be original, innovative, reasonably practical, and functional. This necessitates up-to-date information on the products in the market, which can be obtained by regularly attending trade fairs and exhibitions, frequent visits to shops and markets inside and outside Japan, and looking at the numerous household product catalogs in Japan. For food products, this marketing strategy is very costly for Philippine exporters of household goods, all of whom are small scale and usually cannot afford such a marketing approach. This explains the limited breakthrough of Philippine firms in the market.

Another factor for the limited market success of Philippine, and in general Asian exporters, is the Japanese consumers' revealed preference for European

and other western goods. One Philippine exporter interviewed says that he has joined trade fairs all over the world, including Japan, and has noticed that Japanese do not seem to be as much interested in Philippine- or Asian-made products as they are in European goods.

Competition. China is the single most important player in Japan's nonfood consumer goods import markets. Its abundant supplies of raw materials, low wages, and competitive prices, helped further by considerable technical assistance from Japan, have made it the leading supplier (accounting for more than half of imports) of the Japanese consumer goods market in almost all product categories. China has already established itself as Japan's main production base for apparel and fashion goods (bags, footwear, and accessories), furniture and household products, and toys. Not only Japanese firms but also European and US firms supplying the Japanese market have transferred their production facilities to factories in China to reduce costs and shorten delivery time. Moreover, support industries for these sectors are also remarkably emerging and rapidly growing in China. Distribution-related operations, such as inspection and price tagging (the equivalent of the secondary processing plants for food products) are likewise being transferred to China.

Fast becoming a major player to trail China and overtake the Southeast Asian countries is Vietnam. Vietnam is now next to China and ahead of Thailand and Indonesia¹⁵ as source of apparel exports to Japan. As revealed, a JETRO Japanese Market Report's list of imported household goods seen in household goods stores in Tokyo contains 7 lines for China-made goods, 9 for Vietnamese, 5 for Thailand, 4 for Indonesia, and only 2 lines for the Philippines.

Philippine Vulnerability. Like the processed food sector, the Philippine nonfood consumer exports sector is dominated by SMEs and, hence, faces the same problems of inadequate credit facilities, technical know-how, and government support. The Philippine advantage in design and craftsmanship easily fades out with certain disagreeable but nevertheless common business strategies of importers. Philippine exporters, for instance, complain that foreign buyers buy only samples or even just take pictures of Philippine-made products during trade fairs and exhibits, and have these copied by factories in China. The Philippine advantage in goods made from materials that are only available in the Philippines is likewise easily lost with the exportation of the unprocessed raw materials from the Philippines. This is the case for *bangcuang*

¹⁵ The Philippines is not included in the list of top five apparel exporters to Japan. Completing the list is India. This is despite the fact that Thailand, Indonesia, and the Philippines were the Southeast Asian countries that stepped in to take the place of Korea and Taiwan in the late 1980s as apparel exporters to Japan.

and *raftia*. These materials are not available in China but China has already started importing them from the Philippines.

Lack of government support is the most common grievance of exporters of consumer manufactures (as well as processed food exporters). Stories abound in all the FGDs and interviews about how Philippine booths in international trade fairs and exhibits are so inferior compared with those of other Asian countries, and how much government support these other Asian countries are extending to their country's businesses. Philippine exporters attribute the unified stand of their Asian competitors in international business meetings and gatherings—something Philippine businesspersons are not equipped with when they attend similar international meetings—to government leadership and support of industry organizations.

More objectively, a leading exporter cites as one reason the undermanned and low budget of Philippine overseas trade attaché. The trade sections of the Philippine embassies do not have commercial and marketing intelligence that are supposed to provide its exporters information and data on how to better compete with other exporters. According to this leading exporter, the commercial section of the Philippine embassy in Thailand was, at one time, even handled by a Thai national. He laments that exporters definitely could not expect this Thai national to give them tips on how to beat their Thai competitors.

Industrial manufactures

Strengths and opportunities

Industries in Japan are said to be “de-industrializing” or “hollowing-out.” This means that only certain sections of the industry, such as research and development and manufacture of newly introduced and high-technology products, stay in Japan while mass production processes are relocated or outsourced to lower-cost countries, such as ASEAN member countries like China and Vietnam. Generally, equipment (e.g., household appliances, personal computers (PCs) and peripheral devices, and cellular phones) assembly operations and production of standard equipment parts have mostly shifted to subsidiaries of Japanese, US, and European manufacturers and a few local companies in the developing countries of Asia. The Philippines, together with other ASEAN member countries—China and more recently, Vietnam—has become the multinational corporation (MNC) export bases for these products. The global trend in electronics and automotive sectors is for the industrial giants of the developed countries to concentrate in new product market development. Hence, there exist enormous opportunities for subcontracting

or original equipment manufacturing (OEM) in these sectors. There is also a growing trend toward the so-called “turnkey” model, an arrangement in which raw materials are not supplied by the foreign buyers but are sourced by the assemblers/exporters. This is a most welcome development as it may result in higher value-added of this export industry.

The major strength of the Philippine industrial sectors comes from the skilled, highly literate, and English-speaking labor force. The sector also receives relatively greater government support. Most of the exporting companies are large enterprises with little or substantial foreign capital infusion, are located in the export processing zones, and enjoy tax incentives. Largely because the sector is the biggest contributor to the country's export earnings and because of the presence of large and multinational players in the sector, the government has been more receptive to the sector's calls for less redtape. Paperless trading, including custom procedures, for instance, has already been set-up and implemented for the electronics and automotive industries.

Electronics. Of the 60 percent share of electronics in total Philippine exports to Japan, more than half are components and devices—such as discretes, integrated circuits (ICs), power transistors, signal transistors and diodes, DRAM, SRAM, micro controllers, ASSPs, ASICs/system LSIs, MPUs/MCUs, AS memory, and others—collectively referred to as semiconductors.

Philippine electronics exports are highly correlated with foreign direct investments. The major industry players are American (Intel, Texas Instruments, Motorola, National Semiconductors), European (Philips Semicon and Temic Telefunken), and Japanese (Matsushita Telecommunication Industries and Uniden). American subsidiaries dominate the semiconductor sector. The European firms are generally into IC packaging. There are a few Japanese firms in the semiconductor sector. The majority of the Japanese subsidiaries, however, are in the sub-assembly sector of semiconductor support industries. Within the sub-assembly sector, Japanese firms are heavily concentrated in computer peripheral production (floppy disc drives (FDDs), hard disc drives (HDDs), and computer disc read-only-memory (CD-ROM)). There are also Japanese-owned firms in secondary supplier industries, such as lead frames for IC packaging, molds and dies, and plastic carrier tapes for IC packaging.¹⁶

The growth of the global semiconductor market accelerated in the latter part of the 1990s due to major technological breakthroughs in audio-visual, computer, and telecommunications systems. From 1999 to 2000, the market expanded by more than 35 percent. Japan accounts for more than a fifth of the global market. Japan's semiconductor market likewise grew by 35

¹⁶ Morisawa and Tecson (1997).

percent due specifically to a brisk demand for cellular phones, PCs, digital cameras, and digital television. The global slowdown in demand for electronic products in 2001 resulted in a decrease in the demand for semiconductors. The Japanese semiconductor market showed more vitality as it posted a contraction of only 6 percent, much smaller than the 35 percent worldwide decline. The Japanese market quickly recovered in 2002. The market then was expected to expand further as an offshoot of new demand for next-generation cellular phones; televisions and set-top boxes for household use; video game units; and higher speed, larger-capacity data communication services and other telecommunications infrastructure. These types of equipment require semiconductors loaded with technologies for communication networks and image processing.¹⁷

Automotive Parts and Accessories. In August 1995, Japan deregulated the importation of auto parts and accessories. As a result, the value of imported assembly and replacement auto parts and accessories increased by 124 percent in 1996 and the share of imports in the sector increased by 24 percent despite the decline in overall industry sales.¹⁸ Although there is a decline in total demand, the case varies item by item. In general, demand is growing for engine parts, ignition parts, transmission, and steering components. While the demand for certain suspension and brake components is somewhat weaker, strong demand remains for some suspension and speed control parts, such as coil springs, shock absorbers, and suspension struts. The demand for accessories, such as vehicle electronics (especially micro discs), auto mufflers, and those that improve safety and comfort, is growing. Since Japan ranks second only to the US in terms of the number of licensed automobiles, and cars in Japan serve not only as a means of transport but more of a hobby object in which the owner takes pride, there exists a big potential for the expansion of the Japanese automotive parts and accessories market.

Another recent development that augurs well for imports is the diversification in the sourcing and distribution of replacement auto parts and accessories. In the past, suppliers were limited to producers of genuine parts and recommended parts.¹⁹ At the time of this study, imported parts, parts supplied directly from auto part manufacturers, private brand parts of auto parts dealers, parts supplied by used cars dealers, and salvaged parts are available in the market. While genuine parts still dominate the replacements parts market, imported parts are making substantial inroads for common parts

¹⁷ JETRO Japanese Market Report: Electronic Components, no. 61, March 2002.

¹⁸ JETRO Japanese Market Report: Automotive Parts and Accessories, no. 13, March 1998.

¹⁹ Recommended parts are non-genuine auto parts that are approved by the Japan Automobile Products Association (JAPA).

and accessories, such as spark plugs, wiper blades, brake pads, air filters, oil filters, clutches, and others.

In particular, nationwide auto parts store chains led by Autobacs and Yellow Hat, as well as local independent stores, are increasingly becoming popular. Apart from sales, these auto parts stores provide services like oil change, tire replacement, audio system installation, and sport equipment installation. Their growing presence in the market has led to increasing imports of auto parts and accessories. Autobacs, for instance, directly imports from foreign manufacturers of tires, motor oil, aluminum wheels, audio equipment, interior panels, system carriers and leisure tables. Yellow Hat, on the other hand, imports system carriers, roof containers, and sunshades. These stores have resorted to foreign products not only as a strategy to reduce cost but also to differentiate them from their competitors. While these stores go to Europe and the US for name brand products, they source their own private brand products and bargain items from Southeast Asia. They actively search for marketable products, visiting exhibits and trade shows, and attending business meetings in both Japan and abroad.

Moreover, since the opening of the market in 1995, and with the continuing deregulation, several measures to promote imports are being undertaken. *One*, JETRO actively assists and supports sales promotion missions in Japan for foreign auto parts suppliers, as well as overseas auto parts buying activities of Japanese companies. *Two*, JETRO has created permanent exhibition facilities for foreign-made parts at imported automobile showrooms in Tokyo, Nagoya, and Osaka. *Three*, the Japan Federation of Auto Parts Sales Association (JAPA) has put up a consultation window for foreign auto parts manufacturers planning to enter the Japanese market. Finally, the Japan Automobile Service Promotion Association has developed an information network system on foreign auto repair parts. The system includes a database on types, prices, and other detailed information on foreign parts manufacturers. To be included in the database, these manufacturers can register via the association's home page or by mail.

Weaknesses and threats

The market for industrial manufactures is relatively more open than any other market in Japan. Almost all industrial manufactures are already free trade items that are not subject to import restrictions and import taxes. The only hurdle to entry is the Quality, Cost, Development, Delivery, and Management (QCDDM) requirement. Aside from the usual quality, cost and delivery standards, the Japanese market looks at the technical development capability (D) and management stability (M). These factors even become more critical with the trend toward original equipment manufacturing (OEM).

Competition. The major threat to Philippine exporters of electronics, auto parts, and other industrial manufactures comes from competing Asian countries. Even for industrial manufactures, China is fast-becoming the production bases of Japanese firms with nearly half of Japanese foreign direct investments (FDI) in electronics now going to China. Following China as site for Japan's FDIs is Vietnam. Since its reorientation toward a market economy, Vietnam has been very aggressive in attracting foreign investors. Vietnam was among the first countries (together with the US, Germany, and other European countries), and the only Southeast Asian country visited by the JETRO-sponsored auto parts and accessories buying missions from 1995 to 1998.

Philippine Constraints. The electronics and automotive sectors in the Philippines have remained largely as assembly operations. Labor, the Philippines' value-added in this sector, only covers a small portion (roughly 10%) of the assembled product. The greater part consists of the imported raw materials, most of them supplied by the foreign buyer.²⁰ Hence, these sectors' substantial contribution to total exports in gross terms become insignificant in net terms. Based on employment data, industry leaders estimate the net foreign exchange earnings of the electronics industry to be only about 15 percent of reported exports. This rough estimate is consistent with Morisawa and Tecson's (1997) survey, which reveals a 10 percent local content for electronics assembly industry, and 15–20 percent for the automotive industry.²¹ The study of Morisawa and Tecson (1997) attributes the low local value-added partly to the dominance of MNCs, which they say are less inclined to establish linkages with local suppliers.²²

The more central reason for the high degree of import dependence of the electronics and automotive and industrial sectors, in general, is the weak and underdeveloped support industries. The presence of competitive support industries is important for the Philippines to be able to benefit from the "turnkey" arrangement. However, not enough firms in the Philippines emerged that can supply the raw materials needs of the electronic and automotive exporters. Reasons for this are discussed extensively in Morisawa and Tecson (1997). There are difficulties encountered by supplier firms, which are mostly small and medium enterprises (SMEs), such as fluctuations in orders, lack of access to raw materials and capital equipment, high risk of capital and technological investment, and financial constraints.²³ Government policies

²⁰ Two models are employed in these sectors. For model 1, buyers supply the assembler/exporter all the major raw materials. For model 2, also referred to as "turnkey," assembler/exporter source raw materials on its own.

²¹ Morisawa and Tecson (1997), p. 84.

²² Ibid., p. 79.

²³ Ibid., p. 90.

aimed at developing the support industries also failed. The Electronic Local Content Program (ELCP) of 1975, for instance, only created a captive market of assemblers for the supplier firms. With the protective environment, firms were not induced to upgrade quality and be cost-effective.²⁴ The numerous financing programs (numbering more than 30) put up by the government for the electronics SMEs likewise did not address their problem of insufficient collateral—the biggest constraint to credit access. The results of these financing programs were also limited as they were not disseminated properly and were not focused on capital expenditures for productivity improvements and technological upgrading.

A second major area of concern for this sector is the country risk factors. The industrial manufactures export sector, being highly capital-intensive, are the most sensitive to country risk factors. Peace and order condition, political stability, and policy continuity are major drawbacks for Philippine exporters of industrial manufactures.

Despite the greater attention the industry is getting from the government (relative to other sectors), there is still a perceived lack of government support. Industry players call for the government to provide better infrastructure (e.g., land and air transportation infrastructure) and to establish a performance monitoring system for government agencies that will significantly reduce if not eliminate red tape and corruption. The mere size and global exposure of the industry make it susceptible to even the slightest changes in the regulatory environment.

Another factor that holds back the industry is the limited cooperation between industry and academic institutions. The industry requires a highly and appropriately trained manpower. Many of the engineering and vocational program curricula in the Philippines, however, are either irrelevant or inadequate. The educational and other training institutions in the Philippines also lack facilities for practical training. The government has failed to provide the assistance required by the learning and training institutions, and to facilitate the interaction between industry and academe.

Making the Agreement Philippine Exporters-Friendly

For Philippine exporters to reap fruits from the economic partnership between Japan and the Philippines, the Philippine party must make the following basic demands.

First, the agricultural and processed food sectors must be included in the agreement. As a producer of agricultural products, the Philippines stands to

²⁴ Ibid., p. 92.

benefit from the liberalization of the agricultural and processed food imports of Japan. As major Philippine agricultural exports are not cultivated in Japan, there is no reason why the Japanese agricultural sector needs to be protected vis-a-vis Philippine exporters.

Two, Japan must commit to undertake import promotion programs particularly for Philippine made products. Specific programs and concrete steps that are needed to promote and facilitate the flow of goods from the Philippines to Japan include:

- (1) seminars and workshops on the Japanese market,
- (2) buying missions to the Philippines,
- (3) sales promotion missions in Japan,
- (4) accreditation program for Philippine private testing centers,
- (5) system and procedures for claim verification.

Three, Japan must commit to establish an SME-focused official development assistance (ODA) agenda with two key elements:

- (1) efficiency enhancement programs in the areas of production, quality control (including use of additives/chemicals) and management, and
- (2) capital accumulation loans programs that address among other things the collateral problem of SMEs.

Finally, Japan must commit not only to provide but also to refocus assistance towards human resource development programs such as

- (1) basic research programs leading to new product development,
- (2) engineering and technical academic support programs (e.g.: curriculum development, building training laboratories with adequate and appropriate machinery and equipment), and
- (3) programs that promote greater, closer and constant interaction among academe, industry and government (e.g. creation of science parks that will put factories and training/research institutes together²⁵).

To wrap-up, an official of the commercial section of the Japanese embassy notes that with the economic partnership agreement, Japan hopes to see a better and more liberalized investment environment in the Philippines. Among the items in the so-called "wish list" submitted by Japan to the Philippine government is foreign (Japanese) ownership of land. The granting of this request may be favorable for Philippine exports if two things happen. One, if the additional incentives lead to more Japanese investments in the Philippines.

²⁵ Something like an industrial-equivalent of the Rockwell Center in Makati.

And two, if the Japanese investments result in technology transfer. In so far as Japanese investments mean more exports to Japan²⁶ and Japanese MNCs are known for providing considerable technical training for their engineers and technicians particularly in the form of on the job training in the host country and in Japan²⁷, giving serious consideration to this request may be justified provided the above mentioned basic demands are granted.

²⁶ The “development exports” from the Asian countries, especially China, is the main avenue by which the correlation between investments and exports occurs in the case of food products and consumer manufactures. The correlation between foreign investments and exports in the industrial sectors, especially electronics and automotive, have long been established. See Morisawa and Tecson (1997), for instance.

²⁷ It is a common practice in the electronics and automotive sectors in Japan for the assemblers to organize their suppliers into associations and provide them with technical assistance and training. If Japanese investors in the Philippines apply the same model, then more incentives to Japanese investors may lead to the emergence of stronger and more competitive support/supplier industries.

Appendices

Appendix 1. Philippine exports to Japan market position matrix vulnerable quadrant

SITC ¹ Code	Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996–2000	Share of Products in Japan's Total Imports Growth Rate 1996–2000
2655	Abaca, Manila hemp, waste	65.579	14.22	(40.00)
2823	Other ferrous waste, scrap	32.470	8,455.94	(1.77)
6353	Builders joinery, wood, etc.	29.240	288.32	(25.24)
2816	Iron ore agglomerates	19.339	0.92	(138,832.56)
3343	Gas oils	13.832	1,415.71	39.57
6561	Narrow fabric, woven, others	12.498	5,643.50	(224.99)
8218	Parts, metal, wood furniture	12.370	2,178.18	(1.17)
0353	Fish, smoked	8.107	456.83	(1.02)
7724	Switching apparatus, 1000v+	7.368	61.23	(0.71)
7285	Parts public work machine, etc.	6.752	647.50	(6.31)
8217	Furniture, nes, other materials	6.539	6.64	(20.19)
2485	Wood, non-coniferous, continuously shaped	6.413	1,207.37	(60.45)
7284	Machinery, appliances, specialized, industries, nes	5.737	1,342.08	(47.27)
6649	Glass, nes	5.260	213.93	85.51
8745	Measuring, controlling, scientific instruments, nes	4.794	229.50	(1.16)
7449	Parts, hoists, lifts equipment	4.626	14,857.73	(0.26)
0615	Molasses	4.581	466.63	(40.38)
8139	Parts, light fitting, signs	4.315	106.38	(0.74)
6993	Pins, needles, iron, steel, etc.	4.223	18.47	(38.59)
7484	Gear, gear box, parts, etc.	4.054	2,039.91	(22.06)
7728	Parts, electric panels, etc.	3.864	2,513.96	(0.69)
7131	Aircraft piston engines	3.791	223.92	(5.21)
8924	Postcards, transfers, etc.	3.626	1,877.62	(1.02)
8991	Carved, molded goods nes	3.588	7.62	(29.22)
7499	Machinery parts, non-electrical, nes	3.410	136.59	(17.29)

Appendix 1. (continued)

SITC¹ Code	Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996–2000	Share of Products in Japan's Total Imports Growth Rate 1996–2000
8997	Baskets, brooms, brush, etc.	3.385	22.13	(56.54)
7429	Parts, pumps, liquid elevators	3.203	113.11	(4.67)
6921	Reservoir, tanks, vats, etc.	2.929	2,365.25	(2.16)
2882	Other non-ferrous metal waste	2.865	3.36	4.75
0361	Crustaceans, frozen	2.839	0.89	(234.67)
7513	Photo, thermocopy apparatus	2.772	251.57	(17.32)
7414	Commercial, Refrigerating, freezing equipment, parts	2.652	152,686.61	(28.92)
8972	Imitation jewelry	2.615	45.64	(2.19)
7643	TV, radio transmitters, etc.	2.196	5,815.16	(210.55)
1123	Beer etc. made from malt	2.103	691.90	(13.32)
6764	Other bar, rod iron, steel	2.079	167.07	(0.38)
7453	Weighing machine, weights, parts	2.026	3,142.62	(0.04)
7415	Air conditioning machine, parts	1.688	564.47	(34.89)
6671	Pearls	1.391	32.35	(0.12)
7119	Parts for steam boilers	1.364	201.03	(154.54)
0989	Food preparations, nes	1.289	226.93	(41.88)
6518	Yarn, staple fibers, etc.	1.282	5,161.47	(32.02)
5234	Sulphides, sulphates, etc.	1.193	2,849.86	(76.57)
0599	Juices, other than citrus	1.133	25.58	(12.07)
7283	Other mineral working machinery	1.114	795.10	(1.40)
6582	Tarpaulins, sails, awnings	1.034	545.75	(33.71)
0223	Milk products	1.027	299.18	(46.58)
0019	Live animals, nes	0.980	168.66	(0.50)
2690	Worn clothing, textiles, rag	0.976	226.03	(407.87)
7269	Part, type-founding, typesetting, printing machinery	0.896	191.05	(129.10)
6129	Other leather articles nes	0.861	21.81	(94.72)
7436	Machinery. Filtering, gases or liquids	0.836	30.12	(41.71)

Appendix 1. (continued)

SITC¹ Code	Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996–2000	Share of Products in Japan's Total Imports Growth Rate 1996–2000
2732	Gypsum, limestone, etc.	0.821	7,834.23	(72.36)
7591	Parts of copying machine	0.815	171.68	(0.34)
7438	Parts, air pumps, fans, etc.	0.779	2,646.38	(1.61)
5922	Albuminoidal substances, etc.	0.772	58,388.00	(17,500.69)
6524	Other woven fabrics, = >85% cotton fabric, weight >200g/m ²	0.758	558.70	(97.63)
6994	Springs, leaves, metal	0.739	1,293.78	(1.45)
6552	Other knitted crochet fabrics	0.675	2,725.30	(233.47)
7781	Batteries, accumulators	0.633	13,940.30	(10.30)
7448	Lifting, etc. machines nes	0.554	37.99	(15.86)
5913	Herbicides, retail sale	0.529	1,983.10	(75.29)
8110	Prefabricated buildings	0.520	105.05	(1,005.43)
7331	Metal forming machinery tools	0.506	4,415.63	(110.17)
2731	Building, dimension stone	0.481	1,022.70	(86.86)
7512	Calculating, accounting, etc. machines	0.476	1,309.17	(17.70)
7372	Metal-rolling mills, rolls	0.404	839.34	(110.76)
8131	Lamps, light fittings, nes	0.384	18.49	(151.18)
0345	Fish fillets, fresh, chilled	0.367	13.15	(1,288.22)
0342	Fish, frozen excluding fillets	0.361	52.25	(98.42)
6541	Fabric, of silk, silk waste	0.349	0.42	(57.95)
7317	Machine shaping, cutting tools	0.336	472.97	(14.72)
7234	Construction & mining machineries, nes	0.326	723.08	(14.57)
6519	Yarn, textile fibers, nes	0.324	746.12	(197.21)
7519	Other office machines, nes	0.321	434.59	(198.96)
8458	Other garments, not knitted	0.321	51.94	(35.60)
8928	Printed matter, nes	0.286	462.09	(31.07)
2926	Bulbs, cuttings, live plant	0.276	50.07	(34.57)

SITC ¹ Code	Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996–2000	Share of Products in Japan's Total Imports Growth Rate 1996–2000
7452	Industrial dishwashing, cleaning, drying bottles machine	0.267	164.75	(169.63)
7272	Other food-processing machine parts	0.267	29.36	(24.79)
8513	Footwear, nes, rubber, plastic	0.265	30.33	(18.73)
8857	Clocks	0.250	109.57	(37.10)
8973	Gold, silver jewelry, ware	0.221	111.19	(1,925.84)
8982	Musical instruments, nes	0.211	42,402.69	(5.08)
6912	Aluminum structure, parts	0.206	67.94	(422.97)
8442	Suits, dresses, skirts, etc.	0.172	151.17	(29.77)
5752	Acrylic polymers	0.158	768.72	(3.79)
6871	Tin, tin alloys, unwrought	0.149	362.45	(335.15)
1124	Spirits	0.135	152.27	(671.51)
0484	Bread, baked goods	0.132	680.13	(31.42)
8519	Parts footwear, etc.	0.132	177.40	(97.99)
2911	Bone, horn, ivory, coral, etc.	0.107	0.25	(11.36)
8747	Oscilloscopes, etc.	0.102	11.23	(717.15)
7373	Welding, brazing, etc. machines	0.096	754.57	131.53
8416	Underwear, nightwear, etc.	0.087	212.17	(1.38)
8461	Accessories, not knitted	0.085	100.42	(24.47)
7754	Electric shavers, clippers, parts	0.084	2,871.37	(25.40)
7316	Metal surface, finishing tools	0.084	2,079.49	(39.89)
7252	Other pulp, papermaking machines	0.082	3,688.88	(68.06)
5334	Paints, varnishes, etc.	0.081	459.66	(11.01)
6842	Aluminum, aluminum alloys, worked	0.076	682.87	(239.11)
2925	Seeds, etc., for sowing	0.075	129.81	(3.03)
7247	Other textile machinery nes	0.073	1,540.61	(182.79)
5137	Monocarboxylic acids, derivatives	0.072	1,213.15	(4.56)
7456	Spraying machinery etc.	0.066	1,356.99	(267.58)

SITC ¹ Code	Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996–2000	Share of Products in Japan's Total Imports Growth Rate 1996–2000
7431	Air, vacuum pump, compress	0.050	493.13	(18.44)
7417	Gas generators, air liquefier	0.048	1,396.25	(2.36)
8411	Overcoats, outerwear, etc.	0.044	35.28	(176.49)
2919	Other animal materials nes	0.043	30.80	(269.94)
6341	Veneer, plywood sheets	0.042	4.75	(50.56)
5222	Other chemical elements	0.030	65.88	(40.29)
0611	Sugars, beet or cane, raw	0.027	47.34	(8,837.14)
7418	Other temperature change machines, etc.	0.019	352.85	(103.40)
7311	Machine tools, metal removal	0.012	4,964.37	1,389.26
6841	Aluminium, aluminium alloy, unwrought	0.002	12.43	(46.44)

nes= not elsewhere specified

Figures in parentheses are negative growth rates.

Source of data: Personal Computer Trade Analysis System (PC-TAS).

¹SITC: Standard International Trade Classification

Note: Figures in parentheses denote negative numbers.

Appendix 2. Philippine exports to Japan market position matrix**Retreat Quadrant**

SITC Code	Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
2891	Precious metal ore, concentrates	57.128	-10.454	-14.402
2734	Gravel, crushed stone, aggregates	20.108	-27.921	-767.475
2657	Coconut fiber and waste	16.819	-35.010	-10.056
7612	Black & white TV receivers	7.609	-40.802	-0.692
6821	Copper, anodes, alloys	7.029	-39.582	-4148.084
8711	Binoculars, telescopes, etc.	6.097	-16.005	-36.280
6259	Other tires, tubes, etc.	5.491	-29.940	-36.539
6254	Tires, pneumatic, new, cycles	4.537	-11.490	-5.486
6954	Hand tools, etc. nes	3.344	-26.739	-27.246
8993	Candles, matches, etc.	2.932	-71.686	-5.161
6662	Ornamental ceramic articles	2.531	-11.087	-4.985
6955	Saw blades	2.389	-45.553	-0.557
8413	Jackets and blazers	2.237	-19.827	-8.479
7439	Part, centrifuge, filtering, etc.	2.217	-4.227	-116.546
6824	Copper wire	2.108	-62.330	-42.892
5122	Other acyclic alcohol, derivatives	2.028	-46.100	-104.659
0589	Fruit, nuts, preserved, prepared, nes	1.899	-30.142	-0.647
8437	Shirts, men's, boys, knit	1.869	-72.909	-149.757
0581	Jams, jellies, marmalades	1.658	-85.167	-1.576
6354	Wood, domestic use excluding furniture	1.509	-45.516	-33.674
8811	Cameras, flash equipment, etc.	1.347	-75.787	-892.553
8414	Trousers, breeches, etc.	1.330	-33.581	-6.716
6575	Twine, cordage, etc. products	1.324	-50.829	-28.718
7648	Telecommunication equipment, nes	1.296	-28.542	-4.687
2879	Other non-ferrous ore, concentrates	1.273	-7.763	-33.484

Appendix 2. (continued)

SITC Code	Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
8447	Blouses, shirt-blouse, etc.	1.047	-12.429	-28.337
8992	Artificial flowers, etc.	1.036	-37.317	-12.865
8481	Leather apparel, accessories	0.961	-13.530	-4.003
0724	Cocoa butter, fat or oil	0.886	-41.772	-100.562
2831	Copper ores, concentrates	0.862	-54.100	-2229.865
8422	Suits and ensembles	0.734	-20.427	-40.174
8998	Small-wares, toiletries nes	0.703	-83.841	-13.235
0341	Fish, fresh, chilled, whole	0.702	-46.493	-4.470
8515	Other footwear, uppers, textile	0.694	-55.443	-53.311
0577	Edible nuts: fresh, dried	0.545	-28.113	-18.561
0363	Molluscs	0.542	-36.647	-33.187
5121	Acyclic monohydric alcohol	0.541	-50.633	-20.922
2782	Clay, refractory minerals, nes	0.528	-26.691	-37.920
2658	Vegetable textile fibers, nes	0.524	-43.495	-20.623
8312	Trunks, suitcases, etc.	0.491	-2.669	-1254.180
6661	Ceramic household articles	0.487	-30.527	-73.982
8484	Headgear, fittings, nes	0.478	-64.872	-117.111
1211	Tobacco, not stripped, etc.	0.456	-76.806	-3.720
8415	Shirts	0.450	-58.072	-21.747
2929	Material vegetable origin, nes	0.437	-11.367	-75.084
8947	Sports goods	0.422	-40.240	-2885.806
8512	Sports footwear	0.422	-28.852	-14.938
0362	Crustaceans, not frozen	0.420	-59.512	-1.434
8424	Dresses	0.414	-50.297	-24.672
5419	Pharmaceutical goods, excluding medicaments	0.385	-43.724	-36.455
2922	Natural gums, resins, etc.	0.380	-49.712	-25.050
5312	Synthetic brighteners, lakes	0.366	-65.510	-16.890
2881	Ash, residues metals nes	0.357	-39.682	-2.171
8423	Jackets	0.353	-48.586	-22.668

Appendix 2. (continued)

SITC Code	Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
6956	Knives, cutting blades	0.352	-40.556	-43.143
8427	Blouses, shirt-blouse, etc.	0.342	-36.951	-17.976
8211	Convertible seats, parts	0.327	-42.872	-0.304
7243	Sewing machines, parts	0.320	-44.198	-23.121
6911	Metal structures, parts	0.320	-89.785	-5.672
3344	Fuel oils, nes	0.304	-7.615	-85.236
7239	Parts nes, civil engineering machines	0.297	-72.231	-30.613
2112	Whole bovine hide<8kg dry	0.270	-24.259	-8693.646
0547	Vegetables provisionally preserved	0.267	-47.234	-54.901
8511	Footwear, with metal toe-cap	0.250	-37.164	-1.021
0371	Fish, prepared, preserved, nes	0.248	-59.544	-23.610
6974	Table kitchen, household articles nes	0.242	-57.738	-138.849
4313	Fatty acid, etc. from wax	0.237	-89.053	-79.359
6633	Non-ceramic mineral manufactures	0.233	-12.331	-127.027
0813	Oil-cake, oilseed residue	0.232	-57.924	-28.653
6613	Building stone, worked, etc.	0.196	-46.446	-894.904
7784	Electromechanical hand tools	0.170	-82.396	-3.740
6952	Hand saw, file, rasp, etc.	0.169	-75.452	-5.879
8959	Other office, stationery supplies	0.156	-93.529	-3.794
0815	Vegetable residues, waste	0.151	-86.595	-9.962
0593	Juice, other citrus fruit	0.149	-41.272	-1.960
2927	Cut flowers and foliage	0.144	-31.458	-3.487
8319	Travel goods nes	0.141	-42.259	-1.512
6565	Embroidery	0.130	-84.028	-524.169
6117	Leather of other animals	0.117	-87.032	-277.430
8311	Handbags, nes	0.117	-53.723	-116.097
8987	Other recorded media	0.111	-72.011	-209.905

Appendix 2. (continued)

SITC Code	Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
8842	Spectacles and frames	0.091	-58.034	-11.995
8854	Watches, other than precious metal	0.084	-9.636	-4.479
6292	Vulcanized rubber belting	0.083	-84.634	-6.849
7711	Transformers, electrical	0.082	-71.558	-1.391
8514	Other footwear, leather uppers	0.079	-32.195	-42.295
6412	Paper, paperboard, uncoated	0.079	-10.193	-11.322
0811	Hay, fodder, green or dry	0.077	-14.514	-245.348
8453	Jerseys, pullovers, etc. knitted	0.069	-71.899	-4.433
8428	Underwear, nightwear, etc.	0.067	-65.028	-43.774
8859	Time-measuring equipment nes	0.066	-94.728	-61.157
1110	Non-alcoholic beverage, nes	0.060	-18.208	-0.282
5331	Other coloring matters	0.054	-69.690	-111.308
7486	Clutches, shaft couplings	0.049	-95.713	-22.882
0548	Vegetable products, roots, tubers	0.049	-40.289	-25.622
2924	Plants, pharmaceuticals, perfume, etc.	0.040	-90.069	-79.949
8421	Overcoats, other coats, etc.	0.034	-79.641	-94.990
8994	Umbrellas, walking sticks	0.033	-73.980	-3.781
7426	Centrifugal pumps, nes	0.033	-79.984	-21.595
7478	Taps, cocks, valve, etc., nes	0.032	-75.222	-2.447
2484	Wood, non-conifer, sawn	0.026	-74.329	-144.818
6715	Other ferro-alloys	0.016	-97.865	-10554.026
0354	Fish liver, roe, dried, smoked	0.014	-38.690	-214450.046
7444	Jacks, hoists for vehicle	0.013	-98.446	-60.514
0561	Vegetables, dried	0.013	-89.664	-57.614
6652	Glassware, household, etc.	0.012	-72.649	-47.266
0567	Vegetable prepared, preserved, nes	0.009	-28.199	-17.918
7163	Electric motors, generators AC (alternating current)	0.007	-51.943	-20822.605

SITC Code	Description	Share of Philippine Exports in Japan's Imports 2000	Share of Philippine Exports in Japan's Imports Growth Rate 1996-2000	Share of Products in Japan's Total Imports Growth Rate 1996-2000
8943	Funfair, table game articles	0.006	-99.506	-207.741
5311	Synthetic organic dyestuffs	0.005	-95.571	-105.204
7266	Other printing, ancillary machines	0.005	-95.397	-176.567
8455	Brassieres, corsets, etc.	0.004	-99.549	-18.736
7812	Passenger transport vehicles	0.001	-98.113	-1774.992
5416	Glycosides, glands, etc.	0.000	-99.977	-17.115
7523	Digital processing, storage units	0.000	-98.749	-1.619
0441	Maize seed	0.000	-100.000	-0.088
0459	Buckwheat, etc., unmilled	0.000	-100.000	-8228.664
0723	Cocoa paste	0.000	-100.000	-3.859
2223	Cotton seeds	0.000	-100.000	-374.109
2312	Natural rubber excluding latex	0.000	-100.000	-5174.158
5147	Carboxyamide-function compounds	0.000	-100.000	-15.735
5243	Metallic acid salts, etc.	0.000	-100.000	-3.884
6342	Densified, reconstituted wood	0.000	-100.000	-2.228
6513	Cotton yarn, excluding thread	0.000	-100.000	-1871.655
6791	Tube, etc., seamless, iron, steel	0.000	-100.000	-661.510
7244	Spinning, extruding, machine, etc.	0.000	-100.000	-19.219
7633	Turntables, record players	0.000	-100.000	-0.386

nes= not elsewhere specified

Source of data: Personal Computer Trade Analysis System (PC-TAS).

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3 Toward a Strategy for Manufactured Exports to Japan

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Ferdinand Maquito and Peter Lee U¹

Overview of Export Performance and Policy

The Philippines today can be characterized as an export-oriented economy. Its exports easily account for close to half of its GDP in (real) peso terms. Data since 1990 suggest that the top Philippine exports are manufactures. However, there are still some natural resource-based exports like bananas, crustaceans, and iron ore agglomerates. Meanwhile, Japan's top 10 exports to the Philippines consist entirely of manufactures with the top four categories being mostly electronics in nature. Motor vehicles and parts and motorcycles round out the top ten (Tables 2 and 3).

Clearly, the success story in Philippine exports has been our electronics exports, accounting for half of total exports as provided in Table 1.

The electronic products category figures prominently as top exports of the Philippines to Japan and vice versa. This is not surprising as many of the major electronics exporters are Japanese firms.

The relative success of the country's electronics exports masks, however, a hollowing out of Philippine industry. By as early as 1985, the services sector had firmly overtaken the industry as the largest producer by value added, and also as the biggest employer. Moreover, it looks like the services sector will continue to be the leading sector of the economy with the growth of call centers, business process outsourcing, and other ICT-enabled services that have begun to find their home in the country.

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Table 1. Share of manufactured exports to total exports, Philippines, 1985-2000

	1985	1990	1995	1996	1997	1998	1999	2000
Total exports (US\$ M)	4,629	7,821	17,447	20,543	25,228	29,496	35,037	38,079
Manufactures (%)	59.7	76.6	81.5	84.7	86.1	88.4	90.1	89.9
Manufactured exports (US\$ M)	2,765	5,995	14,224	17,409	21,712	26,090	31,562	34,242
of which								
Electronics (%)	38.2	32.8	52.1	57.3	60	65.8	57.1	64.8
Machinery (%)	1.1	2.5	5.2	7.4	12.4	12.7	15.7	17.3
Garments (%)	22.5	26.3	18.1	13.9	10.8	9	7.2	7.5
Textiles (%)	1.4	1.5	1.5	1.4	1.4	0.9	0.7	0.7

Source: Balisacan and Hill (2003), p. 232

Table 2. Values and shares of Japan's exports to the Philippines and Philippine exports to Japan, 1998-2000

Selected Industry	1998		1999		2000	
	US\$ M	% share	US\$ M	% share	US\$ M	% share
<i>Japan's Exports to the Philippines</i>						
Food and live animals	15.9	0.2	6.5	0.1	5.6	0.1
Beverages and tobacco	0.1	0.0	2.2	0.0	4.7	0.1
Inedible crude materials	55.3	0.9	50.6	0.8	68.5	1.1
Fuels, lubricants	20.3	0.3	21.8	0.3	32.9	0.5
Animal and vegetable oils, fats, wax	0.2	0.0	0.7	0.0	0.3	0.0
Chemicals and related products	347.3	5.5	409	6.3	430.4	6.7
Manufactured goods	471.2	7.4	585.3	9.0	632	9.8
Machines and transport equipment	5,123.7	80.4	5,106.2	78.3	4,994.8	77.4
Miscellaneous manufactures	325.4	5.1	335.6	5.1	285.3	4.4
Goods not classified by kind	11	0.2	6.1	0.1	2.4	0.0
All commodities	6,370.4	100.0	6,524	100.0	6,456.9	100.0
<i>Philippine Exports to Japan</i>						
Food and live animals	619.9	14.0	725.2	13.7	716.3	10.0
Beverages and tobacco	4.8	0.1	5	0.1	4.3	0.1
Inedible crude materials	309.2	7.0	300	5.7	370	5.1
Fuels, lubricants	71.5	1.6	35.8	0.7	107.3	1.5
Animal and vegetable oils, fats, wax	23.6	0.5	23.8	0.4	18.3	0.3
Chemicals and related products	41.6	0.9	35.5	0.7	42.3	0.6
Manufactured goods	204.1	4.6	245.7	4.6	274.9	3.8
Machines and transport equipment	2,646.1	59.7	3,280.5	61.8	4,874.9	67.7
Miscellaneous manufactures	383.2	8.6	466.1	8.8	470.7	6.5
Goods not classified by kind	127.7	2.9	186.5	3.5	319.9	4.4
All commodities	4,431.7	100	5,304.1	100	7,198.9	100

Source: Argamosa, 2003 Table 4.3

Table 3. Top 10 products in Philippines-Japan trade, 1999 and 2000 (in million USD)

Philippine exports to Japan		1999	Philippine exports to Japan		2000
7599	Parts, data processing etc., machine	775.8	7764	Electronic microcircuits	1,477.8
7527	Storage units, data processing	643.8	7527	Storage units, data processing	916.2
7764	Electronic microcircuits	621.9	7599	Parts, data processing, etc. machine	634.8
0573	Bananas, fresh or dried	382.2	0573	Bananas, fresh or dried	388.4
7731	Insulated wire, etc., conductor	273.8	9310	Special transactions not classified	319.9
9310	Special transactions not classified	186.2	7526	Input or output units	271.5
2816	Iron ore agglomerates	145.6	7731	Insulated wire, etc., conductor	268.9
7763	diodes, transistors, etc.	97.6	2816	Iron ore agglomerates	160.5
0361	Crustaceans, frozen	90.5	7763	diodes, transistors, etc.	139.5
7649	Parts, telecommunication, equipment	90.4	7649	Parts, telecommunication, equipment	139
Subtotal		3,307.8	Subtotal		4,716.5
TOTAL		5304	TOTAL		7,198.9
As % to total exports to Japan		62.4	As % to total exports to Japan		65.5

Table 3. (Continued)

Japan's exports to the Philippines		Japan's exports to the Philippines	
7599	Parts, data processing, etc. machines	7599	Parts, data processing, etc. machine
7768	Electronic computer parts, crystals	7768	Electronic computer parts, crystals
7764	Electronic microcircuits	7649	Parts, telecommunication, equipment
7649	Parts, telecommunication, equipment	7764	Electronic microcircuits
7284	Machinery appliances specialized industries nes	7284	Machinery. appliances specialized industries nes
7843	Other parts, motor vehicle	7843	Other parts, motor vehicles
7285	Parts, public works machinery, etc.	7831	Public transport passenger vehicles
7812	Passenger transport vehicles	7285	Parts, public works machinery, etc.
8811	Cameras, flash equipment, etc.	7851	Motorcycles, etc.
7851	Motorcycles, etc.	7812	Passenger transport vehicles
Subtotal		Subtotal	
TOTAL		TOTAL	
As % to total exports to the Philippines		As % to total exports to the Philippines	

nes = not elsewhere specified or stated

Source: Argamasa (2003), Table 4.4 nes = not elsewhere specified or stated

Source: Argamasa (2003), Table 4.4

This, however, is not necessarily a cause for concern. It seems that the migration of such services to the Philippines is driven by economic reasons of comparative advantage. The relative abundance of educated and skilled (also English-speaking) Filipino workers seems to be the main magnet attracting multinational firms to outsource various services here. However, it is precisely the rise of services that differentiates the Philippine development story from the typical development pattern of other countries as observed by Kuznets (1966). Typically, industry first takes over from agriculture as the engine of growth, and only later does the services sectors take over from industry. In the case of the Philippines, it seems to have skipped the industrialization stage and leap-frogged right into the services sector phase. For this reason, many economists have judged Philippine industrialization a disappointment.

Nevertheless, this paper does not suggest that the country must pursue an industrial policy that purposely favors manufacturing. Otherwise, this would handicap the services sector precisely at its moment of opportunity—the same thing as done to the manufacturing sector in the 1960s and 1970s. One could take the view that services, in particular, IT-enabled services, are the opportunities of the moment that must be seized and not let them slip by. Some may argue that the world is in the midst of an information (or digital) revolution that parallels the industrial revolution, and that the knowledge economy will now be ascendant. If that is the natural flow of the economy, then by all means, the sector should be allowed to respond to those market signals since the country seems to have the comparative advantage in labor at the moment.

However, the success of the electronics exports suggests that the country still has a niche in some manufactured exports. It would thus be foolish to ignore manufactured exports altogether. This paper seeks to look at what strategies may be pursued to maintain, and perhaps nourish, whatever remaining competitiveness the country has in manufactured exports—without distorting market signals to the detriment of other sectors. This is the lesson the country should have learned by now from its history of industrial policy.

Investment and Trade Relations with Japan

This survey aims to investigate further the elements of a good export strategy. It intends to analyze the relationship between performance (as embodied in export as a result of a production process) and incentives (including, but not limited to, what the government creates through its policies).

A Brief Historical Background of Industrial and Export Policy

The Philippines had followed a highly state interventionist approach (including import substitution) to developing industry, such as automobile, steel, oil, and others (e.g. the seven major industrial projects [MIP] of former Minister of Trade Bobby Ongpin under President Ferdinand Marcos). Apparently, these efforts failed. After all these years, the country still has industrial infants that never grew up. The Philippines had one of the highest shares of manufacturing to GDP in the 1960s. However, this share stagnated through the decades of the 1970s and 1980s. It has deteriorated some more in the 90s. Ironically, it seems that in areas where the country was successful (i.e., electronics), the corresponding level of government intervention was not provided.

This is a pity, considering that the Philippines posted impressive growth rates in the three decades after World War II, averaging around 3 percent growth in per capita GNP. In contrast, per capita GNP growth may have averaged only 0.2 percent in the period 1902–1948.² Bautista et al. (1979) characterized postwar policy to promote industrialization as benefiting mainly the import-substituting consumer goods manufacturing sector. In their opinion, these policies were biased against export-oriented industries, and to capital and intermediate goods industries.³

It is commonly agreed that import substitution in the Philippines as an industrialization strategy began in 1949 with imports and foreign exchange controls in response to a balance of payments crisis. While import substitution as a strategy initially had some benefits, it would eventually be constrained by the relatively small domestic market. Meanwhile, policy reforms in the early 1960s, by and large, continued this policy bias against export industries in favor of import-substituting industries producing finished consumer goods.

A consequence of this bias toward import substitution in consumer goods was that most of production activities were in assembly and packing operations that were heavily dependent on imported materials and capital equipment. Ironically, this bias against backward integration and exports prevented the Philippines from capitalizing on what should have been its comparative advantage—its labor surplus. As a result, the share of labor-intensive manufactured goods to total exports remained small throughout the decades of the 1950s and 1960s.

² Hooley 1968) as cited in Bautista et al. (1979).

³ This historical review draws extensively from Bautista et al. (1979), and from Balisacan and Hill (2003).

The decade of the 1970s saw export industries begin to receive some attention. The Export Incentives Act (RA 6135) was enacted in 1970 to stimulate nontraditional manufactured exports. It provided for exemption from export taxes on industrial exports and granted tax credits on export sales and excise taxes on intermediate inputs. Presidential Decree 92 of January 1973 allowed the deduction of the total cost of direct labor and local raw materials used in export production from taxable income. This was intended to promote backward integration and labor employment.

Foreign exchange controls were also a bias handicapping export producers. The government's efforts to maintain a relatively strong peso worked against exporters. The peso was "floated" in February 1970 in response to a balance of payments crisis. While the peso depreciated (or more properly, 'devalued', since the Central Bank very much still 'fixed' the exchange rates), it would remain for the assassination of Senator Benigno Aquino Jr. to trigger significant depreciation of the peso in 1983 to 1985.

Perhaps one of the most significant export promotion measures of this decade may have been the establishment of export processing zones—with the first being located in Bataan in 1976. As Balisacan and Hill (2003) noted, these export zones provided a location for investors that offered better infrastructure than the ones prevailing in the rest of the country. Exports grew quickly in these zones.

These measures seemed to have paid off with the impressive growth of nontraditional manufactured exports from 1970 to 1977, growing from USD 41.6 million to USD 421.4 million in 1977.⁴

Many studies suggest that export growth—in particular, manufactured export growth—is positively related to economic growth and technological progress.

Unfortunately, productivity has traditionally been the Philippines' Achilles' heel. Since the country's labor is no longer cheap—China, Vietnam, and other countries have cheaper unskilled labor—it needs to improve productivity, especially labor productivity, if the country hopes to remain competitive.

One measure of productivity is the total factor productivity (TFP). There have been much empirical work done estimating the TFP growth rates for the Philippines and its neighboring countries. It is particularly worrisome that the Philippines, in recent decades, has lagged behind its ASEAN neighbor countries in this area (Table 4).

⁴ Table 7, pp. 25-26 in Bautista et al. (1979).

Table 4. Productivity estimates

Author	Period	Annual Rate TFP (%)				
		Philippines	Thailand	Singapore	Malaysia	Indonesia
Kawai (1994)	1970-1980	0.8	1.2	0.7	2.5	3.1
	1980-1990	-2.2	2.6	1.6	0.7	-0.1
Lindauer and Roemer (1994)	1965-1990	0	3.3	3.6	1.1	2.7
Bosworth et al. (1995)	1980-1986	-4.6	0.3	-0.8	-1.9	-1.1
	1986-1992	0	4.0	4.0	2.8	0.8
Marti (1996)	1970-1985	-1.1	1.3	1.5	0.5	0.8
	1970-1990	-0.4	1.6	1.4	0.4	-0.5

Source: Felipe (1997)

One way to improve labor productivity is to provide workers with more capital, i.e., more investments. The Philippines is usually characterized as capital scarce and thus in need of foreign capital and investments. However, foreign investments are important also for another reason. It is typically through foreign investments that a country is able to pick up technology. Superior technology, in turn, can enhance productivity. The Philippines does not invest enough in research and development.

Radelet (1999) presents evidence that manufactured exports growth can enhance economic growth and technological progress by fostering ties between domestic firms and multinational firms that have cutting-edge technologies. This seems to have been true in the case of electronics exports. Some studies like the World Bank (2000)⁵ have characterized the Philippine export structure as the most "high-tech" in the region, and perhaps the world. Balisacan and Hill (2003)⁶ caution, however, against such a label for Philippine exports, noting that electronics products can span from relatively low to high technology, and the country's exports actually specialize in low-technology electronics activities.

It is almost certain that the success of electronics exports can be explained in part, if not wholly, by the tremendous amounts of investment, especially foreign, into the sector. The Philippine Economic Zone Authority (PEZA) estimates that electronics accounted for 51 percent of total PEZA investments in 1995-1999. In the same period, exports from these zones increased from 22 percent to 50 percent of total Philippine exports. Multinational corporations accounted for 85 percent of these exports, with Japanese firms alone accounting for 46 percent.⁷

The entry of multinational firms can be beneficial in many ways. First, they may provide domestic firms access to cutting-edge technologies they may not otherwise have. Second and very important, they also bring access to export markets. Not to be ignored are also the demonstration effects that can spillover to other sectors of the economy. Domestic companies may emulate multinational companies' methods of operations. Multinationals may also demand higher standards of service from domestic companies.

Unfortunately, the country seemed to be unattractive to investors at the time of this study. Perceived political instability seems to be a real deterrent to foreign investors, although this is mostly outside the realm of pure economics. Other common complaints of investors have been about poor infrastructure.

⁵ World Bank (2000), p. 19.

⁶ In Balisacan and Hill (2003), p. 225.

⁷ See Balisacan and Hill (2003), p. 231.

There seems to be a vicious cycle at work here, a chicken-and-egg problem—some of these infrastructures need or could benefit from foreign investments in the first place.

Conceptual Framework

As the term implies, a free trade agreement (FTA) would engage two countries into a trade arrangement whereby market forces will be made to work freely. Classical trade theory advances comparative advantage as the principle behind trade. The basic policy recommendation is for countries to specialize (completely or partially) in the production of goods wherein they have comparative advantage. The basic policy recommendation would be to concentrate on where countries have comparative advantage and import the rest. The countries can then engage in the export of the goods where they have comparative advantage, and in the import of goods where they do not have comparative advantage. The implication here is that each country has different comparative-advantaged goods, which naturally occurs because of the use of the concept of “comparative.” A country may have absolute advantage in all goods vis-à-vis another country, but there is always the possibility that the absolutely disadvantaged country can have a comparative advantage in one of the goods vis-à-vis the absolutely advantaged country. Hence, when countries trade freely based on comparative advantage, there is maximization of total output of goods resulting from the full utilization of the economic resources of both countries. Under a free market system, such an efficient condition will be naturally attained, as both countries will receive the appropriate price signals from the market.

The comparative advantage principle of classical trade theory was first derived from David Ricardo's (1817) formulation, where he cites production technological differences as being the primary source of each country's comparative advantage within a two-country and two-good, two-technology framework. A second source of comparative advantage was proposed by Eli Heckscher (1919) and Bertil Ohlin (1928), using a two-country, two-good, two-input framework. They proposed that countries will have their comparative advantage in a product that uses more intensively the resource that is more relatively abundant in that country. In either case, the exploitation of the resulting comparative advantage will lead countries to specialize and trade in such a way as to maximize output based on the full utilization of economic resources. This principle forms the basis and economic rationalization, albeit theoretical, of free bilateral trade.

For a balanced and more realistic perspective, however, it would be prudent to touch on the demerits or weaknesses of free trade based on comparative

advantage. Perhaps the most glaring weakness is that the comparative advantage analysis lacks a dynamic perspective. In its most basic formulation, the comparative advantage analysis is a static one, and can only provide a static strategy, which is based on the given status quo. It does not consider, for example, the case where free trade could evolve in such a way where a country can export a good in which comparative advantage does not currently exist but has the potential to be so. In this paper, we refer to the potential of having comparative advantage as dynamic comparative advantage. We view this concept to be the more relevant in that it stresses the need for a developing country to view trade as a means in its economic development—a concept that is inherently dynamic.

Exploiting dynamic comparative advantages appears to have been a major feature of East Asian postwar development. One major analysis of this development is the “East Asian Miracle” Report by the World Bank. The report can be considered as a monumental step for the World Bank, which is well known to be a vocal proponent of neoclassical economics that is heavily based on free markets. In this report, the World Bank naturally stressed the need for free markets, but at the same time it also conceded the possibility of “selective intervention,” which utilized government-organized contests as its basic principle for competitive discipline. This is actually a significant deviation from neoclassical economic theory. To be fair, neoclassical theory admits to cases of legitimate government intervention when the market mechanism fails. These cases fall under externalities, monopolies, and public goods. The contest mechanism of selective intervention, however, could be considered as a novel case whereby the government intervenes in setting the rules, referees, and rewards.

One paradigm that is less popular, at least in Western economic thinking, and has been used to describe and analyze the development of highly performing East Asian economies, is the flying geese model. The Flying Geese (FG) model was first proposed by Kaname Akamatsu in the 1930s to describe the various wave-like patterns of industrial development that he observed first within the local Japanese economy. The model’s popularity was somewhat given a boost when it was cited by Saburo Okita⁸ in a 1985 presentation to describe structural transformation in East Asia.⁹

As documented by Kiyoshi Kojima (2003), the flying geese model consists of three patterns, each based on empirical observations regarding the ebb

⁸ Recipient of 1971 Magsaysay Award for International Understanding; Minister of Foreign Affairs, 1979-1980.

⁹ Saburo Okita (1985), pp.18-29.

and wane of Japanese industries.¹⁰ The name of the model derives from the inverted V-shape formations of various statistics collected in Akamatsu's empirical investigations. The shapes suggested to Akamatsu the flight of wild geese through the autumn skies of Japan.

The first (original) pattern describes the evolution of a particular industry, in terms of its imports, production, exports, and reverse imports. An industry's pre-birth stage starts with the importation of the industry's products. This eventually ushers in the birth of a domestic industry, which is essentially an import-substitution phase as local production competes with imports. In time, the domestic industry becomes competitive enough to substantially if not completely displace the imports, and proceeds to compete in the international market by exporting some of its production. With the emergence of international competitors that could produce more cheaply, the domestic industry wanes and eventually goes through reverse importation as the new competitors are able to penetrate the domestic market and displace local production.

The second pattern of the FG model describes the waves of evolution through various industries within one country. Industrial development starts from primary industries, then moves on to light industries, to heavy industries, and then to high-technology industries. Movement to the next industry is initiated as the predecessor industry wanes and resources are allocated to the successor industry. Such allocation normally entails a steady increase in capital endowments, so that succeeding industries become more and more capital-intensive and less and less labor-intensive.

In its third formulation, the FG model has been used to describe the waves of industrial transplantation across countries, with Japan playing the role of lead goose. Japanese industries are seen to relocate from Japan to the newly industrialized economies, and then to the more advanced or early members of ASEAN. More recently, Japanese industries have moved in to mainland China and into the newer and less advanced members of ASEAN.

Kojima further identifies two other features of the FG model that could be considered as strategies to fully exploit the merits of the FG model. One feature is what he refers to as "Pro-Trade FDI," which pertains more to the third pattern of the FG model. Japanese industries are transplanted abroad through FDI, which flow from potentially comparative disadvantaged industries in Japan to potentially comparative advantaged industries in the host country. Such investments would contribute to export as the host country's industry actualizes its comparative advantage due to technological upgrading that

¹⁰ A first-generation student of Kaname Akamatsu.

comes with the FDI. Kojima argues that the Japanese FDI to its East Asian neighbors can be largely characterized as pro-trade FDI.

Another feature of the FG model is what Kojima refers to as “agreed specialization.” This is a strategy for a situation where Japanese FDI is confronted with a set of host countries with similar potential comparative advantage (e.g., ASEAN 4). The problem is that if transplantation of all industries is made to all of these host countries, then there is failure to exploit economies of scale. To avoid this problem, the set of similar host countries will receive FDI in different countries. Each host country could then fully develop its potential comparative advantage in the industry to which it is hosting the FDI.

The Japanese Government’s View

In January 2002, the Koizumi administration proposed the Japan-ASEAN Comprehensive Economic Partnership (JACEP). In the ASEAN summit talks in September 2002, it was decided that a framework for JACEP be proposed by this year.

A clear vision has yet to be ironed out, but Japanese government-related staff and documents reveal a strong commitment for Japan to continue forming, what the Ministry of Economy, Trade, and Industry (METI) White Paper refers to as an East Asian Business Zone. There are basically three reasons for such a favorable attitude of the Japanese government. Firstly, systematization of the JACEP would lead to enhanced competitiveness of the Japanese manufacturing network in operation across ASEAN. Even with the steady progress of the *Common Effective Preferential Tariff* (CEPT) arrangements, there is still much room in removing barriers to trade and investments that could result in gains in competitiveness for Japanese FDIs in ASEAN. Secondly, the Japanese government is in favor of a strategic diversification of Japanese investments, which recently have tended to concentrate on China. While China’s participation in the international economy is much welcomed, prudence dictates against putting all of the Japanese eggs into the Chinese basket. Lastly, the initiatives of China and the United States (US) to form bilateral agreements with ASEAN member countries are considered as a threat. The Japanese government is warning against complacency. It is to its best interest not to waste the manufacturing network it has been building up all these years, when interests in ASEAN by the two large economies have not been as keen.

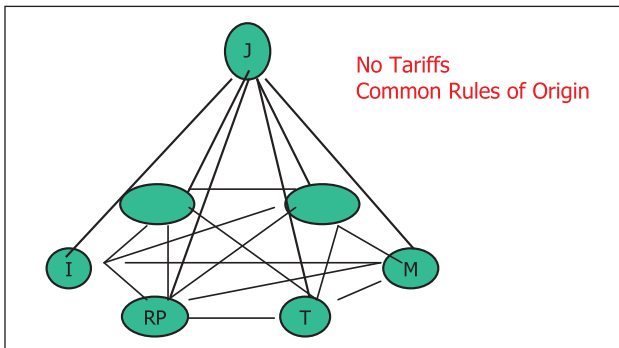
One more thing to note about the Japanese government’s posture is that while it considers the WTO rules as a basis for systematizing JACEP, it also recognizes the need to be flexible and even go beyond such rules. Underlying this is the need to integrate East Asia as countervailing force to

the European Union (EU) and the *North American Free Trade Agreement* (NAFTA). Ex post, Japanese FDIs have been instrumental in working toward this goal of integration, and could very well be the core to further integration of the East Asian region.

While the Japanese government sees ASEAN+3 as the ultimate form of East Asian integration, ASEAN-Japan partnership has the potential to move ahead more quickly than Northeast Asian arrangements. Despite the close cultural and historical similarities of Northeast Asian countries, progress toward integration may be more difficult.

The Japanese METI¹¹ has drawn up a regional approach framework (Figure 1). Bilateral agreements between Japan and with each of the ASEAN 4 (Indonesia, Malaysia, the Philippines, and Thailand) countries were then scheduled to be completed by 2004, and with the whole ASEAN 10 by 2005. The JACEP was eventually signed by Japan and ASEAN 10 on April 2008, after eleven rounds of negotiations. The regional approach envisions a completely barrier-free setup among Japan and the ASEAN 10 countries by 2020s.¹²

Figure 1. METI's regional approach framework



METI = Ministry of Economy, Trade, and Industry

Note: Not all East Asian countries are shown.

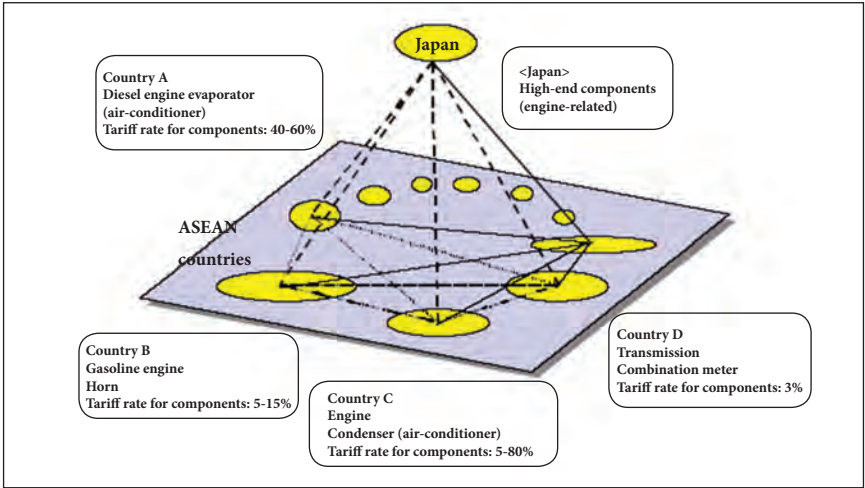
Source: Author interview of METI staff and METI White Paper (2003)

¹¹ Based on an interview with a METI official and from METI's 2003 White Paper.

¹² There is a wide range of liberalization schedules depending on negotiations. For the Philippines, the JACEP entered into force on July 2010, with a liberalization schedule which extends up to 2018. Newer members of the ASEAN are allowed a longer liberalization schedule.

One notable feature of the regional approach framework (Figure 1) is that it is very much similar to the existing production network of Japanese companies in ASEAN (Figure 2). The Japanese government’s vision of the systematization of an East Asian Business Zone is, therefore, intimately linked to and very much driven by the existing Japanese manufacturing networks in East Asia. The Japanese government’s role is basically one of supporting such networks so that Japanese companies become more competitive in the international market.

Figure 2. Optimum supply network of the automobile industry in ASEAN



Source: Ministry of Economy, Trade, and Industry (METI) White Paper (2003), p. 303

To provide analytical inputs to the JACEP framework, IDE-JETRO has prepared an analysis of the international competitiveness of ASEAN countries.¹³ In this analysis, the International Competitive Coefficient (ICC)¹⁴ index is used instead of Balassa’s RCA to measure the competitiveness of East Asian products. The results are summarized in Table 5. As can be seen from the table, the Philippines has actual or promising competitiveness in manufactured goods.

¹³ Hiratsuka (2003).

¹⁴ The ICC index is defined per commodity or industry *i* to be equal to

Table 5. Grade of competitiveness by commodity

	Competitive Industry	Promising Industry	Uncompetitive Industry
Singapore	(6),(7),(8),(9),(10),(12), (13),(14),(15),(28),(29)	(16),(18),(20),(24), (25),(26),(30)	(1),(2),(3),(4),(5), (11),(17),(19),(21), (22),(23),(27),(31)
Malaysia	(2),(3),(4),(5),(6),(7),(8),(9), (15),(21),(26),(31)	(10),(11),(12),(13), (14),(16),(18),(20), (28),(29)	(1),(17),(19),(22), (23),(24),(25),(27), (30)
Thailand	(1),(2),(3),(4),(5),(6),(7),(8), (9),(10),(13),(14),(15),(16), (17),(21),(22),(26),(27),(31)	(11),(18),(20),(23), (29)	(12),(19),(24),(25), (28), (30)
Philippines	(3),(5),(6),(7),(8),(9),(15),(17), (18),(31)	(10),(12),(19)	(1),(2),(4),(11),(13), (14),(16),(20),(21), (22),(23),(24),(25), (26),(27),(28),(29), (30)
Indonesia	(2),(3),(4),(5),(6),(7),(8),(9), (13),(14), (15),(21),(26),(31)	(10),(11),(16),(28), (29),(30)	(1),(12),(17),(18), (19),(20),(22),(23), (24),(25),(27)
Vietnam	(1),(2),(3),(4),(5),(6),(14)	(7),(8),(10),(11), (13),(15),(20),(21), (27),(18)	(9),(22),(23),(24), (25),(26),(28),(29), (30)
China	(1),(2),(3),(4),(5),(6),(7),(8), (9),(10),(11),(17),(21),(22), (31)	(13),(14),(15),(16), (18),(19),(20),(26), (28),(29),(30)	(12),(23),(24),(25), (27)
Japan	(7),(8),(10),(11),(12),(13), (14),(15),(16),(17),(18),(19), (20),(21),(22),(23),(24),(25), (26),(27),(28),(29),(30),(31)		(1),(2),(3),(4),(5),(6) (9)
South Korea	(3),(4),(6),(7),(9),(11),(12), (13),(14),(15),(17),(18),(21), (22),(26),(27),(29)	(20),(24),(28),(30), (31)	(1),(2),(5),(8),(10), (16),(19),(25)
Taiwan	(3),(4),(5),(6),(7),(8),(9),(11), (12),(13),(14),(15),(17),(18), (21),(26),(27)	(20),(28),(29),(30)	(1),(2),(10),(16), (19),(22),(23),(24), (25),(31)

Notes: (a) Agricultural related industries: (1) agricultural products, (2) processed agricultural products
 (b) Light industry: (3) apparel, (4) footwear & leather articles, (5) furniture, (6) miscellaneous manufactured goods
 (c) Light machinery: (7) home electrical appliances, (8) office & communication apparatus, (9) personal computers & peripheral equipment, (10) precision apparatus
 (d) Supporting industries: (11) metal processing, (12) molds, (13) parts of home electrical appliances, (14) parts of office & communication apparatus, (15) electronic parts, (16) parts of precision apparatus, (17) motorcycle parts, (18) automobile parts, (19) machine tool parts, (20) industrial machinery parts

- (e) Heavy machinery: (21) motorcycles, (22) commercial vehicles, (23) passenger cars, (24) machine tools, (25) industrial machinery
- (f) Material industries: (26) yarn & fabrics, (27) synthetic fiber textiles, (28) petrochemical products, (29) basic petrochemicals, (30) iron & steel, (31) glass & cement.

Source: Hiratsuka (2003)

Perspective: Japanese Companies in the Philippines

Companies in the Export Processing Zones

This section presents a perspective obtained from interviews with Japanese companies operating in the Philippines, especially in the special economic zones (SEZs). Due to the relatively small sample size, not much can be said of the general applicability of the findings.

We also had the common problem of short data series. This made it difficult to both achieve and assess the reliability of findings. Fortunately, we got access to longer data series from the Philippine Economic Zone Authority (PEZA). This data was used as an organizing point for the analysis in this section. The interviews with the Japanese manufacturing companies (including the statistical data obtained) were used to supplement the analysis of the PEZA data, where possible. The PEZA data consisted of monthly data from January 1997 to December 2002 for direct employment, imports (in US dollars), and exports (in US dollars) in the different SEZs in the country. This data was used for estimating the export production function for each SEZ, with direct employment and imports taken as inputs to production. Export and import values were deflated using monthly export price indices and import price indices (base year=1995), respectively. The price indices were obtained from various issues of the *Selected Philippine Indicators* by the National Census and Statistics Office (NCSO). *Ordinary least squares* (OLS) was used to estimate the technological coefficients of a Cobb-Douglas export production function¹⁵, thus,

$$LOG(EX) = \hat{\alpha} * LOG(EMP) + \hat{\beta} * LOG(RIM)$$

where $LOG(EX)$ = logarithm of real exports
 $LOG(EMP)$ = logarithm of direct employment
 $LOG(RIM)$ = logarithm of real imports
 $\hat{\alpha}, \hat{\beta}$ = estimated technological coefficients.

¹⁵ For an extended analysis of the export production model based on PEZA data, see Maquito and Carbonel (2010), wherein the productivity residual is explained by shared growth factors (i.e., stability of employment, local procurement, and regional integration)

Because of the shorter length of the price indices, estimation was done for a consistent data period between January 1998 and December 2002. Moreover, SEZs without 1998 data were not estimated. The best estimation results are given in Table 6, sorted according to increasing Economies of Scale (EOS) factor.

As the term implies, the EOS factor is indicative of the economies of scale of each SEZ, and is derived from the sum of the technological coefficient estimates. The export production function exhibits increasing returns to scale if the EOS factor is greater than unity, constant returns to scale if equal to unity, and decreasing returns to scale if less than unity.

From Table 6, it can be observed that, with the exception of West Cebu Industrial Park, all of the SEZs displayed increasing, if not constant, returns to scale. This is a positive sign—indicating that the majority of SEZs are operating in a production region where increasing production would be accompanied by decreasing average costs.

Sources at the Yutaka Manufacturing Philippines, Inc. (YMPI), a second-tier subcontractor for the Honda *keiretsu* (a form of Japanese organization or structure) did identify higher production as a possible source of enhanced competitiveness. Related to this is the domestic demand factor, which was cited by other companies (Toyota, Asahi, and Honda) as a crucial factor for their local operations. It is interesting to note that the information technology (IT)-related firms that were interviewed were not as emphatic about domestic demand. One possible reason for this is the higher value added of IT-related industries vis-à-vis machinery-related industries. Fujitsu, SSPI, and Enomoto mentioned that the produced parts are sometimes delivered by air.

The SEZs in Table 6 can be classified depending on the significant explanatory variables. Nine of the SEZs have significant technological coefficients for both of the explanatory variables (CATEGORY 1). Eleven SEZs have a significant technological coefficient only for direct employment (CATEGORY 2). A minority formed by two SEZs have a significant technological coefficient only for real imports (CATEGORY 3). This suggests that Philippine labor is a significant input to export production in the majority of SEZs. In fact, in most of the CATEGORY 1 and CATEGORY 2 SEZs, firms have employment technological estimates greater than that for real imports. This would suggest that the cost-minimizing share of employment will be higher than that of real imports. Hence, export production in the SEZ appears to be labor-intensive.

Table 6. Export production function estimation results

	Employment	Real Import	EOS Factor
West Cebu Industrial Park		0.9278874	0.9278874
First Philippine Industrial Park		1.0361566	1.0361566
Baguio City Economic Zone	0.2403555	0.8620287	1.1023842
Leyte Industrial Devt. Estate	0.328715	0.7827399	1.1114549
Bataan Economic Zone	0.6389222	0.4876453	1.1265675
Cavite Economic Zone	1.2662194		1.2662194
Mactan Economic Zone	1.1354897	0.14444	1.2799297
Laguna Techno Park	0.9679828	0.3132673	1.2812501
Light Industry & Science Park 1	1.0437114	0.2391181	1.2828295
Victoria Wave	1.2831927		1.2831927
First Cavite Industrial Estate	1.3108485		1.3108485
Mactan Economic Zone II	1.3486368		1.3486368
Luisita Industrial Park	1.3593132		1.3593132
Daiichi Industrial Park	1.2870485	0.1319954	1.4190439
Light Industry & Science Park 2	1.4337332		1.4337332
Subic Shipyard Special Economic Zone	1.3227522	0.1202609	1.4430131
Lima Technology Center	1.4573385		1.4573385
Gateway Business Park	1.4622038		1.4622038
Laguna International Industrial Park	1.4628399		1.4628399
New Cebu Township	1.5207115		1.5207115
Toyota Industrial Complex	1.3973197	0.1783027	1.5756224
Angeles	1.5938713		1.5938713

The three categories of SEZs could be linked to the optimality of the SEZ export production. CATEGORY 1 is taken to be the most optimal of the three categories in the sense that both inputs are statistically significant in explaining the movements in real export. This implies that the CATEGORY 1 SEZs are able to combine efficiently the two inputs. This follows from the definition of a production function as being, *ex post*, the combination of inputs that will produce a given output at the minimum cost. For a Cobb-Douglas production function, zero use of one input cannot be optimal unless perhaps the price of one input factor is infinitely high. CATEGORY 2 and CATEGORY 3 SEZs, therefore, are considered as less optimal than CATEGORY 1 SEZs in the sense that the insignificance of the one input implies an inability of these SEZs

to combine the two inputs efficiently. No particular ordering is attached to CATEGORIES 2 and 3.

The optimality of CATEGORY 1 may be further understood by looking more closely at the behavior of real imports. It was observed that of the two inputs, real import is generally the more volatile one, for all of the SEZs. It appears that the SEZs do not adjust employment to accommodate short-term (monthly) changes in export production, and that real import bears the brunt of short-term adjustments. This is assuming that export production is largely determined by the market side—a plausible assumption given that exports are supplied to the competitive international market.

This adjustment role of real import led us to investigate the correlation between real imports and real exports, and its relationship to the categories we have arbitrarily created. We have estimated the following relationship using OLS across SEZs as

$$ADJR2 = 0.272 * EOS + 0.322 * DUM1$$

where ADJR2 = is the adjusted coefficient of correlation for an
 OLS estimation of real export on real import,
 EOS = is the EOS factor, and
 DUM1 = is a dummy variable that is equal to 1 when the SEZ
 is CATEGORY 1 and equal to zero, otherwise.

Both estimates were significant at the 95 percent level. The adjusted coefficient of correlation for this regression is 66.8. This estimation result suggests that the correlation between real imports and real exports increases as the EOS factor increases, all other things constant. This implies that higher EOS factors are accompanied by higher correlation between real export and real import. Moreover, the relationship indicates an increase in the real import–real export correlation when the SEZ is CATEGORY 1. This supports our view that CATEGORY 1 SEZ is optimal in terms of being able to adjust imported inputs so as to meet the production of exports.

Table 6 may suggest that CATEGORY 2 may be more optimal than CATEGORY 3 since the EOS factor for CATEGORY 3 is the lowest of all the SEZs listed in the table.

This reminds us of our interview with PIMES Corporation officials where it was suggested that the SEZ (in this case, the Cavite Economic Zone) can be made more efficient. To be sure, PIMES and each of the locators in the said SEZ can individually contribute to overall SEZ efficiency. Our sources, however,

suggested that there are possible improvements that go beyond the control of each locator. Unfortunately, our sources declined to elaborate. This reminded us of a possible coordination failure in the said SEZ.

Looking back at Table 6, we see that the Cavite Economic Zone is a CATEGORY 2 SEZ, with only direct labor as a significant explanatory variable of export production. In fact, of the four public economic zones, the Cavite Economic Zone has the lowest correlation between real import and real export. This would imply some kind of bottleneck both on the level of each locator and on the level of the SEZ, which hinders a high responsiveness of imports to exports.

One last observation on Table 6, which would be of relevance to the ultimate purpose of this survey, is the excellent performance of the Toyota Industrial Complex, which is dominated by Japanese investments. It exhibits the second to the highest EOS factor, and is a CATEGORY 1 SEZ. It is surpassed only by the Angeles Economic Zone, which apparently does not have any Japanese locators and is a CATEGORY 3 SEZ. On closer inspection, however, we found that export production in the Angeles Economic Zone is significantly explained by the last month's value of real imports, although current real imports do not. Even with this new estimation, the EOS factor did not change substantially. However, it does indicate some loss of optimality in that imports have to be stored for one month prior to production. This could constitute higher costs due to inventory. Hence, the Toyota Industrial Complex can be considered as a CATEGORY 1 SEZ with the highest EOS factor, and worthy of emulation by the other SEZs.

One integral component of SEZ operations is the incentive structure provided by the Philippine government to SEZ locators. Our sources mentioned the need for fairness in the incentives being provided by the government. In the case of Toyota, our sources feel the proper strategy is to develop exports of parts suppliers. They do not disagree with incentives for completely built up (CBU) exports, however, they would like to see incentives to apply also to parts suppliers. Honda sources appear more ambivalent, revealing that they have a model up their sleeves that they plan to locate production in the Philippines for export as CBU to other ASEAN countries. The incentives may have an effect on the development of local parts suppliers. In the case of Asahi Glass, our sources stressed how excessive liberalization vis-à-vis our ASEAN neighbors have opened up the country to cheap imports from China. After massive layoffs and restructuring in response to intense imported competition, Asahi Glass is now competitive enough to export. Market share, however, has not recovered and there is the issue of whether government incentives can be given to enhance competitiveness while minimizing the adjustment costs. Given a fair and

efficient incentive mechanism, the firms interviewed showed a strong eagerness in continuing to establish a manufacturing network in the country.

The JETRO conducted a questionnaire survey of Japanese-affiliated manufacturers based in 11 Asian countries and regions.¹⁶ Questions were fielded over a wide range of topics and issues: future plans, subcontracting and cost structure, problems and even views on an FTA between the Philippines and Japan.

Among the countries surveyed, the Philippines had the highest proportion of firms exporting 100 percent of their sales (41.7%, way above the total average of 19.8% and the ASEAN average of 21.4%). It is likely that the majority of the respondents in the Philippines were located in an export zone.

Of particular relevance to the paper perhaps are some responses on the procurement patterns of Japanese firms in the Philippines compared with similar firms in neighboring countries. Japanese manufacturers in the Philippines tend to have the lowest rate of locally procured materials and parts (Table 7). The JETRO survey reports that 60.5 percent of Japanese firms in the Philippines indicated "difficulty in procurement of local parts and raw materials" as one of their production problems. This is significantly higher than the average of 44 percent for ASEAN. In the survey, only Vietnam had a higher proportion of firms (61.8%) expressing this problem.

Some of our interviewees also confirmed this difficulty of finding local subcontractors to outsource parts of their production activities. This is consistent with observations that Philippine industry suffers from poor backward linkages. The semiconductor industry for instance, has often been cited as an example of an export with low domestic value-added.

This finding of poor linkage with domestic suppliers is consistent with the findings of Radelet (1999). He noted that many countries pursued the strategy of establishing an "export platform" or enclave where exporters could operate in an environment free from problems of poor trade policies, weak infrastructure, bureaucracy, and inconsistent rule of law prevalent in the general environment. In many of these countries, he found similar poor backward linkages with domestic suppliers. It is possible that in an EPZ, the incentive of relatively free importation of raw materials and capital equipment (duty free in the Philippine case) will reduce the incentive for locators to go outside for suppliers. Domestic suppliers outside EPZs also generally do not enjoy duty exemptions for their own inputs, which may render them uncompetitive.

¹⁶ The countries or regions included Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam, China, Hong Kong, India, South Korea, and Taiwan.

Table 7. Percentage of respondents procuring locally, by share of materials and parts

	% of materials and parts locally procured in your location											
	0	1-20	21-30	31-40	41-50	51-60	61-70	71-80	81-90	91-100	Unknown	
Total	5.1	27.7	11.7	7.1	6.9	6.5	8.3	7.9	9	9.8	3	
ASEAN Subtotal	5.7	31.9	11.5	7.2	6.9	7.2	7.3	6.5	7.9	7.9	2.1	
Thailand	3.5	25.2	9.7	8.8	9.7	8.4	8.4	8.4	8.4	9.3	3	
Malaysia	2.9	28.2	13.2	7.5	3.4	9.2	9.2	6.9	9.2	10.3	0.6	
Singapore	8.8	20.2	11.4	7.9	6.1	7	7	11.4	12.3	7.9	4.2	
Indonesia	2.5	31	8.9	8.2	10.8	8.9	8.2	4.4	8.2	8.9	1.3	
Philippines	10.1	45.6	17.4	4.7	4.7	3.4	5.4	2	4.7	2	0.7	
Vietnam	13.4	55.2	6	3	3	3	1.5	6	1.5	7.5	4.3	
Republic of Korea	13.3	20	3.3	6.7	-----	3.3	16.7	6.7	10	10	9.1	
Taiwan	5.7	17.1	0.5	8.6	7.6	1	13.3	15.2	9.5	11.4	2.8	
China (excluding HK)	3.3	24	12	6.6	7.1	6.8	6.8	8.5	10.7	14.2	4.7	
Hongkong	2.9	29.4	7.6	5.9	8.8	5.9	5.9	5.9	8.8	8.8	-----	
India	2	5.9	9.8	7.8	7.8	5.9	23.5	13.7	13.7	9.8	3.8	

Source: JETRO, 2003.

This would then seem to be an obvious strategy to increase Philippine manufactured exports—to improve the backward linkage of Philippine manufacturing by raising the capability of local firms to supply the needs of multinationals' affiliates here. We recall that when General Motors decided to locate in Thailand over the Philippines, they cited the well-developed supplier network that was available there. Further study would be needed to establish the reason for the poor domestic supply capability.

In the case of a Free Trade Agreement (FTA) with Japan, only 6.1 percent of Japanese firms in the Philippines indicated "High customs duties on imported capital and intermediary goods" as a production problem. This is about half the overall average proportion of firms reporting this as a problem. Only Korea and Taiwan had lower proportion of firms reporting this problem. This may be because most of the respondent firms for the Philippines are located in EPZs. In fact, this is likely the case as the Philippines had the largest proportion of firms participating in the survey reporting 100% of their sales as exports.

Strategic Implications

In this section, we comment on some provisions of the Japan-Singapore Free Trade Agreement with a view to drawing out strategic implications for an RP-Japan FTA.

Provision (from the summary of chapter)

- This chapter commits both countries to grant preferential tariff free market access to an extensive range of products. It also provides for possible acceleration of tariff elimination or inclusion of additional products for tariff elimination in the future. In addition, each country must ensure that its excise taxes and other charges are not levied in an unjust manner that would result in discrimination against imported products.
- Japan and Singapore are prohibited from maintaining any export duties that may distort bilateral trade and are obliged to ensure that their nontariff measures are similarly non-distortive and transparent.

Comments/Suggestions

Provision should be made to allow for temporary protection (in other forms) of locally produced import-competing products. This will allow such products to compete in the international market later on, and to exploit dynamic comparative advantages inherent in the flying-geese dynamics that has driven successful industrial development in the highly performing economies of East Asia. Such a

provision will require the following: (elements of these provisions were crafted in Hirakawa, U, Maquito (2008), which was a roadmap study submitted to the Philippine Automotive industry and the Philippine government)

1. A credible or binding commitment by the Philippine government to set and enforce the deadline for withdrawal of protection on such import-competing products;
2. Such deadlines need to be set based on a clear understanding of the dynamic comparative advantage of import-competing firms;
3. A preference for applying temporary protection on products where FDIs from Japan are present or are potential entrants, particularly in products with high export potential (pro-trade FDI);
4. A preference for applying temporary protection on products that fits into the international division of labor within ASEAN, allowing, therefore, for the possibility of agreed specialization so as to maximize benefits from economies of scale; and
5. A preference for applying temporary protection for FDIs, which is open to generating backward linkages with indigenous manufacturing firms.

Provision should be made for allowing nontariff but structural features, which are inherent to exploiting the dynamic competitive sources of firms. Example are (a) close linkages between contracting and subcontracting firms, (b) close linkages between financiers and firms, and (c) close relationships between laborer and firm. In the past, these have been criticized as nontariff, structural impediments.

Provision (from the summary of chapter)

The individual tariff schedules of Japan and Singapore, consist of each country's commitments in the area of tariff concessions. These schedules stipulate the products that are subject to zero tariff concessions and the corresponding time frames within which tariffs are eliminated.

Comments/Suggestions

Tariff schedules should be made based on information related to locally based producers obtained through one of the following:

1. Direct consultations with producers
2. Historical analysis of production

Where such a scheme is too costly to implement (because of immense difficulty in getting data) performance-contingent tariff schemes could be designed based on readily observable performance indicators. For example, a

tariff schedule based on exports can be set in contest-like fashion. Tariffs will be reduced by a certain percentage once locally produced exports (including those of locally located Japanese firms) have reached a certain level. Given the possible disincentive of such a scheme, however, a credible deadline should be set for the complete removal of tariffs, or clearly set rewards in terms of subsidies could be provided later based on export performance.

Note

Most, if not all, of the suggestions given above are based on an understanding of the effective features of Japan's development in the past. These are still considered to be valid in the case of the Philippines given that it is at a later stage of development vis-à-vis Japan. The Japanese side should be able to understand most of these suggestions. Recent trends, however, have caused some sectors within Japan to yield to the free-market view, being espoused by other advanced neoliberal countries like the US. This has resulted, to some extent, in a blind embrace of free trade principles, bereft of any strategic vision in some sectors within Japan, and has inadvertently inflicted a lingering slump to the Japanese economy. While free trade can benefit trading countries, it should be approached strategically, to minimize adjustment costs. It is crucial for the Philippines' negotiating party to be aware of this pitfall, to maintain a strategic vision throughout the negotiation process, and to work for mutually beneficial arrangements. The breakdown of the Japan-Mexico FTA talks has made the NAFTA an even more formidable competitive regional block, making the importance of Japan-ASEAN partnership even more important.

Illustration of the exploitation of flying-geese dynamics

Crucial to the proper exploitation of the flying-geese dynamics is the identification of competitive stages of products in both the catching up economy (in this case, the Philippines) and the lead goose economy (Japan). For this, we refer to the ICC indices calculated by Hiratsuka (2003) and presented in Section III. The ICC is helpful in identifying the stage at which a product (or industry) is in the catching up product cycle of the flying-geese dynamics. Based on ICC calculations, Hiratsuka (2003) came up with the Table 5 above comparing the international competitiveness of different product categories for ASEAN and Northeast Asian countries.

Based on this table, the following strategy set could be arrived at:

1. Temporary protection and appropriate incentives be given to precision apparatus, molds, and machine tool parts. These are industries deemed to be promising Philippine industries and at the same time

- competitive industries in Japan. These are the industries where there is a lot of potential for pro-trade FDI from Japan.
2. Promote the export to Japan of apparels, furniture, miscellaneous manufactured goods, and personal computers and peripheral equipments. These industries are deemed competitive in the Philippines and at the same time uncompetitive in Japan.
 3. Promote the gradual and selective export of home electrical appliances, office and communication apparatus, electronic parts, motorcycle parts, automobile parts, glass and cement. These are industries where both the Philippines and Japan are currently competitive. Gradual and selective exports can do a lot to avoid resistance from Japanese industries.
 4. Promote importation from Japan of metal processing, parts of home electrical appliances, parts of office and communication apparatus, parts of precision apparatus, industrial machinery parts, motorcycles, commercial vehicles, passenger cars, machine tools, industrial machinery, yarn and fabrics, synthetic fiber textiles, petrochemical products, basic petrochemicals, and iron and steel. These are industries where the Philippines is currently uncompetitive while Japan is competitive. The possibility of local production of these items should be borne in mind.
 5. Agreed specialization should be considered in precision apparatus (with Indonesia and Malaysia), and molds (with Malaysia). These are promising industries in the Philippines, which are also promising in the mentioned ASEAN 4 countries. Within the ASEAN 4, the Philippines alone has a promising status in machine tools part. It does not have overlapping promising status with Thailand. There is, therefore, potential for continued agreed specialization with the other ASEAN 4 countries.

In general, the above would suggest the following tentative elements of an export strategy to Japan. *First*, the strategy could focus on the possibility of exporting manufactured goods. The Japan-ASEAN Comprehensive Economic Partnership, obviously, is virtually driven by existing Japanese manufacturing networks. *Second*, the strategy should maximize the leverage that the country could get from linking with such existing manufacturing networks. The Philippines' sterling export performance so far has done this. Moreover, such manufacturing networks could supplement the country's institutional weaknesses or tendencies to be self-defeating that were inherent in failures in past industrializing policies. *Third*, the strategy could be realized over the

medium to long term due to the time it would need for such manufacturing networks to develop indigenous SME subcontractors, and other supporting institutional structures.

Fourth and last, the strategy is going to be firm-led, with the government and other socioeconomic institutions playing an active supporting role. The point is to be market-friendly but not leaving everything to the invisible hand of the market, which would most likely be disabled in a developing country context. Clearly, this precludes a strategy that is based on Major Industrial Projects.

In connecting to Japan-led production networks, however, there is one recent tendency that may undermine the Philippines' ability to accomplish this task. Japanese manufacturing firms have developed a tendency to concentrate their production operations, instead of the more regionally balanced network implied in Figures 1 and 2 above. Leaning too much on market forces may leave the Philippines in a relatively weak position in the production network, leaving her with a narrow range of sophisticated products to sell in the international market.¹⁷

Appendix

List of interviewees in survey/personal interview.

1. Mr. Shigeo Tsubotani
Chairman and CEO
Fujitsu Philippines, Inc.
2. Mr. Mitsunari Takano,
President
Honda Cars Philippines
Mr. Alfredo Magpayo,
AVP
Honda Cars Philippines
3. Mr. Nobuhiro Tabata
President
Toyota Motor Philippines
4. Mr. Nagamine
President
Fujitsu Computer Products Corporation of the Philippines
5. Mr. Hironari Kotoda
Executive Vice President
Asahi Glass Philippines, Inc.

¹⁷ This has been cited as one major reason for the Philippines having fallen into a "lower middle-income trap" from which it may take her decades to escape. (Felipe, 2012)

(Subcontracting Firms)

6. Mr. Akira Ishii
President
Sanyo Plastic Philippines, Inc.
7. Mr. Joji Miyake
President
Toyota Auto Parts Philippines, Inc.
8. Mr. Hitoshi Sakamoto
Senior Vice President
Enomoto Philippine Manufacturing, Inc.
9. Mr. Tadashi Yamaji
President
Philippine International Manufacturing and Engineering Services

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4 Analysis of Industry and Sector-Specific Impacts of a Japan-Philippines Economic Partnership

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Royce Elvin O. Escolar¹

Introduction

Trade liberalization, now more than ever, has not lost its contentious character. Amidst the backdrop of multilateral liberalization as exemplified by the WTO, the Asian region is in a frenzied state over negotiations of a different kind. The trend of bilateral FTAs has started and was even spurred by the perceived failure of the WTO as exemplified by the impasse in the September WTO Ministerial meeting in Cancun, Mexico. The pace and coverage of negotiations have been picking up and countries in the Asia Pacific seem eager to join the bandwagon.²

Japan, in particular, has been very active recently in wooing its neighbors with economic partnership agreements. Such partnership does not only provide for elimination of trade barriers under a standard FTA, it also includes a broader area of cooperation that aims for greater integration between the partners. In the Japan-Singapore Economic Partnership Agreement (JSEPA), the areas included are as follows: trade in services, investment, movement of natural persons, intellectual property, government procurement, competition, financial services cooperation, information and communications technology, energy, science and technology, human resource development, employment and labor management relations, small and medium enterprises, broadcasting,

¹ Asian Institute of Management Policy Center.

² Japan has started serious bilateral FTA discussions with the Philippines, Thailand, and Malaysia. Outside the region, it is undergoing negotiations with Chile while talks with Mexico are expected to be concluded by June 2004. Singapore has signed FTAs with the United States in May 2003 and Japan in January 2002. Thailand has signed an FTA with Australia and is in the final stages of negotiations with Japan.

and tourism.³ Bilateral agreements are becoming a practical way for countries to agree on a wider range of topics as opposed to the delay and difficulties of a multilateral consensus under the WTO.

This paper aims to identify potential winners and losers among the various sectors and industries in the Philippine economy if and when a Japan-Philippine Economic Partnership Agreement (PJEPA) is established. Specifically, the study aims to pinpoint internal and external factors that enable specific sectors to gain or be burdened by an FTA with Japan. Understanding the mechanisms of how trade policy affects different sectors will have far-reaching implications in policy reforms. By identifying these factors, it is our hope that private sector initiatives and public policy reforms may be encouraged to mitigate the short-term harm to specific sectors caused by trade openness.

The study proceeds by providing a brief background on the current state of Japan-Philippine economic relations. A brief preview on recent studies done on the Japan-Philippine FTA will also be included in Section II. Section III details the research methodology and conceptual framework used in this study. Section IV analyzes industry and sector impacts in the Philippine economy. Adjustment costs accompanying trade liberalization and market characteristics that affect adjustment costs will be discussed in Section V. Section VI ends with the conclusion.

Background

Japan-Philippine Trade through the Years

Japan remains the Philippines second largest export market after the United States (US) accounting for 15.06 percent of the total Philippine export to the world in 2002. The country is also the top supplier of Philippine imports in 2002, accounting for 21 percent of the total imports of the Philippines.⁴

A look at Philippine-Japan trade statistics would show that the value of Philippine exports to Japan have expanded from USD 1.74 billion in 1992 to USD 5.29 billion in 2002, a growth of 204.48 percent for the 10-year period (Table 1). In fact, for the same 10-year period, 2002 exports to Japan in terms of value were second only to 2000 levels. The year 2000 saw a very big spurt in export growth, outpacing import growth for that period and contributing to the smallest trade deficit the Philippines had with Japan in the last 10 years. Yearly export growth to Japan outpaced import growth from 1995 to 2000. The year 2001 saw a marked decline in exports due largely to the

³ Japan-Philippines Economic Partnership Agreement Working Draft (Philippine APEC Study Center Network, August 2003).

⁴ Department of Trade and Industry (DTI) website at <http://tradelinephil.dti.gov.ph/betp/Japan4>

Table 1. Japan-Philippines trade (In USD Million)

Year	Export	Export Growth (%)	Import	Import Growth (%)	Balance of Trade
1992	1,738	-	3,078	-	(1,340)
1993	1,817	4.55	4,029	30.90	(2,212)
1994	2,024	11.39	5,188	28.77	(3,164)
1995	2,742	35.47	5,957	14.82	(3,215)
1996	3,668	33.77	7,129	19.67	(3,461)
1997	4,192	14.29	7,414	4.00	(3,222)
1998	4,232	0.95	6,029	-18.68	(1797)
1999	4,660	10.11	6,136	1.77	(1,476)
2000	5,606	20.30	6,511	6.11	(905)
2001	5,054	-9.85	6,633	1.87	(1,579)
2002	5,292	4.71	7,233	9.05	(1,941)

Note: Figures in parentheses are negative figures.

Source: National Statistics Office (NSO)

fall in the electronic subsector by USD 247 million. Figures for 2002 showed a rebound with exports registering a respectable 4.7 percent growth from 2001 figures.

As a partial reflection of this recovery, Philippine exports to Japan from January to April 2003 registered a 1.8 percent increase to USD 1.72 billion from USD 1.69 billion for the same period in 2002. Imports, meanwhile, outpaced export growth by recording an 8.6 percent growth from 2002 figures. For January to April 2003, Philippine imports from Japan reached USD 2.4 billion compared to USD 2.22 billion for the same period in 2002.⁵

Compared to its ASEAN neighbors, the Philippines in 2001 ranked fourth for both Japanese import and export market (Tables 2 and 3). A cursory look at Japanese import figures show that Malaysia and Thailand have climbed the ranks at our expense throughout the years. For instance, in 2001, the Philippine export value was just 64 percent of Thailand's export value to Japan. In 1980, the reverse was true—Thailand's export to Japan was only 57 percent of our country's export.

Comparing the export growth rates of the Philippines to Japan from that of Malaysia and Thailand, one can clearly see that staring from 1980 up until 1995, Philippine export growth to Japan lagged sorely behind its

⁵ National Statistics Office (NSO) website at www.census.gov.ph

Table 2. Value of Japan imports by principal country of origin (1975–2001) (in billion Yen)

Country	1975	1980	1985	1990	1995	1998	1999	2000	2001
Total value	17,170	31,995	31,085	33,855	31,549	36,654	35,268	40,938	42,416
Indonesia	1,018	3,004	2,431	1,821	1,335	1,416	1,429	1,766	1,806
Growth rate (%)	-	195.09	-19.07	-25.09	-26.69	6.07	0.92	23.58	2.27
Malaysia	205	792	1,035	780	992	1,133	1,241	1,563	1,561
Growth rate (%)	-	286.34	30.68	-24.64	27.18	14.21	9.53	25.95	-0.13
Thailand	215	257	246	599	950	1,068	1,008	1,142	1,260
Growth rate (%)	-	19.53	-4.28	143.50	58.60	12.42	-5.62	13.29	10.33
Philippines	331	445	300	313	326	579	603	776	779
Growth rate (%)	-	34.44	-32.58	4.33	4.15	77.61	4.15	28.69	0.39
Singapore	119	345	381	512	644	616	618	694	654
Viet Nam	12	11	16	85	161	229	223	285	317
Brunei	304	738	454	183	127	135	120	178	206
Myanmar	7.6	18	8.5	6.0	8.7	12	12	13	12
Cambodia	0.2	0.1	0.1	0.5	0.7	2.1	3.9	5.6	8.0

Source: Japan Foreign Trade Statistics

Table 3. Value of Japan exports by principal country of origin (1975–2001) (in billion Yen)

Country	1975	1980	1985	1990	1995	1998	1999	2000	2001
Total value	16,545	29,382	41,956	41,457	41,531	50,645	47,548	51,654	48,979
Singapore	452	885	925	1,547	2,158	1,930	1,854	2,244	1,786
Thailand	284	435	488	1,315	1,850	1,222	1,285	1,469	1,442
Malaysia	168	465	523	793	1,573	1,216	1,265	1,497	1,337
Philippines	305	382	224	363	667	948	997	1,106	995
Indonesia	548	780	520	724	935	560	551	818	778
Vietnam	24	25	35	31	86	174	185	213	216
Myanmar	18	49	44	14	15	24	21	21	23
Brunei	10	20	21	12	12	8.0	6.0	6.1	6.8
Cambodia	0.0	5.6	0.4	0.6	7.2	5.8	5.7	5.6	6.1

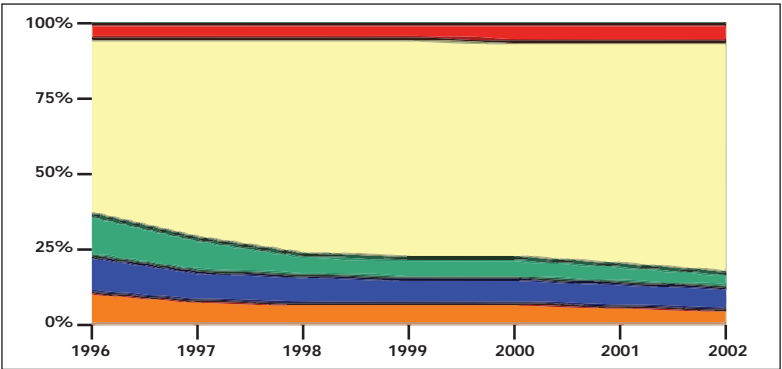
Source: Japan Foreign Trade Statistics

neighbors. Only in 1998 did the Philippines catch up in terms of export growth rates.

If the goal of an FTA is to stimulate the Japanese economy, then it is not surprising to note that Japan has initiated serious FTA discussions with the top four ASEAN export markets of Japanese products (Table 3). Negotiations with Indonesia, the top Japanese import market and the fifth market for Japanese exports, are still in its exploratory stages (as of this writing) possibly because Indonesia relatively does not figure prominently in Japanese export markets.

In terms of product composition, industrial manufacturers have been increasing their domination of Philippine exports to Japan with a 76 percent share in 2002. This is in contrast to the 1996 level of 58 percent. Meanwhile, other product categories have seen declining shares. From 1996 to 2002, resource-base products' shares declined from 14 percent to 5 percent; food and food preparations from 12 percent to 7 percent, and consumer manufactures from 11 percent to 5 percent (Figure 1).

Figure 1. Export share of major product category to total Philippines export to Japan



Source: National Statistics Office (NSO)

FTA Negotiations/Conformity to WTO Arrangements

Japan's Ministry of Economic Affairs indicated that FTAs, as part of the Japanese strategy, plays an important role in strengthening partnerships between countries in areas not covered by the WTO with the goal of achieving liberalization beyond levels attainable under the WTO. Three points must be noted on the Japanese policy on concluding FTAs with other countries. To quote the Economic Affairs Bureau of the Japanese Ministry of Foreign Affairs, these are⁶:

⁶ Japan's FTA Strategy - Economic Affairs Bureau (Ministry of Foreign Affairs, October 2002).

- Duties and other regulations of commerce should not be higher or more restrictive than the corresponding duties and other regulations of commerce prior to the formation of the FTA.
- Partner countries must eliminate duties and other restrictive regulations of commerce with respect to substantially all the trade (Article 24 of the General Agreement on Tariffs and Trade). That is, countries must achieve a standard of liberalization that compares favorably to international standards in terms of trade volume (e.g., NAFTA average of 99%; Mexico and EU FTA average of 97%).
- Must ensure completion of regional trade agreements (RTAs) within a 10-year period, at least in principle.

The JSEPA, being the first ever FTA signed by Japan, is important since it will temporarily serve as the model and standard on which Japanese negotiations with other Asian countries will be patterned after. However, the Japanese government acknowledges the need for flexibility with its negotiations with other ASEAN countries whose level of development is not equal to that of Singapore. Thus, they have indicated openness in exploring a "Singapore-plus" or "Singapore-minus" approach to these negotiations. It is therefore "possible to have specific areas such as investment and services agreed in advance or to conclude an economic partnership agreement limited to covering such areas."⁷

Previous Studies

Econometric studies done by Japanese researchers tasked to analyze the feasibility of a PJEPA generated favorable results. Simulation done using the Global Trade Analysis Project (GTAP) and Computable General Equilibrium (CGE) models showed that a PJEPA will benefit the Philippines more than Japan in terms of real GDP growth and that almost all of its industries, except selected service sectors, will benefit. The model also showed that a Japan-Malaysia and Japan-Thailand FTA would provide negative effects on the Philippine economy (Urata and Kiyota 2003; Kawasaki 2003).⁸

Meanwhile, a CGE-Microsimulation Approach done by Cororaton (2003) to analyze the possible effects of a PJEPA on unemployment, distribution, and poverty in the Philippines generated the following preliminary results:⁹

⁷ Ibid.

⁸ Presentations made during a PASCN-sponsored roundtable discussion with Japanese researchers, July 2003.

⁹ The initial results of the econometric simulation by Cororaton were presented in a workshop hosted by the Philippine Institute for Development Studies (PIDS) held last 29 August 2003.

- An FTA with Japan will contract the Philippine agriculture sector as production reallocation and resource movements favor the nonfood manufacturing sector;
- Higher unemployment for agricultural laborers;
- Lower returns to capital in agriculture;
- Lower income for rural households dependent on agriculture;
- Industry, particularly the nonfood manufacturing sector, will expand due to increased export price competitiveness caused by lower domestic price of inputs brought about by the influx of cheaper imports;
- Lower unemployment for production workers;
- Increase returns to capital in industry;
- Increase income for urban households particularly in the National Capital Region (NCR);
- Income inequality as measured by the Gini coefficient deteriorates, gap between rural and urban income will increase; and
- Labor sector's most adversely affected will be low-educated male in the rural sector.

Given the initial results of the above, a case for policy intervention is required to reduce the bias of an FTA against agriculture and the rural sector.

Conceptual Framework and Methodology

The Heckscher-Ohlin (HO) theorem states that a country will have a comparative advantage in goods whose production involves intensive use of the factor that is abundant in the country. Thus, under conditions of unrestricted trade, each country would specialize and export the goods that utilized the abundant factor intensively.¹⁰ This theory predicts that Japan, being relatively capital-intensive compared to the Philippines, will be expected to contribute increased capital investment and technology transfer that will positively affect long-run growth prospects of the Philippines. Meanwhile, as verified by the current composition of trade between the two countries, the Philippines, a relatively labor-intensive economy versus Japan, is expected to provide labor-intensive or resource-based products or possibly labor inputs to complement Japanese capital investments.

The Stolper-Samelson theorem, meanwhile, states that a change in the price of a good, changes the price of the factor used intensively in the good's production more than proportionally and in the same direction. In combination with the HO theorem, the implication of the Stolper-Samuelson theorem is that

¹⁰ Beth Yarbrough and Robert Yarbrough (2000), p.82.

opening a trade raises the real reward to the abundant factor while lowering real reward to the scarce factor.¹¹ This is because trade boosts the production and relative price of the comparatively advantaged good. Therefore, the controversy on the effects of trade is explained by the Stolper-Samuelson theorem since breaking trade barriers leads to output price changes that alter real factor rewards in favor of the abundant factor. Owners of the abundant factor are then expected to support freer trade while owners of scarce factors are expected to resist open trade even though theoretically the whole country is made better off from free trade as the gains from the winners are more than enough to compensate the losers. The resistance is due to the fact that redistribution rarely happens in reality. Thus, in the Philippines, theoretically, owners of labor-intensive and resource-based exports are expected to flourish while capital-intensive industries will face stiffer competition from their Japanese counterparts.

International trade tends to shift resources to sectors where worker productivity relative to wages and returns on investment are higher compared with other domestic industries, while eliminating jobs in less productive and less profitable sectors. Import competition forces less efficient producers to either modernize their production processes or face bankruptcy. In theory, the capital and workers forced to leave the declining industries can then be employed in industries that are more efficient, competitive, and profitable.¹² Adjustment costs are incurred because of rigidity of movement of factors of production across industries.

The analysis of this paper will focus on selected industries or sectors to determine if they will benefit or be harmed by the proposed FTA with Japan. In effect, the paper will be highlighting the comparative advantages and disadvantages of various sectors/ industries in the Philippines. In the process of analysis, internal and external factors that affect competitiveness in an FTA scenario will also be brought to light. Policy recommendations will strive to present solutions to maintain Philippine industry competitiveness. The DTI already identified specific priority sectors it deems as existing and potential export winners or sources of revenue streams. This study will closely adhere to this sector selection.

A detailed study on every sector affected by an FTA with Japan is beyond the scope of this paper due to budget and time constraints. Such detailed sector-specific studies, in themselves, can be the topic of individual research papers that can extensively delve into all the issues in much detail. This

¹¹ Ibid, p.109.

¹² Daniel Griswold (1999), p. 3.

limitation should be borne in mind in assessing the recommendations and results of this study.

Also, an FTA with Japan does not in any way rule out the utilization of the Philippines of links with other regional partners such as, but not limited to, those defined under the ASEAN Free Trade Area (AFTA). Within AFTA, there are rooms for improving the competitiveness of certain Philippine exports to Japan or other third country through so-called triangular relations to benefit all participants. For instance, Philippine furniture makers can explore producing in Indonesia at lower costs using Philippine management and skilled workers combined with Indonesian natural materials under joint venture agreements or outsourcing.

Therefore, competition from Thailand and Malaysia, which may sign separate FTAs with Japan, can be mitigated by cooperation measures among the Philippines, Thailand, and Malaysia. In this case, competition and cooperation should not be seen as mutually exclusive.¹³

Philippine industry and sector-specific prospects and impacts

The sectors included in this study account for 82.46 percent of total Philippine exports to Japan in 2002. A major portion of this is from electronics exports, which is by far the largest export category of the Philippines to Japan, obtaining a 64 percent share (Table 4). This is a significant increase from the 30 percent share of the electronics sector in total exports to Japan in 1995. Fresh foods and marine products combined account for a 6.5 percent share of the country's export to Japan in 2002.

Furniture and Housewares

The Philippine Furniture Industry is concentrated in three main production centers mainly, Metro Manila, Pampanga, and Cebu. There are about 15,000 establishments in this industry dominated by SMEs (90% of total). The breakdown of the industry in terms of firm size is as follows:¹⁴

Cottage—small	: 9, 750 (65%)
Medium	: 3,750 (25%)
Large	: 1,500 (10%)

Due to its mostly SME composition, the furniture industry is labor-intensive and employs about 500,000 direct workers, 300,000 indirect workers, and

¹³ This illustrates the concept of co-opetition—a game theoretic approach to business strategy that revolutionized the way people look at competition (Brandenburger and Nalebuff 1996).

¹⁴ DTI website: www.dti.gov.ph/contentment/9/16/7.jsp

Table 4. Summary of Philippine merchandise exports to Japan by major product grouping

FOB value in dollars	2002	
	VALUE	% Share
Total exports to Japan	5,295,453,657	100.00
Housewares	26,576,991	0.50
Furniture	20,063,255	0.38
Builders' woodworks	71,720,730	1.35
Electronics	3,392,717,513	64.07
Machineries/transport equipment/apparatus and parts	478,695,939	9.04
Fresh foods	223,168,543	4.21
Marine products	121,691,538	2.30
Construction materials	31,836,154	0.60
Subtotal	4,366,470,663	82.46

Source: NSO

Table 5. Top export markets of Philippine furniture, 2001
(USD in millions)

US	USD 188.15 M
Japan	26.92 M
Great Britain and Northern Ireland	9.07 M
Netherlands	7.88 M
France	7.02 M
Others	57.74 M

Source: Bureau of Export Trade Promotion (BETP), Department of Trade and Industry (DTI)

about 1 million in subcontractors and suppliers. The US and Japan are the top destinations for Philippine furniture (Table 5). The top 5 manufacturers account for 16 percent of total exports while the top 20 manufacturers account for 24 percent of total exports.¹⁵

For exports to Japan, rattan and wood furniture have seen steadily declining figures from 1995 to 2002. In 1995, the country used to export USD 8.7 million and USD 6.7 million worth of rattan and wood furniture to Japan, respectively. In 2002, these figures both went down by 56 percent

¹⁵ Ibid.

Table 6. Summary of Philippine furniture exports to Japan by major product grouping (FOB value in USD)

	2002	2001	2000	1999	1998	1997	1996	1995
Total furniture	20,063,255	26,917,169	54,320,874	42,858,077	33,612,675	29,417,729	24,973,546	19,979,984
Bamboo furniture	40,539	184,707	136,579	123,903	121,367	97,742	81,196	57,103
Buri furniture	5,691	0	30,600	12,320	92,030	313,516	211,209	159,908
Furnishings	80,007	230,849	85,208	20,492	13,541	172,584	996,749	533,361
Metal furniture	1,278,301	1,685,954	1,589,841	1,134,143	1,416,152	2,795,544	3,136,562	2,196,075
Parts of furniture	9,169,471	13,053,549	38,385,755	31,026,251	16,248,343	5,450,253	1,557,315	746,718
Plastic furniture	364,105	270,038	296,552	146,713	96,559	70,698	185,415	275,246
Rattan furniture	4,882,416	5,932,052	6,077,784	5,219,492	5,567,265	8,177,644	9,424,119	8,725,709
Stone furniture	234,217	302,775	564,438	368,833	781,535	656,964	769,802	497,063
Wood furniture	3,759,848	5,106,118	7,003,659	4,740,836	9,247,682	11,498,389	8,460,733	6,742,071
Furniture of other materials	248,660	151,127	150,458	65,094	28,201	184,395	150,446	46,730

Source: BETP, DTI

to USD 4.9 million and USD 3.8 million, respectively. Parts of furniture registered the largest business cycle shifts from a mere USD 746,000 worth of exports to Japan in 1995 to USD 38.4 million in 2000. Figures have significantly dropped since then from 2000 levels to only USD 9.2 million in export value in 2002 (Table 6). The big drop of total furniture exports in 2001 was attributed to the social and political instability of the country during that time coupled with the general weakness of demand abroad. Philippine furniture exports enjoy zero tariffs in Japan.¹⁶

The main production centers of housewares products are located in the NCR, Region 3 (Pampanga and Angeles), Region 4 (Laguna, Rizal, Quezon, and Cavite), Region 5 (Albay), Region 6 (Bacolod, Iloilo, and Aklan) and Region 7 (Cebu). The product's main export market is the US.¹⁷ Japan is also a major export market but only registers about one-fourth of the value of total housewares exports to the US. The challenge for the overall sector is to sustain its export growth rates and expand its market share in Japan via intensive marketing, product development, and cost competitiveness.

Basketwork/wickerwork and articles of textile materials, meanwhile, were the biggest value items in the housewares category in 2002, both accounting for 72 percent of the total housewares exports to Japan. Woodcraft export to Japan has been declining significantly through the years from 1995 levels of USD 5.9 million to a negligible USD 892,000 in 2002—a decrease of 85 percent in seven years (Table 7).

Global trends in the furniture and housewares sector include customer service innovations such as “just-in-time” deliveries and customized service.¹⁸ It should be noted that most Japanese customers do not like to wait so that Philippine companies interested in succeeding in the Japanese market should be mindful about the efficiency of their delivery systems. Global taste preferences favor products with strong brand identity and up-to-date design trends. Since China is the largest exporter of furniture to Japan, it would also be advantageous for Filipino manufacturers to visit China to survey and study their craft and designs.

For Philippine furniture and housewares manufacturers to remain competitive in Japan, they must be flexible enough to adapt to changes in buyers preferences and to continuously update their designs by regularly participating in trade fairs and conventions and having closer information sharing with Japanese buyers. The furniture industry should also give

¹⁶ APEC Tariff Database at www.apectariff.org

¹⁷ DTI website at www.dti.gov.ph/contentment/9/16/7.jsp

¹⁸ Ibid.

Table 7. Summary of housewares exports to Japan by major product groupings (FOB value in USD)

	2002	2001	2000	1999	1998	1997	1996	1995
Total Housewares	26,576,991	30,837,761	34,239,629	36,744,352	33,755,776	44,615,310	37,776,469	29,786,234
Growth rate (%)	-13.82	-9.94	-6.82	8.85	-24.34	18.10	26.83	
Basketwork/ wickerwork	9,825,267	10,080,475	8,435,843	8,136,864	7,593,435	8,700,355	10,789,255	10,770,014
Shellcraft and other carving materials	91,380	135,731	143,619	64,061	71,006	105,339	118,287	123,676
Woodcraft	892,683	1,223,825	1,724,762	2,113,317	2,459,681	3,044,897	4,173,985	5,950,719
Ceramics/stoneware	433,501	1,128,820	1,098,546	915,588	689,276	1,792,223	1,883,326	1,647,668
Articles of textile materials	9,514,531	13,169,307	16,893,595	20,505,529	16,526,592	19,229,263	12,883,963	5,942,828
Artificial flowers and trees	387,788	411,305	631,580	649,317	662,789	1,029,118	1,113,389	1,227,194
Metalware	142,034	160,500	968,243	1,203,245	955,744	2,099,404	2,207,316	1,617,111
Articles made of glass	210,034	270,622	263,047	217,804	283,545	146,077	115,894	81,715
Decorative/handblown glass	71,505	165,231	195,124	130,707	222,001	46,655	0	0
Glassware	138,529	105,391	67,923	87,097	61,544	99,422	115,894	81,715
Other housewares	5,079,773	4,257,176	4,080,394	2,938,627	4,513,708	8,468,634	4,491,054	2,425,309

Source: BETP, DTI

importance to being organized and promoting cleanliness not only in the products but also in home offices of companies interested to venture in Japan. It is customary for Japanese companies to first personally visit the office of their foreign partners or suppliers before finalizing a contract.¹⁹

The Chamber of Furniture Industries of the Philippines (CFIP) identified major concerns of the furniture export industry as follows:

- lack of supply of raw materials,
- insufficient and antiquated woodworking and other technology,
- lack of financing opportunities for SMEs,
- high labor cost,
- lack of information and necessary trainings,
- low productivity, and
- political, economic, and peace and order situation of the country.²⁰

The inherent domestic strength identified with this sector is its human capital with its highly skilled labor force experienced in mixed media, design capability, and good quality craftsmanship.²¹ To be competitive, there is a need to link and empower the predominantly SME composition of the furniture and housewares sector in terms of harnessing economies of scale and standardization of product quality. The availability of indigenous raw materials such as rattan is also a concern that has important implications for the competitiveness of the industry. For rattan, Philippine furniture manufacturers had explored importing from rattan-abundant Indonesia. This has posed new problems since Indonesia imposed an export tax that is tantamount to banning exports of rattan to the Philippines. In addition, collaboration between Indonesian and Filipino businessmen on this triangular trade relation seems to be sorely wanting and had, in the past, been bogged down by equity disagreements.²² A possible solution is to elevate negotiations to the industry association level. Another problem encountered was instead of firm-level cooperation, Indonesian manufacturers sometimes opted to just import Filipino craftsmen. This raises the issue of brain drain when technology is transferred to foreign industry to the detriment of the local industry that now faces less supply of skilled labor. Rules of origin issues will also have to be threshed out in these cases, which may be arduous given the many overlapping trade agreements in the region.

¹⁹ Leotes Lugo (2003).

²⁰ "Furniture exports post positive growth." www.bworld.com.ph (February 20, 2003).

²¹ Ibid.

²² Inputs from Director Ramon Kabigting of DTI-BITR given during the JPEPA Forum held on September 11, 2003.

The renewal of the Capital Investment Act, which expired in 1998, is also on top of the wish list of the CFIP. The Act enabled exporters to buy their capital inputs duty-free. As it is, exporters pay a 10 percent value-added tax (VAT) and a 3 percent tax on machinery, materials, and tools used for production. The establishment of a permanent one-stop center to feature the showrooms of the best furniture exporters of the country should also be studied. With this, foreign buyers need not visit each plant located in different provinces whenever no trade shows are in progress. Malaysia and Indonesia reportedly have similar centers to attract foreign buyers.²³

Electronics industry

The electronics industry had the biggest product share in total exports to Japan, accounting for 64 percent of the total Philippine exports to the country in 2002. On average, total electronic exports increased annually by 8.53 percent from 1996 to 2000 (Table 8).

The semiconductors (microelectronics) subsector is the biggest in the industry. It involves manufacturers of integrated circuits (ICs), transistors, diodes, resistors, capacitors, coils, transformers, printed circuit boards (PCBs), and other components. Philippine subsidiaries of Intel, Texas Instruments, Philips, Amkor, and Fairchild Semiconductors are some of the major players in the market.

Electronic Data Processing (EDP) Equipment, composed of computer, peripheral storage, and input/output manufacturers, is the next biggest subsector. This sector is dominated by Japanese companies such as Toshiba, Acer, Epson, Fujitsu, Ionics, and Sampo Technology.

Other sectors in the electronics industry and their export value in 2002 are office equipment (USD 21 million), telecommunications (USD 98 million), consumer electronics (USD 58 million), automotive electronics (USD 103 million), communication and radar (USD 17 million), control and instrumentation (USD 10 million), and medical/industrial instrumentation (USD 1.3 million). The last two sectors involve Philippine-based companies. Dominated by multinational firms, the electronics industry employs about 335,000 workers. Of the 715 electronic firms, 72 percent are foreign-owned while 28 percent are locally owned.²⁴

²³ "The Sun is Shining on the Philippine Furniture Industry," 3M Philippines website at www.3m.com/int/ph/about3M/newsroom/3M_furniture.html

²⁴ DTI website at www.dti.gov.ph/contentment/9/16/7.jsp

Table 8. Summary of Philippine electronics export to Japan (FOB value in USD)

	2002	2001	2000	1999	1998	1997	1996	1995
Total Electronics	3,392,717,513	3,175,969,129	3,422,671,394	2,647,193,112	2,394,533,196	2,027,562,257	1,547,229,388	835,658,337
Components/ devices (semiconductors)	1,792,329,151	1,631,825,737	1,887,249,365	1,478,231,880	1,460,390,286	1,255,878,399	914,272,626	537,147,026
Electronic data processing	1,292,015,182	1,170,006,639	1,261,984,119	962,519,621	714,591,131	571,789,445	376,790,316	96,704,168
Office equipment	20,918,775	25,112,898	16,256,948	10,242,447	11,260,557	8,004,309	4,258,960	21,575
Medical/industrial instrumentation	1,310,984	607,522	682,763	617,652	147,948	11,293	13,239	0
Control and instrumentation	9,979,497	17,498,920	12,037,805	9,949,173	7,207,341	198,139	623,180	313,995
Communication and radar	17,200,633	22,240,474	24,458,799	18,152,759	11,671,155	10,400,357	19,051,133	11,900,670
Telecommunications	98,287,687	136,348,399	55,188,355	28,607,278	44,165,899	37,978,159	74,542,613	54,917,744
Automotive electronics	103,068,919	104,649,532	103,059,630	78,283,364	53,454,907	29,759,556	34,571,149	53,577,206
Consumer electronics	57,606,685	67,679,008	61,753,610	60,588,938	91,643,972	113,542,600	123,106,172	81,075,953

Source: BETP, DTI

Prospects for the industry abound. Morgan Stanley, a well-known American multinational financial services corporation, projects that the information and communication market in China will grow by 30 percent a year for the next 4–5 years driven by demand for personal computers and mobile communications. They estimated that Chinese domestic production would only meet 15 percent of the rise in demand.²⁵ Europe and the US will also be formidable markets especially in the mobile phone category. Branching out to nontraditional export markets should be the focus of exporters given the weakness of the economies of Japan and the US in recent years.

Tariff barriers in Japan for products in the electronic industry are nonexistent. The benefits of increased trade and market access will be dependent on increased investments and possibly expansion of existing operations to meet increased global demand for electronic products. An FTA would then benefit the industry through the investment route, which will eventually be converted into increased trade volumes.

The capacity of Filipino workers to sustain their competitiveness in this field is crucial. In this light, the planned partnership between the PEZA and the Semiconductor and Electronic Industry of the Philippines, Inc. (SEIPI) in setting up a training institute to upgrade technological skills of Filipino engineers is laudable. The turnover in technology is swift and employment opportunities favor those who are prepared to adapt and learn new skills and applications. The growing need for components supplier, accompanying the expected increases in demand for electronic products, will also provide additional opportunities for investment and employment.

Motor vehicle parts and components

Automotive parts are the biggest component of transport equipment exports to Japan, accounting for 95 percent of the total USD 412 million exports in 2002. However, exports at USD 390 million still pale in comparison with automotive parts imports from Japan amounting to USD 440 million in 2002. Combined motor vehicle, motorcycle units, and motorcycle parts' share in total transport equipment export, however, are negligible especially in 2001 and 2002. The drop is most notable for motor vehicle exports. From a high of USD 4.9 million, motor vehicle exports to Japan declined significantly reaching its lowest point in 2002 when it registered only USD 28,190 in export value (Table 9). Motor vehicle imports from Japan reached USD 83.9 million while motorcycle parts imports dominate with USD 55.6 million in 2002.²⁶ The magnitude of parts

²⁵ Ibid.

²⁶ National Statistics Office (NSO) website at www.census.gov.ph

Table 9. Machineries/transport equipment/apparatus and parts export to Japan (FOB value in USD)

	2002	2001	2000	1999	1998	1997	1996	1995
Total machineries/ transport equipment/ apparatus and parts	478,695,939	389,203,123	394,139,151	410,166,528	354,039,140	413,903,977	319,938,998	229,749,261
Machineries/ equipment/apparatus	15,015,713	14,242,908	13,776,267	12,970,294	11,498,518	4,088,753	6,182,627	3,364,971
Metal machinery/ equipment/apparatus parts	51,215,534	44,313,052	51,913,925	36,746,438	27,410,795	27,014,153	27,457,997	15,261,187
Transport equipment	412,464,692	330,647,163	328,448,959	360,449,796	315,129,827	382,801,071	286,298,374	211,123,103
Motor vehicles	28,190	103,266	2,380,273	2,757,542	4,936,502	3,610,198	557,940	275,996
Automotive parts	390,168,641	309,903,294	318,208,071	302,242,228	270,004,176	358,262,496	276,633,265	202,902,176
Metal automotive parts	386,465,512	305,781,936	312,162,466	297,576,164	267,753,168	357,824,219	276,347,894	202,302,525
Other automotive parts	3,703,129	4,121,358	6,045,605	4,666,064	2,251,008	438,277	285,371	599,651
Motorcycle	65,231	22,136	21,529	53,300	56,311	30,258	15,613	181,257
Motorcycle parts	0	14,658	0	0	0	0	0	0
Others	22,202,630	20,603,809	7,839,086	55,396,726	40,132,838	20,898,119	9,091,556	7,763,674

Source: BETA, DTI

Table 10. Summary of Philippine construction materials export to Japan (FOB value in USD)

	2002	2001	2000	1999	1998	1997	1996	1995
Builders' woodworks	71,720,730	74,763,619	154,868,469	62,732,469	36,376,502	24,646,394	43,426,574	21,014,167
Construction materials	31,836,154	22,984,588	38,030,527	27,111,264	23,297,248	20,137,833	18,690,275	19,816,815
Construction materials, metal-based	7,165,303	5,191,480	5,781,414	2,997,483	5,611,425	5,941,521	5,973,327	7,836,367
Sanitary wares and bathroom fixtures	16,343,850	12,436,699	21,664,607	16,034,960	10,640,305	10,045,708	8,252,645	6,590,590
Clay and ceramic materials	171,903	205,970	112,227	11,667	52,705	25,308	62,504	9,632
Cement/cement product	0	1,520	31,807	14,108	17,327	3,354	2,388	9,058
Asbestos materials	14,288	307	14,077	0	57,400	84,510	0	0
Other construction materials	8,140,810	5,148,612	10,426,395	8,053,046	6,918,086	4,037,432	4,399,411	5,371,168

Source: BETP, DTI

imports from Japan indicates our dependence on imports and lack of local suppliers base in this sector.

The decline in motor vehicle exports may be due to the consolidation of operations and diversion of exports of CBUs to other ASEAN countries instead of Japan. Export of CBU to Japan may be passé but opportunities for exports to other Asian countries still exist and are still expanding.

The parts and components manufacturing sector is composed of 256 companies producing various parts and components made of metals, plastic, rubber, and composite materials—both for the overseas export and replacement markets. The principal components manufacturers are Yazaki-Torres Manufacturing Corp. (wiring harness); United Technologies Automotive Phils. (wiring harness); Temic Automotive (Phils.) Inc. (anti-brake lock system); Honda Engine Manufacturing Phils., Inc. (engines); Asian Transmission Corp. (automotive transmissions); Toyota Autoparts Phils. (automotive transmission); Fujitsu Ten Corp. of the Phils. (car stereos); and Aichi Forging Co., Inc. (forged parts). By the end of 1999, the parts industry contributed investments of approximately P27 billion, employment of 45,000, and export of over USD 1.1 billion, a more than ten-fold increase from 1988 levels.²⁷

Recognizing the promise of the parts sector, foreign auto manufacturers in the Philippines bared their expansion plans in July 2003. Mitsubishi Motors Corporation of Japan plans to put up an assembly plant for CBUs for export in addition to a parts production plant, which is part of its overall plan to make the Philippines its export hub for Asian utility vehicles (AUV). Honda Motors Co. Ltd. has just opened a new vehicle transmissions facility in Laguna to serve its subsidiaries in the US, Japan, and Europe. Toyota Motors Philippines Corp., through its subsidiary firm Toyota Autoparts Phils. (TAP), meanwhile, expanded its transmission plant to boost its annual exports to USD 77 million.²⁸

Construction materials

In the construction materials industry, the builders' woodworks sector lords it over the others with an export value to Japan of USD 71.7 million in 2002 (Table 10).²⁹ Imports from Japan in 2002 amounted to only USD 71,000. At the time of this writing, there are about 36 export-oriented manufacturers in this sector. Processing plants are concentrated in Manila (12), Bulacan (6), Davao

²⁷ DTI website at www.dti.gov.ph/contentment/9/16/7.jsp

²⁸ Philippine Business Report, Vol. 14, No. 7, DTI, July 2003, p. 2.

²⁹ The builders' woodworks sector involves goods such as: joineries/moldings, doors, windows, door and window jambs/frames, wood parquet tiles and bamboo tiles.

del Norte (6), Cagayan de Oro (3), Cavite (3), Laguna (2), Cebu (2), Agusan del Norte (2), Zamboanga del Sur (1), South Cotabato (1), and Batangas (1).³⁰

The sanitary wares sector is the next big ticket item and holds the biggest potential for the construction materials industry, garnering exports of USD 16.3 million in 2002. This figure is a substantial 148 percent increase from its export levels in 1995 pegged at USD 6.6 million (Table 10). The current sanitary wares sector is composed of 11 producers, three of which are exporters. Again, manufacturing plants are mostly located in Metro Manila (8), with 2 in Cavite and 1 in Bulacan. Japan remains the top export market, controlling 62 percent of total exports in 2000 (Table 11).

The case of the cement industry

Increased competition may pose a concern for domestic cement players although the industry is still better off since it will not be facing competition from cheaper cement imports from Taiwan and Indonesia.

Import figures show that in 1999, China was initially displaced by Taiwan and Japan as the main sources of imported cement with a share of total imports of 52 percent (Taiwan) and 39 percent (Japan) (Table 12). Japanese cement, meanwhile, was a major player in 1998 when it accounted for 45 percent of total Philippine imports. The following year, Taiwan's share of total imports rose further to 57 percent while the re-entry of Indonesia, which garnered a 23 percent share, relegated Japan to third place or a 19 percent share. For the first three quarters of 2001, Indonesia overtook Taiwan as the biggest exporter of cement to the Philippines, accounting for approximately half of the total volume imported. Taiwan contributed 35 percent and Japan, 14 percent.³¹

Southern Cross Cement Corporation (SCCC) is the local importer of cement from Japan under the Star brand name. It has a 15,000 metric ton capacity cement-handling terminal at the Manila Harbor Center. The company's cement terminal is equipped with both bulk-loading and bagging machines, enabling cement to be delivered to customers in bulk or bags. SCCC's sales of cement are predominantly in bulk implying that the majority of their sales are for big infrastructure projects and not in retail. SCCC sources its cement from its Japanese parent companies, Taiheiyo Cement Corporation and Tokuyama Corporation. Imported cement from Japan in 2002 stood at USD 6.1 million. Taiyo Cement indicated that its main buyers, Japanese contractors in the Philippines, were demanding Japan-quality cement that had higher specification than the Philippine cement. Southern Cross has been

³⁰ DTI website at www.dti.gov.ph/contentment/9/16/7.jsp

³¹ The figures were obtained from PHILCEMCOR contained in the Cement Report of the Tariff Commission.

Table 11. Sanitary wares top market for export

Priority Markets	Export Value in 2000 (in USD Million)	Share in Philippine Exports (%)	Ave. Growth Rate 1996–2000 (%)
Japan	21.7	60	28
Taiwan	6.5	18	879
United States	5.3	15	171
Singapore	0.9	3	594
Australia	0.6	2	79

Source: BETP, DTI

importing cement in bulk from Japan since 1999 and in bags from Indonesia since 2000. Countries with reported excess cement capacities are Thailand with 32.9 million metric tons; Indonesia, 26.6 million metric tons; Japan, 15.6 million metric tons; Malaysia, 13.7 metric tons; and Korea, 12.9 metric tons. In 2002, the Philippines was also suffering from a surplus of 14.2 million metric tons. However, it was an open target for foreign cement exports because it had the most open market with a 3-percent tariff for ASEAN cement and 5 percent for non-ASEAN. This is in stark contrast to other Asian countries that charge between 5 percent and 100 percent in tariffs.³²

DTI has reinstated tariff protection in response to calls from the local cement manufacturers allegedly being unfairly hurt by imported cement from Japan, Taiwan, and other countries. A definitive safeguard duty of PHP 20.60 per 40 kilogram (kg) bag was imposed and would be effective for three years on imported gray Portland cement from various countries starting December 10, 2001.

Initially, the Tariff Commission concluded that there was no basis to impose safeguard measures for cement. Furthermore, its study showed that there was no link between employment and the influx of imports. DTI reversed this decision of the Tariff Commission and concluded that “the sudden, sharp and significant surge in cement imports during the period of investigation has resulted in significant declines in sales volume, market share, actual production, capacity utilization, profitability and employment of the domestic cement industry.”³³

The outcome was a defining moment for the Safeguard Measures Act since it defined the exact authority of the DTI Secretary (Box 1). It also defined the parties for and against protection of the local cement industry.

³² Gil Cabacungan, “Cement makers in all-out price war in Cebu,” *Philippine Daily Inquirer*, August 21, 2002.

³³ Secretary Manuel Roxas of DTI as quoted by the DTI Public Relations Office, June 23, 2003.

Table 12. Philippine imports of cement by country of origin, 1996–September 2001

Country of Origin	1996			1997			1998			1999			2000			Jan.–Sept. 2001		
	Imports (MT)	% Share to Total		Imports (MT)	% Share to Total		Imports (MT)	% Share to Total		Imports (MT)	% Share to Total		Imports (MT)	% Share to Total		Imports (MT)	% Share to Total	
China	306,438	45.09		289,251	82.22		88,272	48.99		33,400	7.04		5,400	0.34		0	0.00	
Mexico	209,889	30.88		0	0		0	0		0	0		0	0		0	0.00	
Taiwan	51,800	7.62		10,000	2.84		0	0		247,580	52.18		901,590	57.10		662,200	35.49	
Japan	6,000	0.88		32,567	9.26		81,263	45.10		184,850	38.96		302,600	19.16		258,400	13.85	
Malaysia	22,513	3.31		0	0		0	0		0	0		0	0		0	0.00	
Turkey	11,800	1.74		0	0		0	0		0	0		0	0		0	0.00	
Indonesia	10,000	1.47		0	0		0	0		0	0.00		369,437	23.40		944,715	50.64	
Korea	6,500	0.96		0	0		10,636	5.90		0	0		0	0		0	0.00	
Hong Kong	54,432	8.01		19,961	5.67		0	0		8,600	1.81		0	0.00		0	0.00	
Singapore	240	0.04		0	0		0	0		0	0		0	0		0	0.00	
TOTAL	679,612	100.00		351,779	100.00		180,171	100.00		474,430	100.00		1,579,027	100.00		1,865,315	100.00	

Source of basic data: PHILCEMCO

On one side, 41 parties supported the Philippine Cement Manufacturers Corporation's (PHILCEMCOR) application for safeguard action. These parties included cement plant suppliers, cement workers' groups, members of the House of Representatives, local government executives, community leaders, school principals, and civic organizations. On the other side, opposing the application were 14 parties composed of cement importers, consumer groups, constructors' associations, an Indonesian cement producer/exporter, two Japanese cement producers/exporters, along with the governments of Indonesia and Japan.³⁴

BOX 1

Tariff Commission vs. DTI: The Case of Protecting the Cement Industry

"On 22 May 2001, the DTI received an application for safeguards measure by the Philippine Cement Manufacturers Corporation (PHILCEMCOR) against the importation of gray Portland cement. The DTI's preliminary investigation showed that there was a surge of cement imports into the country in 2000 that caused serious injury on the local cement industry. Further, according to the DTI decision, there were "critical circumstances" affecting the industry that threaten employment and investments.

Following this, on 7 November 2001, DTI issued a decision imposing a provisional safeguard measure equivalent to P20.60 per 40 kilogram bag of gray Portland cement for a period not exceeding 200 days from the date of issuance by the Bureau of Customs.

However, during the 200-day period of the imposition of the provisional safeguard measure, the Tariff Commission concluded that there was no ground for the imposition of a definitive safeguards measure. The DTI disagreed with these conclusions and sought the opinion of the Department of Justice on the DTI Secretary's "scope of options in acting on the Commission's recommendations."

The DOJ then opined that DTI is bound by the findings of the Commission. However, PHILCEMCOR then filed a petition with the Court of Appeals, which then ruled that: 1) the findings of the Tariff Commission do not necessarily constitute a final decision; and 2) such findings are still recommendatory and the DTI Secretary exercises the discretion to review and render a final decision, either affirming or reversing the report of the Commission."

Excerpts from the DTI Public Relations Office Report dated June 23, 2003.

Source: DTI

³⁴ Formal Investigation on Cement Industry, Tariff Commission, p. 11.

In spite of the decision, some of the justifications of the Tariff Commission in not granting protection to the local cement industry are worth revisiting, particularly in the context of imported cement from Japan. These are as follows:³⁵

- Nontariff barriers exist, such as the BPS Memorandum Circular No. 004 (dated 11 September 2001), which provides revised guidelines on the importation of cement. In effect, the circular requires imported cement to be subjected to compressive strength testing lasting for a holding period of 28 days.
- SCCC has a limited silo capacity. Tariff Commission believed that it is not likely that substantially increased imports originating from Japan is imminent.
- Provisions of the Civil Code of the Philippines (Articles 1723, 2190, and 2192), make it more advantageous for local constructors to source their cement requirements from local producers. By doing so, the local cement producers are held liable with the local constructors if inferior material quality is found to be the cause of the collapse of an infrastructure.
- Tariff Commission believed that employment trends in the cement industry will be balanced by trends in employment in the construction industry. It is noted that the construction industry employed 1.58 million workers in 2001 based on data from the Bureau of Labor and Employment Statistics as opposed to the cement industry, which employed less than 4,000 workers in the first half of 2001.

In July 2003, SCCC threatened to pull out of the country unless DTI removes the definitive tariff on imported cement. The company has filed a petition with the Supreme Court asking to restrain temporarily DTI from imposing the P20.60 duty on every 40-kg bag of imported cement. The cement firm said the imposition of the import tariff would have dire consequences on its cash flow.³⁶

Meanwhile, exports of Philippine cement to Japan may face pressures arising from product standards and certifications aside from the low demand due to Japan's sluggish economy. In this case, opening up the cement industry to increased Japanese imports will only give market access to Japan albeit in limited quantities due to constraints in SCCC's silo terminal capacity. However,

³⁵ Ibid, p. 56.

³⁶ Elaine Ramos, "Japanese Cement Firm Threatens Pullout due to Import Tiff," *Manila Standard*, July 14, 2003.

one can also counter that the entry of imported cement in general will depress prices, which will eventually benefit the consumers.

Fresh Food

Fresh food, particularly Philippine fresh fruits exports to Japan, is a significant export item with a total value of USD 206 million in 2002. Japan continues to be the top export destination of the product with a 60 percent share in total fresh fruits exports in 2000 (Table 13). The value of exports to Japan has increased through the years by 13.8 percent—from USD 181.6 million in 1995 to USD 206.2 million in 2002 (Table 14). In the Japanese market, pineapples have a large market share at 97.9 percent, followed by bananas (78.9%), mangoes (60.7%), and papayas (48.4%). The Philippines is also the number one supplier of pineapple fruit juice to Japan at 36.3 percent.³⁷

During the time of this study, there were 23 fresh banana producers/exporters based mostly in Mindanao, 6 mango producers, 2 Davao-based pineapple producers, and 2 papaya exporters. In terms of employment, the fresh fruit export industry is significant with 5.9 million farmers and farm households utilized in the banana industry, 2.5 million farmers and family members employed by the fresh mango industry, and about 420,000 farmers supported by the pineapple industry.³⁸

Table 13. Philippine exports of fresh food (FOB value in '000 USD)

	1996	1997	1998	1999	2000
Total	303,200	285,680	279,580	297,150	354,143
Japan	172,180	176,970	165,230	187,740	214,520
South Korea	19,550	16,670	11,460	24,580	47,764
China	36,030	25,640	39,360	23,840	28,789
HK SAR	29,380	29,710	29,870	19,960	20,888
Taiwan	2,060	3,820	9,830	16,360	18,084
Others	44,000	32,870	23,830	24,670	24,098

HK SAR = Hongkong Special Administrative Region

Source: BETP, DTI

³⁷ JETRO Marketing Guidebook for Major Imported Products, www.jetro.go.jp/ec/e/market/mgb/1-13.pdf, p. 130-131.

³⁸ DTI website; www.dti.gov.ph/contentment/9/16/7.jsp

Table 14. Philippine fresh food exports to Japan (FOB value in USD)

	2002	2001	2000	1999	1998	1997	1996	1995
Fresh Foods	223,168,543	225,299,970	235,476,898	207,240,159	184,817,493	195,853,241	193,961,778	202,699,294
Meat (Fresh)	48,498	34,422	12,372	0	0	0	0	1,657
Cereals	6,212	0	0	0	134,149	101,137	145,994	140,869
Fresh fruits	206,159,666	204,980,248	214,519,971	187,736,570	165,231,155	176,784,704	171,683,855	181,611,188
Fresh vegetables	16,541,105	20,093,213	20,716,126	19,333,260	18,850,138	18,775,415	21,630,888	18,727,340
Nuts and coconut products (Fresh)	413,062	192,087	228,429	170,329	602,051	191,985	501,041	221,956
Coffee (Fresh)	0	0	0	0	0	0	0	1,996,284

Source: BETP, DTI

A potential major point of contention in the FTA talks with Japan would be sanitary and SPS, market, and tariff-free access of Philippine agricultural exports. In the negotiations, attention must be given also to nontariff barriers such as overly strict packaging and phytosanitary standards. The recent economic partnership agreement signed between Japan and Singapore did not include opening up of the agriculture sector. Singapore, unlike the Philippines, does not have a significant agriculture sector. It is inevitable that the agricultural openness of the Japanese economy will be placed on the negotiating table especially when one is negotiating with a developing country with significant agricultural exports and whose development objective is to decrease its poverty incidence focused mainly on the rural-agriculture sector. It should be noted that the free trade pact between Japan and Mexico, a country with substantial agricultural interests, have been extended from its October signing due to the contentious agriculture issue.

However, the Japanese government stance regarding liberalization, at least from the Ministry of Foreign Affairs, may give an optimistic glimpse on how past rigidities attributed to opening up its agriculture sector may be tackled.

"Japan cannot secure the advantages of FTAs without enduring some pain arising from the opening of its markets, but this should be regarded as a process that is necessary for raising the level of Japan's industrial structures. Unavoidable issues will emerge concerning various areas of regulatory control, including movement of natural persons, as well as the opening of markets and the implementation of structural reforms in the agricultural sector. With due respect for political sensitivities, unless we take a stance linking FTAs to economic reforms in Japan, we will not succeed in making them as a means of improving international competitiveness of Japan as a whole."³⁹

The Philippines should do well to regard the above statements with guarded optimism. The statements in favor of broad liberalization and opening up of the Japanese market, although encouraging, has not been converted yet to a national policy. Recent moves by Japan in the agricultural arena are promising. Earlier this year, the Japanese government expanded the coverage of its GSP that cut existing tariff lines to as much as zero percent (Table 15). Although a move in the right direction, the GSP conveniently ignored major Philippine export items such as fresh banana (20%–25% tariff), mangoes (6% tariff), pineapple (20% tariff), asparagus (5% tariff), and other high-value crops.⁴⁰

³⁹ Statement by Japan's Ministry of Foreign Affairs (October 2002).

⁴⁰ APEC Tariff Database at www.apectariff.org

Table 15. Japan GSP coverage for selected agriculture products

Product	Tariff Rate (%)
Coconut oil	0 from 4.5
Papaya	0 from 2
Fruit stones, kernels, and other vegetable products	0 from 3
Vegetable planting materials	0 from 3
Yeast	0 from 3.8
Prepared bananas, avocados, mangoes, other than those packed in airtight containers	4.8 from 9.6
Prepared Mangoes and Guavas	7.5 from 15
Preserved papayas	6 from 10
Prepared papayas	3.8 from 6–7.5
Vegetables, fruits, nuts prepared in sugar	9 from 12.8–18
Prepared cashew nuts	5% from 6 to 10%

GSP = Generalized System of Preferences

Source: *Philippine Star*, August 28, 2003, B-1.

Suspension of GSP privilege is also possible when rapid importation becomes detrimental to local producers.⁴¹ One option for Japan is to space liberalization in its agriculture sector. However, this may adversely affect the public acceptance of a PJEPA on the Philippine side specifically from cause-oriented groups especially if industry is opened beforehand. This may give the impression that the PJEPA is only to benefit Japan. Disregarding the agriculture sector in the negotiations is not an option for the Philippine side especially given the findings of Cororaton (2003) that the agriculture sector will be hardest hit upon the implementation of a PJEPA. Supporting agricultural export expansion will be valuable in mitigating the price bias of free trade against agricultural products and capital.

Marine products

Based on national trade figures, the fishing industry contributed 3.9 percent to the country's GDP in 2001. The importance of this sector in terms of employment is reflected in its employment of about 10 percent of the active labor force in agriculture and 5 percent of the total labor force.⁴²

In terms of its subsectors, the tuna industry reportedly employs at least 18,000 workers inclusive of allied and support industries. Those engaged in

⁴¹ Rocel Felix, "Agriculture exports to Japan seen to rise," *Philippine Star*, August 28, 2003.

⁴² DTI website (www.dti.gov.ph)

municipal operations number 773,000 while 51,000 are in commercial fisheries. The shrimp and prawn industry, meanwhile, directly employs over 120,000. Major processing centers are located in Bulacan, Negros Occidental, Capiz, Cebu, Bohol, and Zamboanga.⁴³

Philippine marine exports to Japan, composed of high-value products, have declined through the years from USD 267 million in 1995 to USD 121 million in 2002—a 55 percent drop in seven years. Shrimp exports in 2002 were only one-half the value of its exports in 1995 while tuna exports in 2002 were just 40 percent of its 1995 export value (Table 16). Tuna exports face tariff of 3.5 percent in Japan while shrimps and prawns are imposed a 1 percent tariff rate.⁴⁴

A study done by the Asian Institute of Management (AIM) Policy Center, noted that the surge in tuna exports increased by 323 percent annually from 1970 to 1998. This growth was a direct result of PD 941, which created the Philippine Export Council (PEC) tasked to develop and implement a national export program. As such, exports grew by 840 percent annually in the 1970s and 6.17 percent annually in the 1980s. During the 1990s, the study noted that exports declined by an average of 0.87 percent annually despite increased production in the same period. The main reason for this is the increasing domestic demand for fresh tuna as raw materials for the canning industry.⁴⁵

There are two types of tuna exported to Japan—the fresh/chilled yellowfin tuna and the frozen skipjack tuna. In 1999, Japan, with 33 percent share of total exports, is the second largest market for Philippine yellowfin tuna, next to the US with 52 percent share (Table 17).

Meanwhile, Japan is the largest frozen skipjack tuna export market for the Philippines in 1999 with a 55 percent share in total exports followed by Thailand at 34 percent share (Table 18).

Sulu Sea, Moro Gulf, and the waters extending to the North Celebes Sea have been identified as the most productive fishing grounds for yellowfin and skipjack. The waters of Mindanao account for 55 percent of the total yellowfin and skipjack catch. Mindanao is also where most of the tuna canneries are located. Foremost among these is General Santos City. This is the center for the production, processing, and trade of tuna in the country. The city has direct access to international markets such as neighboring Brunei, Singapore, Kuala Lumpur, Jakarta, Australia, Japan, Hongkong, the Middle East, Europe, the

⁴³ Ibid.

⁴⁴ APEC Tariff Database

⁴⁵ Lantican and Silva (2002), p.5.

Table 16. Major Philippine marine products export to Japan (FOB value in USD)

	2002	2001	2000	1999	1998	1997	1996	1995
Total Marine Products	121,691,538	125,706,352	150,877,469	144,773,757	167,938,591	161,601,671	195,685,489	267,219,124
Live fish	1,023,786	898,014	999,219	1,099,827	1,231,271	1,845,634	1,824,516	1,823,680
Fresh/chilled/frozen fish	2,370,116	6,742,665	8,116,521	3,101,533	4,020,212	4,985,130	4,206,186	5,391,222
Tuna	20,703,798	13,356,605	21,926,045	27,732,081	41,457,948	30,124,069	41,783,936	51,035,034
Fresh/chilled/frozen	12,673,133	8,497,906	17,442,888	23,260,192	36,166,053	20,099,888	32,469,899	38,894,863
Canned	7,687,399	4,129,076	3,680,200	4,156,107	5,291,895	10,024,181	9,314,037	12,140,171
Crustaceans	88,256,973	91,904,433	106,854,555	101,347,013	103,219,891	102,432,619	128,101,359	178,305,563
Shrimps and prawns	86,400,377	90,174,683	103,692,961	98,025,939	97,718,770	96,013,046	120,877,035	172,258,531
Fresh/chilled/frozen	86,397,420	90,146,143	103,524,181	97,924,394	97,658,285	95,924,156	120,732,042	172,083,188
Lobsters	1,256,232	1,387,152	1,580,780	1,798,625	2,152,642	2,819,509	1,956,046	1,874,176
Mollusk	6,421,388	8,243,101	8,485,218	8,112,810	14,633,677	17,887,376	15,644,016	23,899,621

Source: NSO

Table 17. Philippines' yellowfin tuna exports by major destination, 1999

Country	Volume (MT)	Value (USD '000)
TOTAL	6,382	29,363
United States	2,849	15,143
Japan	2,531	9,787
Hong Kong	5	2,508
Hawaii	213	1,140
China	87	334
Others	114	451

MT = metric ton

Source: NSO

Table 18. Philippines' frozen skipjack tuna export by major destination, 1999

Country	Volume (MT)	Value (USD '000)
TOTAL	28,910	16,370
Japan	15,846	8,437
Thailand	9,804	5,439
Indonesia	2,605	1,897
United States	616	564
Australia	31	15
Canada	9	18

Source: NSO

Pacific Islands, and the United States. The competitive advantages of the tuna industry in General Santos City are as follows:⁴⁶

- The proximity of the city to major fishing grounds makes it an ideal location for tuna canning industries.
- There is room for fishing grounds expansion in the untapped areas of Palau to Papua New Guinea.
- It has an advantage of preserving the quality of fresh tuna since the source is close to the plant. Thus, postharvest losses are minimized since the mode of transfer is within short distances.

⁴⁶ Lantican and Silva (2002), p. 8.

However, various challenges exist that will affect the future competitiveness of Philippine tuna exports. These challenges, if not addressed, would hinder the utilization of benefits of a PJEPA. Some of these concerns as identified by the study and by the SOCKSARGEN Federation of Fishing Associations and Allied Industries, Inc. (SFAAII) are as follows:⁴⁷

- Depletion of fish reserves due to improper resource management
- Competition from other countries
- Inadequate infrastructure, facilities, and related services
- Inadequate fish port facility. The port in General Santos can only accommodate 1,000-ton vessels while international fleets can reach up to 8,000 tons.
- Definition of maritime waters
- Lack of bilateral access agreements with Pacific Island resource holders
- Inefficiency in the supply chain between the fishing companies and canneries through the maintenance of the bidding system. This prevents canneries from forecasting accurately the cost of their tuna and consequently their selling price to their distributors.
- Cash flow problems of canneries, which are passed on to the supply chain (i.e., fishing fleets, fuel and gear suppliers, etc.). Tightening bank policies contribute to cash flow problems.
- Trade promotion is not being maximized as Philippine tuna is exported mostly under a foreign label.

If regional development and poverty alleviation is to be gained through the PJEPA, we should particularly look into Mindanao growth industries and one such industry is tuna. Thus, to prevent depletion of fish resources, stricter implementation of laws regarding protection and conservation of fish resources is needed by all concerned government agencies. Aside from this, massive information campaigns on fishery resource conservation should be enacted through partnerships among stakeholders and local participants.

On the trade side, like their counterparts in the agriculture industry, the tuna industry should be ready to face the issue of SPS measures. The government should also strengthen its participation in international standard-setting organizations to ensure that fish products for export are not required to conform to standards higher than those warranted by scientific evidence (Lantican and Silva 2002).

⁴⁷ Ibid, p. 12–13.

The government should provide training for postharvest techniques and upgrade cold storage facilities. Japanese postharvest techniques should be studied and implemented. Industry must also reform the supply link by possibly adopting a brokerage or a six-month buying program. The DFA, with the possible backing of industry players, must also lobby for bilateral fishing agreements with Pacific Island countries such as Papua New Guinea, Micronesia, and Palau (Lantican and Silva 2002).

Other sectors

The inclusion of services in bilateral trade agreements has been encouraged by the DTI to widen the overseas employment of Filipino professionals like nurses, teachers, IT professionals and accountants.⁴⁸ Mutual recognition of professional certification is therefore important. Steps undertaken in the IT field should serve as a model worthy of replication for other professional fields.

The competitiveness of the country in terms of IT professionals is compromised by the laxity in promoting professional certification. As of this writing, recent figures of Microsoft-certified professionals in Southeast Asia showed the Philippines lagging behind its neighbors with only 1,588 certified professionals as compared with Malaysia's (4,532), Singapore's (5,942), Thailand's (1,711), and Indonesia's (1,711) (Table 19).⁴⁹ Professional IT certification is a clear indication that a person has reached world-class standards and paves the way for work overseas or employment by multinational companies with stringent labor standards. For instance, in Taiwan, certification is a requirement for an IT position in most companies. Thus, government and private organizations should not be complacent and should continue to push for certification programs to help boost the competitiveness of local IT professionals.

Table 19. Microsoft-certified professionals

Country	2001	2002	% Growth
Philippines	1,174	1,588	35.26
Malaysia	3,068	4,532	47.72
Singapore	4,747	5,942	25.17
Thailand	-	1,711	-
Indonesia	1,298	1,697	30.74

Note: Thailand 2001 figures were not available.

Source: INQ7.net, January 28, 2003.

⁴⁸ DTI Philippine Business Report (2003).

⁴⁹ Erwin Lemuel Oliva "Philippines produces fewest MS-certified professionals," INQ7.net, January 28, 2003.

In this regard, the Japanese government, in coordination with the DTI, has instituted a Japan Information Technology Standard Examination of the Philippines (JITSE-Phil), which enables Filipinos to take a globally recognized IT exam in the Philippines that immediately opens doors for employment in Japan. The JITSE-Phil is in its initial stages and will conduct only its second exam on September 2003. Testing centers are scattered in major urban areas in the country such as Baguio, Manila, Cebu, Davao, and Zamboanga.⁵⁰ Such professional standard examinations may prod additional investments in education that will lead to improvements in the standard of professional services as workers are forced to upgrade to remain relevant. Promotion of the JITSE-Phil. program should be intensified, particularly partnerships with local universities and training centers for review sessions. A PJEPA may also be a good opportunity for educational exchanges in science and technology courses that will surely uplift local educational standards in those areas.

In this regard, efforts must be given to promote and enhance the performance of Filipinos in the Japanese IT Standards Examination (JITSE). The Philippine National Standards (PNS), through the Bureau of Product Standards (BPS) of DTI, has adopted the JITSE as its national standard in IT certification program.

However, to avoid a disadvantageous situation wherein the best and the brightest leave the country while those who remain do so because they failed the exams, a better alternative to maintain the best professionals within our shores is to attract Japanese direct investments in the IT field, particularly in the offshore research and development outsourcing. In this case, the country gains from the positive externalities of our workers' domestic presence in terms of technology transfer to other workers leading, hopefully, to an increased overall productivity.

In this regard, our investment climate relative to other countries in the region will be the determining factor. The establishment of a one-stop center at the JETRO Manila office, wherein prospective investors are given market and business set-up information, will assist in improving our investment and business expansion prospects. This is congruent to the results of the survey done by JETRO in 2002 on obstacles faced by Japanese firms in entering new markets. Lack of information on markets and products was cited by 40 percent of the respondents as the main obstacle in expansion. A close second is lack of information on local importers and distributors (Annex I). This is especially relevant for potential SMEs investors who

⁵⁰ Dateline Jetro (2003), p.2.

have limited capabilities to fund start-up costs in exporting (e.g., market research) compared to bigger firms.⁵¹

Specific domestic subsectors exhibit enormous trade deficits that may indicate levels of comparative disadvantage and may mean that these domestic subsectors will face stiffer competition from imported goods upon implementation of an FTA. These sectors and their import and export values in 2002 are as follows:⁵²

- Paper and paper products: USD 28.0 million imports vs. USD 2.0 million exports
- Pharmaceutical products: USD 9.7 million imports vs. USD 153,000 exports
- Machineries/equipment/apparatus: Total of USD 548.0 million imports vs. USD 66.0 million exports
- Iron and steel: USD 214.0 million imports vs. USD 61,817 exports
- Metal-based construction materials: USD 82.0 million imports vs. USD 7.0 million exports
- Chemicals: USD 353 million imports vs. USD 36 million exports
- Petrochemicals: USD 184 million imports vs. USD 17 million exports

Aside from internal industry-level factors of competitiveness, the external environment also plays a big factor in the macro and micro competitiveness of the different sectors. Various surveys identified the quality of politics and governance as a major deterrent to government and private sector's efforts to boost economic growth and attract investments to the country.⁵³

Other factors considered by multinational companies as major deterrents to business are poor infrastructure, high cost of doing business, economic instability, currency fluctuations, lack of political will to implement policies, market size, and the justice system.⁵⁴

The Japan Association of Corporate Executives (JACE) echoed the sentiments of the Japanese ambassador about safety concerns of Japanese

⁵¹ The recent establishment of a Japan External Trade Organization (JETRO)–Business Support Center Philippines (BSCP), the third outside Japan, provides office space for two months rent-free to Japanese SMEs. These firms can thus conduct market research and given expert advice on aspects such as business laws, taxation, and labor.

⁵² National Statistics Office at www.census.gov.ph

⁵³ Results of the 2003 Annual Corporate Survey of Wallace Business Forum, with 36 multinational companies as respondents, identified corruption, political instability, peace and order problems, red tape, and inconsistency of government policies as the biggest problems besetting businesses. The Swiss-based International Management Development (IMD) survey also pointed out government and private sector inefficiency as factors in the drop of Philippine competitiveness rankings through the years.

⁵⁴ Michelle Remo, "Poor Governance is Economy's Top Problem: Survey," INQ7.net, October 13, 2003.

nationals as an investment consideration. The JACE representative indicated that while the Philippines could be an attractive investment site in Asia, Japanese locators would prefer safer places like China and Thailand. The Japanese Chamber of Commerce and Industry in the Philippine have also cited labor unrest as one of the major concerns of Japanese companies in the Philippines.⁵⁵

On Liberalization and Adjustment Costs

Temporary adjustment costs

When import barriers are brought down, relatively inefficient domestic firms face a downward pressure on their sales and profits as consumers are attracted to cheaper imported products from relatively efficient foreign firms. This downward pressure on profits will also be felt through lower wages, job layoffs, lower returns to capital, or even firm closures. Faced with these prospects, affected firms and laborers are expected to shift to other sectors such as an expanding export industry. This transition process is not as easy as it seems. Workers incur adjustment costs for being unemployed, for expenses incurred in actively searching for new jobs, and for training costs to acquire new job skills.

Capital owners in declining industries also face adjustment costs in dealing with a decline in capital values, investment in new production techniques to increase competitiveness, and in some cases, the cost of transferring capital from one industry to the other. Even the expansion of export industries after trade liberalization requires adjustment costs in the form of extra investments to absorb additional workers for expansion of their export markets.⁵⁶

The adjustment process described above leads to efficiency gains because factors of production shift in accordance with comparative advantage. Consumers also gain through lower prices and through more choices afforded to them by trade liberalization. The temporary nature of this adjustment process does not, in any way, lessen the harm it does to affected sectors. This is especially true for developing countries where adjustment costs can mean a rise in unemployment and poverty incidence in their most vulnerable sectors.

Small adjustment costs for the whole economy tend to be large seen from the point of view of specific groups. Meanwhile, the big overall benefits to consumers of trade liberalization tend to be scattered. Thus, due to the convenience of agglomeration, there is an incentive for the affected groups

⁵⁵ Iris Cecilia C. Gonzales and Carina I. Roncesvalles, "Investors Remain Wary (But Prospects Have Improved, say Foreign Governments)," *Businessworld Online*, October 13, 2003.

⁵⁶ WTO (2003).

to lobby for a return to protectionism while consumers quietly sit at the sidelines. In addition, policymakers “know that workers who would lose their job as a result of trade liberalization are aware of this and thus are unlikely to vote for them in the next election, while the workers who get new jobs in the expanding export sector are unlikely to link the existence of new jobs to trade reforms and unlikely to reward the political leaders by voting for them.”⁵⁷

It is important to note that adjustment costs differ from long-term distributional effects of trade. For instance, if a country imports a good that is produced intensively with unskilled labor, it is obvious that domestic unskilled laborers in that specific sector will be affected and will leave that sector thereby increasing the supply of unskilled labor in the whole economy. The main long-run effect of this increased supply is to drive down unskilled labor wages even in those sectors not affected by trade even though only the unskilled labor in the affected industry will have to incur the adjustment cost. All unskilled workers across sectors will have to bear the burden of lower wages. This poses a difficult challenge of a more redistributive system of compensating for the long-run losses of those who are not entitled to adjustment assistance programs.⁵⁸

Factors affecting adjustment costs

The size of adjustment costs may be affected by the macroeconomic status of the country at the time of reform. If the economy is booming and unemployment is high, workers can easily shift from one job to the other and adjustment costs is fairly small. On the other hand, if unemployment is high and the economy is in a recession at the time of reform, adjustment costs are expected to be higher as workers will find it harder to replace lost jobs.⁵⁹ In the case of the Philippines, assuming a contraction in agriculture as an FTA shifts relative prices in favor of manufacturing occurs, the informal service sector may balloon as workers ill-equipped with skills needed in the manufacturing sector opt to find work elsewhere. Skills training courses targeting the affected laborers is therefore important. This may be jointly funded and organized by the government and expanding industries looking for additional labor.

In addition, credit constraints caused by an inefficiently functioning credit market may exacerbate and hinder the adjustment process. Small companies with adjustment-related investments would bear the brunt of this credit

⁵⁷ Ibid., p.19.

⁵⁸ Ibid, p. 31.

⁵⁹ Ibid, p. 22.

constraint as banks tend to look at firm size in giving out loans (Bigsten et al. 1999; Jaramillo and Schiantarelli 1996). Distortions in the credit market may prod government intervention in the form of credit assistance. However, care must be taken since this move may be counterproductive if assistance is given to companies that will not be competitive in the long run.⁶⁰ One option is for the government to announce trade liberalization in advance so that firms may start accumulating profits and utilize internal financing to face future foreign competition. In any case, this solution will not make a difference to low-income workers who are unable to accumulate savings from their income. Laborers affected by trade liberalization will find it doubly hard to obtain loans to finance their own adjustment costs. In the absence of safety nets, particularly in developing countries, this may result in greater economic hardships.⁶¹

In the Philippine setting, the restructuring of loans when a business is on the brink of bankruptcy may also be a cause of credit constraints. There will be lesser opportunities for small laborers to borrow these loans because money that should be available is frozen in loan restructuring.⁶²

Social safety nets have been much discussed in the context of developing countries but inadequate and inefficient government resources hinder its implementation. Safety nets imposed by the Philippine government, such as the Safeguard Measures Act, tries to protect affected firms from import protection by reinstating tariffs until such time that these firms can recover their competitiveness (Annex II).⁶³ Although this may be the most practical method for the government and benefits the protected industry directly, the plight of workers was not taken into consideration. Cost-cutting by affected firms to improve competitiveness may involve lower wages. In cases of wage rigidity by law, job layoffs may occur.

An alternative model is presented by the US through the Trade Adjustment Assistance (TAA). Instead of the reinstatement of tariffs, direct compensation to injured workers and industries for their losses occurs. Compensation for workers in this case could take the form of extended unemployment benefits, retraining, and relocation assistance. For firms, TAA provides low-interest loans and assistance for firms to explore new product lines (Annex III). However, the goal of compensating workers may contradict the goal of hastening their adjustment process. In the case of the TAA, economists observed that its heavy emphasis on unemployment benefits and weak focus on retraining and

⁶⁰ Ibid, p. 33.

⁶¹ Ibid, p. 39.

⁶² Inputs of Director Kabigting of the DTI-BITR during the Forum on JPEPA, September 11, 2003.

⁶³ Other safety nets include RA 8751 or the Countervailing Duty Act and RA 8752 or the Anti-D Duty Act.

relocation assistance may actually encourage workers to remain unemployed rather than seek work in growing industries.⁶⁴

The quality of infrastructure and utilities in a country also affects the adjustment costs of firms. The lack of infrastructure and utilities provision will result in more firm investments in capital goods and higher transaction and information costs—all of which aggravate the cost incurred by the adjusting firm.

The acceptability and credibility of trade reforms may also affect the duration of adjustment costs. If workers and firms who run counter against trade reforms feel that a reversal of policy is at hand, inaction may be the result, which may further prolong their respective adjustment periods.

Conclusion and Policy Implications

The expansion of exporting industries, particularly in agriculture, is important in order for the trade liberalization adjustment process to be smooth. Active export promotion, whether in agriculture or industry, may also give the government the political support it needs to counter protectionist moves by import competing sectors.

Safety nets available to policymakers should not be limited to the reinstatement of tariffs but should instead be directed to retraining and relocation assistance to displaced workers. Private sector and civil society participation should be encouraged as government resources are sorely lacking in this respect.

Consolidation of the estimated 15,000 SMEs accounting for 90 percent of all firms in the furniture sector is a must to exploit economies of scale and to standardize quality. Proper resource management and supply agreements from other countries to address the lack of raw materials should be explored. Boosting SME financing will increase capital expenditures leading to increased productivity in the sector. This should be in conjunction with government incentives, such as the establishment of a one-stop center to showcase furniture exports and tax-breaks for imported capital.

The competitiveness of the tuna industry depends on sustainable resource management and access to bilateral fishing agreements with Pacific countries. Furthermore, investments to improve the capacity of port facilities are needed, along with acquiring modern techniques of postharvest handling and supply bidding.

Most nonfood manufactured goods exports of the Philippines enjoy zero or very low tariffs in Japan. If the Philippines is to benefit from the PJEP,

⁶⁴ Yarbrough (2000), pp.128-129.

we have to be mindful of other trade-related issues such as nontariff barriers (i.e., SPS) or trade procedures and facilitation especially in our agricultural and resource-based exports.⁶⁵ This is especially true for fresh fruit, agriculture, and marine product exports. Capacity-building programs in these areas should then be stressed in the JPEPA.

Firm-level cost competitiveness in the electronics and automotive sectors necessitates that further improvements must be made in developing the local supply base for industries (Annex II). The challenge then is to identify the components that will be in demand from the expansion plans of manufacturers. This can only be done if we are privy to the investment plans of major industry players. The decision on where to assign the Philippines in the value chain segment among other electronics powerhouses in the ASEAN such as Malaysia, Thailand, and Singapore, and in East Asian countries such as South Korea and China, lies in the hands of major multinationals. The same is true for the automotive industry where Japanese and American players dictate where to locate their manufacturing units. What is within our immediate control is how to make the Philippines an attractive investment locus so that we can "lengthen and strengthen that part of the value chain that is assigned to us."⁶⁶

In the construction industry, cement, which has enjoyed safeguard protection by the government, will face limited competition from Japanese cement. Most of the Japanese cement sold in the country are in bulk, which serves a particular market niche. However, nontariff barriers, such as the 28-day compressive strength testing, may be challenged by similar requirements for Philippine cement exports to Japan.

The Philippine government's stand on the service sector, specifically the sending of Filipino nurses and IT professionals to Japan, should only be a short-term program as this will have serious repercussions on the long-term growth prospects of our country. Meanwhile, structures exist that we can fully utilize such as the Science and Technology Advisory Council (STAC) and the United Nations Transfer of Knowledge Through Expatriate Nationals (TOKTEN) Project that enable immigrants to return to their home countries for short-term consultancies for technology transfer purposes.

The employment of Filipino professionals can best serve the country when Japanese companies locate to the country and transfer technology through various means. In this regard, the country's ability to attract Japanese investment relative to our neighbors, especially those that are concluding FTAs with Japan, is of utmost importance.

⁶⁵ Inputs from Director Ramon Kabigting during the Forum on JPEPA, September 11, 2003.

⁶⁶ Ibid.

In a survey by JETRO, insufficient infrastructure was cited by 77 percent of Japanese manufacturers as the biggest factor in adversely affecting the country's investment environment (Annex IV). Port facilities, cheap electricity and water, access to roads, affordable transport costs, telecommunications, and fast custom clearance procedures, when not adequately provided by the government, will be reflected as cost items by companies.

Another challenge we pose to the Philippine public and private sector is to maintain our edge in human capital through continuing education and relevant skills training. Workers must stay relevant in a rapidly changing and more competitive global environment (ex. the certification of IT professionals). Recognition of professional standards between Japan and the Philippines, which has started in the IT field through JITSE, should be expanded to other professional sectors. Continued skills training to complement the specific needs of foreign locators, such as Japanese language programs, should be introduced and promoted so that Filipino workers remain competitive in the eyes of the Japanese.

Firms must also adapt to new technologies and be quick to anticipate new opportunities for diversification. For instance, new opportunities that will cater to Japan's graying society will be in demand. The so-called joint-use goods, goods that are designed with the needs of the elderly and the disabled in mind, have seen value of shipments grow at an average annual rate of 30 percent from 1996 to 2000. Examples of such goods are shampoo and conditioner bottles designed differently to be identifiable by touch, and braille labels on canned drinks.⁶⁷

Firms must also make full use of new innovations in IT to supplement their marketing efforts. For example, the Virtual Trade Fair offered by the JETRO through its website offers Japanese buyers to view and purchase products from different countries online. Local exporters with an aversion to technology will definitely miss out on new business opportunities. Areas with no internet service providers will similarly face the same fate. On the downside, new developments in IT will immediately highlight the price and service disadvantages of uncompetitive products and firms.

The hesitancy to use new technology is more prominent in the SME sector. According to Bureau of Domestic Trade Director Meynardo Orbeta, DTI's initiatives to assist SMEs to set-up online catalogues received a lukewarm response from SMEs based in the provinces due mainly to security concerns

⁶⁷ *Dateline Jetro Market Report* (August 2003). The market of joint-use goods and services in Japan was worth USD 4.1 billion in 1995. In 1996, the market increased to USD 8.3 billion and further to USD 19.2 billion in 2000. A big portion of this is from the consumer electronics goods followed by canned drinks and housing furniture.

that “exposing their products and designs to the global market will result in someone stealing their designs.”⁶⁸ Thus, sustained education is needed in this sector on the areas of intellectual property protection and benefits of IT for SMEs particularly in e-commerce. Most Filipino exporters utilize the internet only for communication purposes and not for business transactions such as e-biddings. The lack of infrastructure support in terms of availability of Internet service providers (ISPs) and applications is also a deterrent to SME adoption of e-commerce.⁶⁹

Given that our ASEAN neighbors like Malaysia and Thailand are seriously concluding FTA negotiations with Japan, what should Philippine firms and labor do to ensure they could derive maximum benefits from the PJEPA? These are valid concerns in that, a) our neighbors have a stronger existing trade relationship with Japan, which implies an already established sales and distribution network; and, b) our neighbors have similar goods to offer Japan. This may have already placed us at a disadvantage but the road to trade liberalization has been paved and either we decide to be a part of it or be left behind in the race. There is no dilemma really as not entering into an FTA with Japan, when others have done so, is a far worse scenario—with our country feeling the whole brunt of trade diversion. Thus, challenges must be seen as opportunities for growth and improvement. One challenge for us is to exploit “co-opetition” or triangular trade relations with fellow AFTA members in our trade with Japan. Given that an ASEAN-Japan FTA is also in the works, it will be very hard for the Philippines to succeed by itself in a competitive environment without cooperation. It will find, as other countries should find, that it can only succeed if our ASEAN neighbors also succeed.

The final and probably the hardest challenge we pose to the public sector is to maintain a stable macroeconomic and investment policy, characterized by transparency, stability, and predictability. Efforts to maintain competitiveness will come to naught if the country succumbs to political and social instability. Of the Japanese-affiliated manufacturers currently in the country, 72 percent identified this as a pressing problem of the Philippine investment environment (Annex IV). Perception may spell the difference between winners and losers in a highly competitive and integrated global economy.

⁶⁸ Sanchez (2003) at http://itmatters.com.ph/news/news_09102003e.html

⁶⁹ Ibid.

Annex I

Obstacles faced by Japanese firms overseas (%)

(N = 897)

Lack of information on markets/products	40.5
Lack of information on local importers and distributors	33.9
Lack of employees with sufficient foreign language skills	26.8
Lack of employees available to take on new tasks	23.0
Lack of information on taxation, investment, etc.	21.5
Lack of information on partners for mergers and tie-ups	17.6
Lack of sufficient funds for entering overseas markets	15.7
Lack of information on investment risks	13.8
Lack of know-how for setting up company in local market	10.6
Lack of employees with hands-on trade know-how	7.8
Absence of FTA, investment treaty, and others, between Japan and the local country	5.0
Others	3.9

FTA = free trade agreement

Source: A JETRO survey on overseas expansion by Japanese firms, conducted in June 2002.

Annex II

Republic Act No. 8800 **Safeguards Measures Act** **An Act Protecting Local Industries by Providing Safeguard** **Measures to be Undertaken in Response to Increased** **Imports and Providing Penalties for Violation Thereof**

Chapter I

General Provisions

SEC. 1. **Short Title.** This Act shall be known as the "Safeguard Measures Act."

SEC. 2. **Declaration of Policy.** The State shall promote the competitiveness of domestic industries and producers based on sound industrial and agricultural development policies, and the efficient use of human, natural and technical resources. In pursuit of this goal and in the public interest, the State shall provide safeguard measures to protect domestic industries and producers

from increased imports that cause or threaten to cause serious injury to those domestic industries and producers.

SEC. 3. **Scope of Application.** This Act shall apply to products being imported into the country irrespective of source.

SEC. 4. **Definitions.** For the purposes of this Act, the following terms are defined as follows:

- (a) "Agricultural product" refers to a specific commodity under Chapters 1 to 24 of the harmonized system (HS) of Commodity Classification as used in the Tariff and Customs Code of the Philippines;
- (b) "Commission" shall refer to the Tariff Commission;
- (c) "Consumers" shall refer to natural persons or organized consumer groups who are purchasers, lessees, recipients or prospective purchasers, recipients of consumer products, services or credit;
- (d) "Critical circumstances" shall mean circumstances where there is prima facie evidence that increased imports, whether absolute or relative to domestic production, are a substantial cause of serious injury or threat thereof to the domestic industry and that delay in taking action under this Act would cause damage to the industry that would be difficult to repair;
- (e) "Directly competitive product" shall mean domestically produced substitutable products;
- (f) "Domestic industry" shall refer to the domestic producers as a whole, of like or directly competitive products manufactured or produced in the Philippines or those whose collective output of like or directly competitive products constitutes a major proportion of the total production of those products;
- (g) "Interested parties" shall include domestic producers, consumers, importers and exporters of the products under consideration;
- (h) "Like product" shall mean a domestic product which is identical, i.e., alike in all respects to the imported product under consideration, or in the absence of such a product, another domestic product which, although not alike in all respects, has characteristics closely resembling those of the imported product under consideration;
- (i) "Market access opportunity" shall mean the percentage of the total annual volume of imports of an agricultural product to the corresponding total volume of domestic consumption of the said product in the country in the three (3) immediately preceding years for which data are available;

- (j) "Minimum Access Volume (MAV)" is the amount of imports of an agricultural product allowed to be imported into the country at a customs duty lower than the out-quota customs duty;
- (k) "Positive adjustment to import competition" shall refer to the ability of the domestic industry to compete successfully with imports after the termination of any safeguard measure, or to the orderly transfer of resources to other productive pursuits, and to the orderly transition of dislocated workers in the industry to other productive pursuits;
- (l) "Price difference" is the amount obtained after subtracting the c.i.f. import price from the trigger price;
- (m) "Product" refers to articles, commodities or goods;
- (n) "Secretary" shall refer to either the Secretary of the Department of Trade and Industry in the case of non-agricultural products or the Secretary of the Department of Agriculture in the case of agricultural products;
- (o) "Serious injury" shall mean a significant impairment in the position of a domestic industry after evaluation by competent authorities of all relevant factors of an objective and quantifiable nature having a bearing on the situation of the industry concerned. In particular, the rate and amount of the increase in imports of the product concerned in absolute and relative terms, the share of the domestic market taken by increased imports, changes in levels of sales, production, productivity, capacity utilization, profit and losses, and employment;
- (p) "Substantial cause" means a cause that is important but not less than any other cause;
- (q) "Threat of serious injury" shall be understood to mean serious injury that is imminent;
- (r) "Trigger price" is the price benchmark for applying the special safeguard measure; and
- (s) "Trigger volume" is the volume benchmark for applying the special safeguard measure.

Chapter II

General Safeguard Measure

SEC. 5. *Conditions for the Application of General Safeguard Measures.*

The Secretary shall apply a general safeguard measure upon a positive final determination of the Commission that a product is being imported into the country in increased quantities, whether absolute or relative to the domestic production, as to be a substantial cause of serious injury or threat thereof to

the domestic industry; however, in the case of non-agricultural products, the Secretary shall first establish that the application of such safeguard measures will be in the public interest.

SEC. 6. *Initiation of Action Involving General Safeguard Measure.* Any person, whether natural or juridical, belonging to or representing a domestic industry may file with the Secretary a verified petition requesting that action be taken to remedy the serious injury or prevent the threat thereof to the domestic industry caused by increased imports of the product under consideration. The petition shall include documentary evidence supporting the facts that are essential to establish:

- (1) an increase in imports of like or directly competitive products,
- (2) the existence of serious injury or threat thereof to the domestic industry, and
- (3) the causal link between the increased imports of the product under consideration and the serious injury or threat thereof.

The Secretary shall review the accuracy and adequacy of the evidence adduced in the petition to determine the existence of a prima facie case that will justify the initiation of a preliminary investigation within five (5) days from receipt of the petition.

The Secretary may also initiate action upon the request of the President; or a resolution of the House of Senate Committee on Agriculture, or House or Senate Committee on Trade and Commerce.

In the absence of such a petition, the Secretary may, *motu proprio*, initiate a preliminary safeguard investigation if there is evidence that increased imports of the product under consideration are a substantial cause of, or are threatening to substantially cause, serious injury to the domestic industry.

The Secretary may extend legal, technical and other assistance to the concerned domestic producers and their organizations at all stages of the safeguard action.

SEC. 7. *Preliminary Determination.* Not later than thirty (30) days from receipt of the petition or a *motu proprio* initiation of the preliminary safeguard investigation, the Secretary shall, on the basis of the evidence and submission of the interested parties, make a preliminary determination that increased imports of the product under consideration are a substantial cause of, or threaten to substantially cause, serious injury to the domestic industry. In the process of conducting a preliminary determination, the Secretary shall notify the interested parties and shall require them to submit their answers within five (5) working days from receipt of such notice. The

notice shall be deemed received five (5) working days from the date of transmittal to the respondent or appropriate diplomatic representative of the country of exportation or origin of the imported product under consideration.

When information is not applied within the above time limit set by the Secretary or if the investigation is significantly impeded, decision will be based on the facts derived from the evidence at hand.

Upon a positive preliminary determination that increased importation of the product under consideration is a substantial cause of, or threatens to substantially cause, serious injury to the domestic industry, the Secretary shall, without delay, transmit its records to the Commission for immediate formal investigation.

SEC. 8. *Provisional Measures.* In critical circumstances where a delay would cause damage that would be difficult to repair, and pursuant to a preliminary determination that increased imports are a substantial cause of, or threaten to substantially cause, serious injury to the domestic industry, the Secretary shall immediately issue, through the Secretary of Finance, a written instruction to the Commissioner of Customs authorizing the imposition of a provisional general safeguard measure.

Such measure shall take the form of a tariff increase, either ad valorem or specific, or both, to be paid through a cash bond set at a level sufficient to redress or prevent injury to the domestic industry. Provided, however, that in the case of agricultural products where the tariff increase may not be sufficient to redress or to prevent serious injury to the domestic producer or producers, a quantitative restriction may be set. The cash bond shall be deposited with a government depository bank and shall be held in trust for the importer who posted the bond. The duration of the provisional measure shall not exceed two hundred (200) days from the date of imposition during which period the requirements of the subsequent sections of this Act on the initiation of a formal investigation, notification and consultation shall have been met, Provided, that the duration of any provisional measure shall be counted as part of the initial period and any extension, of the imposition of the definitive final safeguard measure.

When the provisional safeguard measure is in the form of a tariff increase, such increase shall not be subject or limited to the maximum levels of tariff as set forth in Section 401 (a) of the Tariff and Customs Code of the Philippines.

SEC. 9. *Formal Investigation.* Within five (5) working days from receipt of the request from the Secretary, the Commission shall publish the notice of the commencement of the investigation, and public hearings, which shall afford

interested parties and consumers an opportunity to be present, or to present evidence, to respond to the presentation of other parties and consumers, and otherwise be heard. Evidence and positions with respect to the importation of the subject article shall be submitted to the Commission within fifteen (15) days after the initiation of the investigation by the Commission. The Commission shall complete its investigation and submit its report to the Secretary within one hundred twenty (120) calendar days from receipt of the referral by the Secretary, except when the Secretary certifies that the same is urgent, in which case the Commission shall complete the investigation and submit the report to the Secretary within sixty (60) days.

SEC. 10. **Inspection of Evidence.** The Commission shall make available for inspection by interested parties, copies of all evidence submitted on or before the relevant due date. Provided, however, that any information, which is by nature confidential or which is provided on a confidential basis, shall, upon cause being shown, not be disclosed without permission of the party submitting it. Parties providing confidential information may be requested to furnish non-confidential summaries thereof or if such parties indicate that such information cannot be summarized, the reasons why a summary cannot be provided. Provided, further, that if the Commission finds that a request for confidentiality is not warranted and if that party concerned is either unwilling to make the information public or to authorize its disclosure in generalized or summary form, the Commission may disregard such information unless it can be demonstrated to its satisfaction from appropriate sources that the information is correct.

SEC. 11. **Adjustment Plan.** In the course of its investigation, the Commission shall issue appropriate notice to representatives of the concerned domestic industry or other parties, to submit an adjustment plan to import competition, within forty five (45) days upon receipt of the notice, except when the Secretary certifies that the same is urgent, in which case the adjustment plan must be submitted within thirty (30) days.

If the Commission makes an affirmative determination of injury or threat thereof, individual commitments regarding actions such persons and entities intend to take to facilitate positive adjustments to import competition shall be submitted to the Commission by any (a) firm in the domestic industry, (b) certified or recognized union or group of workers in the domestic industry, (c) local community, (d) trade association representing the domestic industry, or (e) other person or group of persons.

SEC. 12. ***Determination of Serious Injury on Threat Thereof.*** In reaching a positive determination that the increase in the importation of the product under consideration is causing serious injury or threat thereof to a domestic industry producing like products or directly competitive products, all relevant factors having a bearing on the situation of the domestic industry shall be evaluated. These shall include, in particular, the rate and amount of the increase in imports of the products concerned in absolute and relative terms, the share of the domestic market taken by the increased imports, and changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment.

Such positive determination shall not be made unless the investigation demonstrates, on the basis of objective evidence, the existence of the causal link between the increased imports of the product under consideration and serious injury or threat thereof to the domestic industry. When factors other than increased imports are causing injury, such injury shall not be attributed to increased imports.

SEC. 13. ***Adoption of Definitive Measures.*** Upon its positive determination, the Commission shall recommend to the Secretary an appropriate definitive measure, in the form of:

- (a) An increase in, or imposition of, any duty on the imported product;
- (b) A decrease in or the imposition of a tariff-rate quota (MAV) on the product;
- (c) A modification or imposition of any quantitative restriction on the importation of the product into the Philippines;
- (d) One or more appropriate adjustment measures, including the provision of trade adjustment assistance; and
- (e) Any combination of actions described in subparagraphs (a) to (d).

The Commission may also recommend other actions, including the initiation of international negotiations to address the underlying cause of the increase of imports of the product, to alleviate the injury or threat thereof to the domestic industry, and to facilitate positive adjustment to import competition.

The general safeguard measure shall be limited to the extent of redressing or preventing the injury and to facilitate adjustment by the domestic industry from the adverse effects directly attributed to the increased imports. Provided, however, that when quantitative import restrictions are used, such measures shall not reduce the quantity of imports below the average imports for the three (3) preceding representative years, unless clear justification is given that a different level is necessary to prevent or remedy a serious injury.

A general safeguard measure shall not be applied to a product originating from a developing country if its share of total imports of the product is less than three percent (3%): Provided, however, that developing countries with less than three percent (3%) share collectively account for not more than nine percent (9%) of the total imports.

The decision imposing a general safeguard measure, the duration of which is more than one (1) year, shall be reviewed at regular intervals for purposes of liberalizing or reducing its intensity.

The industry benefiting from the application of a general safeguard measure shall be required to show positive adjustment within the allowable period. A general safeguard measure shall be terminated where the benefiting industry fails to show any improvement, as may be determined by the Secretary.

The Secretary shall issue a written instruction to the heads of the concerned government agencies to implement the appropriate general safeguard measure as determined by the Secretary within fifteen (15) days from receipt of the report.

In the event of a negative final determination, or if the cash bond is in excess of the definitive safeguard duty assessed, the Secretary shall immediately issue, through the Secretary of Finance, a written instruction to the Commissioner of Customs, authorizing the return of the cash bond or the remainder thereof, as the case may be, previously collected as provisional general safeguard measure within ten (10) days from the date a final decision has been made, provided that, the government shall not be liable for any interest on the amount to be returned. The Secretary shall not accept for consideration another petition from the same industry, with respect to the same imports of the product under consideration within one (1) year after the date of rendering such a decision.

When the definitive safeguard measure is in the form of a tariff increase, such increase shall not be subject or limited to the maximum levels of tariff as set forth in Section 401 (a) of the Tariff and Customs Code of the Philippines.

SEC. 14. *Contents of the Report by the Commission.* Based on its findings, the Commission shall submit to the Secretary: (a) the investigation report, (b) the proposed recommendations, (c) a copy of the submitted adjustment plan, and (d) the commitments made by the domestic industry to facilitate positive adjustment to import competition.

The report shall also include a description of the short- and long-term effects of the affirmative or negative recommendation, as the case may be, on the petitioner, the domestic industries, the consumers, the workers, and the communities where production facilities of such industry are located.

The Commission, after submitting the report to the Secretary, shall make it available to the public except confidential information obtained under Section 10 and publish a summary in two (2) newspapers of general circulation.

SEC. 15. **Limitations on Actions.** The duration of the period of an action taken under the General Safeguard Provisions of this Act shall not exceed four (4) years. Such period shall include the period, if any, in which provisional safeguard relief under Section 8 was in effect. The effective period of any safeguard measure, including any extensions thereof under Section 19 may not, in the aggregate, exceed ten (10) years.

- (1) Any additional duty, or any duty imposed under this Section may be specific and/or ad valorem. It shall be in the amount necessary to prevent or redress or remedy the injury to the domestic industry;
- (2) If a quantitative restriction is used, such measure shall not reduce the quantity of imports below the level of a recent period, which shall be the average of imports in the last three representative years for which statistics are available, unless clear justification is given that a different level is necessary to prevent or remedy serious injury;
- (3) An action described in Section 13 (a), (b), or (c) that has an effective period of more than one (1) year shall be phased down at regular intervals within the period in which the action is in effect;
- (4) Within two (2) years after the expiration of the action, the Secretary shall not accept any further petition for the same article. Provided, however, that a safeguard measure with a duration of one hundred eighty (180) days or less may be applied again to the same product if:
 - i. At least one (1) year has elapsed since the date of introduction of the safeguard measure, and
 - ii. Such measure has not been applied on the same product more than twice in the five (5)-year period immediately preceding the date of introduction of the measure.

SEC. 16. **Monitoring.** So long as any action taken under Section 13 remains in effect, the Commission shall monitor developments with respect to the domestic industry, including the progress and specific efforts made by worker and firms in the domestic industry to make a positive adjustment to import competition.

- (1) If the initial application of action taken under Section 13 exceeds three (3) years, or if an extension of such action exceeds three (3) years, the Commission shall submit to the Secretary a report on the results of the monitoring, not later than the date that is the midpoint of the

initial period, and of each such extension, during which the action is in effect.

- (2) The Commission, in the preparation of each monitoring report, shall conduct a hearing at which interested parties shall be given reasonable opportunity to be present, to present evidence, and to be heard.

SEC. 17. ***Notice of General Safeguard Measure.*** The Secretary shall notify the concerned Committee on Safeguards of the World Trade Organization:

- (a) When initiating an action relating to serious injury or threat thereof and the reasons for it,
- (b) When adopting a provisional general safeguard measure following a positive preliminary determination, and
- (c) When applying or extending a definitive general safeguard measure following a positive final determination.

SEC. 18. ***Reduction, Modification, and Termination of Action.*** Action taken under Section 13 may be reduced, modified, or terminated by the Secretary only after:

- (a) Taking into account the results of the monitoring indicated in the report submitted by the Commission under Section 16, he determines that:
 - i. No adequate efforts to make a positive adjustment to import competition have been undertaken by the domestic industry, and
 - ii. Changed economic circumstances have impaired the effectiveness of action taken under Section 13.
- (b) A majority of the representatives of the domestic industry submits to the Secretary, at least one (1) year before the expiration, a petition requesting such reduction, modification, or termination on the basis that the domestic industry has made a positive adjustment to import competition.

If reduction, modification, or termination of action is being requested for an action that has been in effect for three (3) years or less, the petitioning industry shall submit its request to the Secretary. The Secretary shall refer the request to the Commission, which shall conduct an investigation following the procedures under Section 9, to be completed within sixty (60) days from receipt of the request. The Commission shall submit a report to the Secretary who shall then take action after taking into consideration conditions under Section 16 (1) and (2), not later than thirty (30) days after receipt of the Commission's report.

SEC. 19. *Extension and Re-Application of Safeguard Measure*

- (1) Subject to the review under Section 16, an extension of the measure may be requested by the petitioner if the action continues to be necessary to prevent or remedy the serious injury and there is evidence that the domestic industry is making positive adjustment to import competition.
- (2) The petitioner may appeal to the Secretary at least ninety (90) days before the expiration of the measure for an extension of the period by stating concrete reasons for the need thereof, and a description of the industry's adjustment performance and future plan. The Secretary shall immediately refer the request to the Commission. Following the procedures required under Section 9, the Commission shall then submit a report to the Secretary not later than sixty (60) days from its receipt of the request. Within seven (7) days from receipt of the report, the Secretary shall issue an order granting or denying the petition. In case an extension is granted, the same shall be more liberal than the initial application.

SEC. 20. *Evaluation of Effectiveness of Action.* After termination of any action under Section 13, the Commission shall evaluate the effectiveness of the actions taken by the domestic industry in facilitating positive adjustment to import competition.

The Commission shall hold a public hearing on the effectiveness of the action at which all interested parties shall be afforded opportunity to present evidence or testimony.

Chapter III

Special Safeguard Measures for Agricultural Products

SEC. 21. *Authority to Impose the Special Safeguard Measure.* The Secretary of Agriculture shall issue a department order requesting the Commissioner of Customs, through the Secretary of Finance, to impose an additional special safeguard duty on an agricultural product, consistent with Philippine international treaty obligations, if:

- (a) Its cumulative import volume in a given year exceeds its trigger volume, subject to the conditions stated in this Act, in Section 23 below, or but not concurrently; and
- (b) Its actual c.i.f. import price is less than its trigger price subject to the conditions stated in this Act, in Section 24 below.

SEC. 22. **Initiation of Action Involving Special Safeguard Measure.** Any person whether natural or juridical, may request the Secretary to verify if a particular product can be imposed a special safeguard duty subject to the conditions set in Section 21 of this Act. The request shall include data that would show that the volume of imports of a particular product has exceeded its trigger volume or that the c.i.f. import price of a particular product has gone below its trigger price. The Secretary shall come up with a finding within five (5) working days from the receipt of a request.

The Secretary may, *motu proprio*, initiate the imposition of a special safeguard measure following the satisfaction of the conditions for imposing the measure set in this Chapter.

SEC. 23. **Determination of Special Duty Based on the Volume Test.** The special safeguard duty allowed to be imposed on the basis of the volume test pursuant to Section 21 (a) of this Act shall be determined as follows:

- (a) The trigger volume referred to in Section 21 (a) of this Act is the amount obtained, after adding the change in the annual domestic consumption of the agricultural product under consideration, for the two (2) preceding years for which data are available, to:
 - i. One hundred twenty-five percent (125%) of the average annual volume of imports of the agricultural product under consideration in the three (3) immediately preceding years for which data are available, hereinafter referred to as the average import volume, if the market access opportunity is at most ten percent (10%); or
 - ii. One hundred ten percent (110%) of the average annual import volume, if the market access opportunity exceeds ten percent (10%) but is not more than thirty percent (30%); or
 - iii. One hundred five percent (105%) of the average annual import volume, if the market access opportunity exceeds thirty percent (30%);
 - iv. Provided that, if the change in the volume of domestic consumption mentioned above is not taken into account in computing the trigger volume, the trigger volume shall be equal to one hundred twenty-five percent (125%) of the average import volume for the immediate three (3) preceding years for which data are available, unless a clear justification is given that a different level is necessary to prevent or remedy serious injury. Provided, further, that the trigger volume shall at least be one hundred five percent (105%) of the average imports of the agricultural product under consideration.

- (b) The special safeguard duty to be imposed subject to the conditions stated under the volume test shall be appropriately set to a level not exceeding one-third of the applicable out-quota customs duty on the agricultural product under consideration in the year when it is imposed. Provided that, this duty shall only be maintained until the end of the year in which it is imposed. Provided further that, this duty may be reduced or terminated in special cases, such as when a shortage of a particular agricultural product exists, as determined by the Secretary.
- (c) In transit volumes of imports of the agricultural product under consideration at the time the special safeguard duty is imposed shall be exempted from the additional duty. However, such volumes shall be counted in the computation of the cumulative volume of imports of the said agricultural product for the following year.

SEC. 24. ***Determination of Special Safeguard Duty Based on the Price Test.*** The additional duty allowed to be imposed on the basis of the price test pursuant to Section 21(b) of this Act shall be determined as follows:

- (a) The trigger price referred to in Section 21(b) of this Act is the average actual c.i.f. import price or relevant reference price of the agricultural product under consideration from 1986 to 1988, unless clear justification is given that a different reference price is necessary to prevent or remedy serious injury. The Secretary shall publish the list of trigger prices corresponding to each of the agricultural products covered by this Act, after the conduct of public hearings on the subject; and
- (b) The special safeguard duty to be imposed subject to the conditions stated under Section 21 (b) of this Act shall be computed as follows:
 - i. Zero, if the price difference is at most ten percent (10%) of the trigger price; or
 - ii. Thirty percent (30%) of the amount by which the price difference exceeds ten percent (10%) of the trigger price, if the said difference exceeds ten percent (10%) but is at most forty percent (40%) of the trigger price; or
 - iii. Fifty percent (50%) of the amount by which the price difference exceeds forty percent (40%) of the trigger price, plus the additional duty imposed under Section 24 (b)(ii), if the said difference exceeds forty percent (40%) but is at most sixty percent (60%) of the trigger price; or
 - iv. Seventy percent (70%) of the amount by which the price difference exceeds sixty percent (60%) of the trigger price, plus

- the additional duties imposed under Section 24 (b)(ii) and (b)(iii), if the said difference exceeds sixty percent (60%) and is at most seventy-five percent (75%) of the trigger price; or
- v. Ninety percent (90%) of the amount by which the price difference exceeds seventy-five percent (75%) of the trigger price; plus the additional duties imposed under Section 24 (b)(ii), (b)(iii), and (b)(iv), if the said difference exceeds seventy-five percent (75%) of the trigger price.
 - vi. As far as practicable, a special safeguard measure determined under the provisions of this Section shall not be resorted to when the volume of the imported agricultural product under consideration is declining.

SEC. 25. ***Agricultural Products Subject to Minimum Access Volume Commitments.*** The special safeguard duty shall not apply to the volumes of the imported agricultural product under consideration that are brought into the country under the minimum access volume mechanism. Provided, however, that these volumes shall be included in computing the cumulative volume of imports of the said agricultural product pursuant to Section 21 (a) of this Act.

SEC. 26. ***Perishable and Seasonal Agricultural Products.*** Shorter time periods and different reference prices may be used in determining the applicable special safeguard measure taking into account the special characteristics of perishable and seasonal agricultural imports.

SEC. 27. ***Notice of Special Safeguard Measure.*** The Secretary shall make the administration of the safeguard measure transparent by giving notice in writing to the WTO Committee on Agriculture, in advance to the extent practicable, but in any event within ten (10) days from the implementation of such measure. Provided, however, that for perishable and seasonal agricultural products, notification shall be made from the first action in any period.

The notice shall include relevant data or as may be deemed necessary, information and methods used in cases where changes in consumption volumes must be allocated to individual tariff lines subject to action under Chapter III of this Act.

Where a special safeguard measure action is taken under the provisions of this Act, the Secretary shall consult with interested WTO members and provide all relevant information on the conditions of the application of such action.

SEC. 28. ***Duration of Special Safeguard Measures.*** The special safeguard measures for agricultural products shall lapse with the duration of the reform process in agriculture as determined in the WTO. Thereafter, recourse to safeguard measures shall be subject to the provisions on general safeguard measures as provided in Chapter II of this Act.

Chapter IV

Special Provisions

SEC. 29. ***Judicial Review.*** Any interested party who is adversely affected by the ruling of the Secretary in connection with the imposition of a safeguard measure may file with the Court of Tax Appeals, a petition for review of such filing within thirty (30) days from receipt thereof. Provided, however, that the filing of such petition for review shall not in any way stop, suspend, or otherwise toll the imposition or collection of the appropriate tariff duties or the adoption of other appropriate safeguard measures, as the case may be.

The petition for review shall comply with the same requirements and shall follow the same rules of procedure and shall be subject to the same disposition as in appeals in connection with adverse rulings on tax matters to the Court of Appeals.

SEC. 30. ***Penalty Clause.*** Any government official or employee who shall fail to initiate, investigate, and implement the necessary actions as provided in this Act and the rules and regulations to be issued pursuant hereto, shall be guilty of gross neglect of duty and shall suffer the penalty of dismissal from public service and absolute disqualification from holding public office.

SEC. 31. ***Prohibition of Concurrent Recourse to Safeguard Measures.*** There shall be no recourse to the used of the general safeguard measure under Chapter II of this Act concurrently with the special safeguard measure as provided for under Chapter III of this Act and vice-versa.

SEC. 32. ***Issuance of Implementing Rules and Regulations.*** Within sixty (60) days after the effectivity of this Act, the Department of Agriculture and the Department of Trade and Industry, in consultation with the Department of Finance, the Bureau of Customs, the National Economic and Development Authority, and the Tariff Commission, after consultation with domestic industries and with the approval of the Congressional Oversight Committee which is hereby created under this Act, shall promulgate the necessary rules and regulations to implement this Act.

SEC. 33. **Oversight.** There shall be a Congressional Oversight Committee composed of the Chairmen of the Committee on Trade and Industry, the Committee on Ways and Means, and the Committee on Agriculture of both the Senate and the House of Representatives to oversee the implementation of this Act.

SEC. 34. **Administrative System Support.** Upon the effectivity of this Act, any sum as may be necessary for the Department of Agriculture, the Department of Trade and Industry and the Tariff Commission to undertake their functions efficiently and effectively shall be included in the General Appropriations Act.

The aforementioned government agencies are hereby authorized to collect such fees, charges, and safeguard duties that are deemed necessary. Fifty percent (50%) of the revenue collected from such fees, charges and safeguard duties shall be set aside in a Remedies Fund, which shall be earmarked for the use of these agencies in the implementation of remedies, including the safeguard measures. The remaining fifty percent (50%) shall be deposited under a special account to be created in the National Treasury and shall be earmarked for competitiveness enhancement measures for the industries affected by the increased imports. The disposition thereof shall be determined through the General Appropriations Act.

SEC. 35. **Assistance to Farmers and Fisherfolk.** To safeguard and enhance the interest of farmers and fisherfolk, nothing in this Act shall in any manner affect the provisions of Republic Act No. 8435, otherwise known as the Agriculture and Fisheries Modernization Act.

SEC. 36. **Conditions for Application of Safeguard Measures.** In the application of any safeguard measure under this Act, the following conditions must be observed:

- (1) All actions must be transparent and shall not allow any anti-competitive, monopolistic or manipulative business devise; and
- (2) Pursuant to the non-impairment clause of the Constitution, nothing in this Act shall impair the obligation of existing supply contracts.

SEC. 37. **Separability Clause.** If any provision of this Act is held invalid, the other provisions of this Act not affected shall remain in force and effect.

SEC. 38. **Repealing Clause.** All laws, decrees, rules and regulations, executive or administrative orders and such other presidential issuances as are inconsistent with any of the provisions of this Act are hereby repealed, amended, or otherwise modified accordingly.

SEC. 39. **Effectivity Clause.** This Act shall take effect fifteen (15) days following its complete publication in two (2) newspapers of general circulation or in the Official Gazette, whichever comes earlier.

Annex III

Trade Adjustment Assistance (TAA)

In the United States (US), special benefits accorded to workers displaced by trade liberalization were first enacted under the Trade Expansion Act of 1962. The North American Free Trade Agreement (NAFTA) Implementation Act, passed in December 1993, contained adjustment assistance geared toward workers displaced by the expansion of trade with Canada and Mexico. The first five years of NAFTA saw a total of 564,967 American workers certified eligible for benefits under trade adjustment assistance (TAA) and NAFTA-TAA programs. Those eligible for TAA benefits, averaging 112,993 workers per year, were relatively small compared to the total US employment average per year of 119 million for the same period.

The reasons why large numbers of eligible workers chose not to avail of the assistance program were as follows:

- Finding a job soon after being displaced
- Dropped out of the workforce altogether
- Financed own job retraining independent of federal trade adjustment programs.

For the five-year period, 1994 to 1998, only about one in four workers eligible—totaling 150,998 or 30,200 workers a year—actually received trade readjustment allowances through TAA.

Critics would counter that the criteria for TAA qualification were too strict thereby reducing the number of eligible workers below true levels. On the other hand, there are counter arguments that the program is too loose by providing aid to job losses incidentally connected to trade. In any case, even if participation were to double, assistance would still be collected by a tiny fraction of American workers.

Source: Daniel Griswold (1999), p. 10.

Annex IV

Results of the 2002 Survey on Japanese-Affiliated Manufacturers in Asia

A 2002 survey on Japanese-affiliated manufacturers in Asia conducted by the Overseas Research Department of the Japan External Trade Organization (JETRO) covering overseas Japanese companies with at least 10 percent in the company would be a good indication on the specific concerns that the Philippines should address to attract more investment and encourage existing business expansion and competitiveness. In the Philippines, 150 Japanese companies participated in the survey, representing a broad range of industries. The findings from these Philippine-based companies are as follows:

- Reasons for improvement in profits for 2003: 67.7 percent cited increase in sales due to expansion of exports; 38.7 percent cited reduction of procurement cost (up from 27.3% from the 2002 survey).
- Countries with Japanese companies reporting exports of 70 percent or more to China: 9.4 percent for the Philippines, the highest among ASEAN countries.
- Rates of locally procured materials and parts of more than 51 percent: 17.4 percent, the lowest in Asia (Vietnam = 19.4%; Indonesia = 36.8%). Increase in local procurement was cited by Philippine-based companies as the main measure for cutting procurement costs of materials/parts. Correspondingly, 60 percent of the companies cited difficulties in the procurement of local parts and materials as the main problem of production.
- Competition with imported products within local market: 60 percent responded facing stiff competition from Chinese products; competition from ASEAN products was a close second at 43 percent.
- Necessary measures to enhance competitiveness (ASEAN response): further cost cutting (80%), human resource development (63%), increase of added values of products (48%), raising of local content ratio (35%), marketing reinforcement (31%), enhancement of research and development (22%), efficient logistics (22%), localization of managerial positions (22%), further implementation of IT (8%), and outsourcing (7%).
- Specific business policies for expansion of scale: 72 percent responded expansion/diversification of production items.
- Problems of treasury, finance, and foreign exchange: 58 percent cited volatility of local exchange rate to the US dollar.

- Problems of labor and employment: 60 percent cited personnel cost of Japanese expatriate officer; 50 percent responded restrictions on staff dismissal and reduction.
- Problems of investment environment: insufficient infrastructure (77%), unstable and insecure political and social conditions (72%), and unclear policy management of local governments (50%).
- Anticipated benefits of an FTA (Asia response): abolition of custom duties (78%), simplification and international harmonization in custom clearance procedures (64%)

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5 Small and Medium Enterprise Development Experience and Policy in Japan and the Philippines: Lessons and Policy Implications

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Introduction

SMEs have played an important role in industrial production in particular and economic growth in general in less developed, developing, and transitional economies worldwide. They have generally provided the bulk of entrepreneurs and employment in these economies, and the necessary foundations for sustained economic growth and rising incomes. Ironically, however, SMEs in these economies have usually been neglected and even discriminated against in terms of government attention, access to finance, management and marketing expertise and technology, among others, relative to large enterprises. This has been particularly true in developing economies where large enterprises have usually been given the primary role in economic and industrial development.

Policies and programs have been formulated across economies to further develop and strengthen the SME sector. SME policies and programs are manifold and vary according to specific country experiences and requirements, and generally address enhancement of exports, market development, furthering the use of technology, and credit access. In this age of globalization, policies directed at increasing the competitiveness of SMEs need to have an outward orientation. SMEs need to look beyond domestic markets and become export oriented as well. Accordingly, the policy framework for SME development needs to deal with globalization and international competitiveness.

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This study has three major objectives. *First*, it aims to document the historical SME development policy experience in the Philippines and Japan. *Second*, it attempts to draw useful lessons and policy implications from the Japanese experience for the Philippines. *Third*, it explores and analyzes opportunities for trade cooperation between the two countries in further fostering Philippine SME development. Although the study focuses on the partnership between Japan and the Philippines, discussions on the relevance and benefits of international cooperation are discussed in light of globalization, particularly in international trade. Thus, bilateral cooperation programs between countries or even regional cooperation programs serve as points of departure for analyses and discussions regarding international competitiveness of SMEs.

The first section discusses the operational definition of SMEs in the Philippines and the definition employed in this study. The second section deals with the current state of SMEs in the Philippines and Japan. For the Philippines, secondary data from the National Statistics Office (NSO) List of Establishments are employed. Data on Japanese SMEs were taken from available published reports of the METI. The third section reviews the economic literature on SMEs, particularly on the contributions of SMEs to the economy. The fourth and fifth sections discuss the historical SME development policy experiences of the Philippines and Japan, respectively. Policies relating to SMEs in both countries are either SME-specific or industry-wide in scope, with specific provisions relating to the SME sector. The sixth section presents issues confronting SMEs, specifically issues on global competitiveness. This section presents the case and the argument for free trade as gathered from the profuse literature of SMEs. This section also presents some statistics and discussions on the bilateral trade between the Philippines and Japan. The seventh and last section presents policy discussions.

Operational Definitions

The basic SME definition differs widely across countries. For instance, SMEs across the ASEAN Countries or ASEAN-5 are defined differently in terms of employment, assets, shareholder funds, sales, and even paid-up capital (Table 1). Thus, depending on the criterion selected, the same firm may be classified as "small" under one criterion and as "medium" under another. As such, broad comparisons of SMEs across different countries may not be entirely appropriate because of the varied operational definitions employed. In highlighting these differences, it must be noted that the definitions adopted by countries do not in practice fundamentally affect the important issues facing and surrounding SMEs. Although the definitions vary, they have one thing in common: the vast majority of SMEs are relatively small and most SMEs employ less than 100

Table 1. Summary of main definitions of SMEs^a in ASEAN-5

Country	Size Definition	Measure
China	Less than 100 employees (varies per industry)	Employment
Indonesia	Less than 100 employees	Employment
Malaysia	^b RM 2.5 million and below Less than 75 employees	Shareholders' funds Employment
Philippines	^c PHP 100,000,000 and below Less than 200 employees	Asset Employment
Singapore	^d SGD 12,000,000 and below fixed assets for manufacturing Less than 100 employees for services	Fixed assets Employment
Thailand	^e B 100 million and below for capital-intensive firms Less than 200 employees for labor-intensive firms	Capital Employment

Source: Hall (n.d.), Table 1

^aSMEs = small and medium enterprises

^bRM = ringgit

^cPHP = Philippine peso

^dSGD = Singapore dollar

^eB = baht

people. This permits broad comparisons across economies despite internal differences among them.

The Philippines employs two criteria in operationally defining SMEs, namely, employment or asset size. Table 2 presents the criteria for size categories of Philippine firms. The employment-based definition has come to be the most widely accepted. Initially, enterprises with 1-99 employees were categorized as small, while enterprises with 100-199 employees were categorized as medium. This was subsequently modified such that small enterprises included those with 1-49 employees, medium covered those with 50-99 employees and large enterprises are those with 100 or more employees. Production units with 1-9 workers are collectively referred to as *household industry* or microenterprises, and fall outside the SME designation. Thus, the recognized size categories for the Philippines are as follows: micro, 1-9 employees; small, 10-99 employees; medium, 100-199 employees; and large, 200 and over employees.

Although definitions based on asset size are not as commonly employed as definitions based on employment, the Philippines also utilizes the value of assets as a criterion of size (Table 2). However, using asset size as a criterion for size classification may have a serious drawback in that continual adjustment

Table 2. SME^a definition by employment and by asset size

Size	By Employment	By Asset Size
Micro	1-9 employees	Up to P 3,000,000
Small	10-99 employees	PHP 3,000,001–PHP 15,000,001
Medium	100-199 employees	PHP 15,000,001–PHP 100,000,000
Large	200 and above employees	PHP 100,000,001 and above

Source of data: NSO and Small and Medium Enterprise Development Council (SMEDC) Resolution No. 1, Series 2003

^aSME = Small and Medium Enterprise

of the definition may be necessary because of changes in the price level. In addition, comparison across economies may not be appropriate or would be questionable at best if asset values would be converted into a common currency, for example, in US dollars (Tecson, Valcarcel, & Nunez 1990).

This study employs the two definitions. Although it follows the asset-based official definition as approved by the Small and Medium Enterprise Development Council (SMEDC) Resolution No. 1, Series of 2003, statistics gathered from the NSO utilized the employment criterion. This criterion appears more practical for the purposes of this study as it lends itself readily to international comparisons.

Overview of Philippine and Japanese SMEs

SMEs in the Philippines

Number of establishments

The period 2000-2002 was marked with economic difficulties, not just domestically but also internationally. This perhaps could have been one reason for the decline in the total number of Philippine establishments during the period. In 2000, the total number of establishments was 820,960. This number decreased to 809,271 in 2002. This decline represented a 0.71 percent decrease in terms of compound growth from the earlier period (Tables 3 and 5). Furthermore, Table 4 reveals that microenterprises dominated Philippine establishments with shares of 91 percent in 2000 and 92 percent in 2002. Small enterprises followed with 7 percent– 8 percent share. The share of each enterprise to the total marginally decreased during this period, except for microenterprises. Although the tables do not present the latter half of the 1990s, the 2000-2002 situation was similar to the situation in the latter half of

Table 3. Number of establishments, by size category and industry, 2000 and 2002

	Total	Micro	Small	Medium	Large
Philippines (2000)	820,960	747,740	67,166	3,070	2,984
Agriculture, Hunting, and Forestry	3,391	1,611	1,527	127	126
Fishery	1,252	523	688	18	23
Mining and Quarrying	376	239	112	12	13
Manufacturing	125,467	108,998	14,121	1,110	1,238
Electricity, Gas, and Water	1,318	660	480	90	88
Construction	3,154	1,724	1,225	93	112
Wholesale and Retail Trade	437,325	416,519	20,038	438	330
Hotels And Restaurants	89,472	81,879	7,377	152	64
Transport, Storage and Communication	15,267	11,302	3,622	168	175
Financial Intermediation	24,118	18,129	5,801	82	106
Real Estate, Renting and Business Services	40,477	35,483	4,348	291	355
Education	9,675	5,127	4,032	306	210
Health and Social Work	28,414	26,795	1,412	116	91
Other Community, Social and Personal Services	41,254	38,751	2,383	67	53
Philippines (2002)	809,271	743,424	60,485	2,716	2,646
Agriculture, Hunting, and Forestry	3,005	1,423	1,365	101	116
Fishery	1,125	489	591	20	25
Mining and Quarrying	327	208	95	9	15
Manufacturing	122,962	108,790	12,250	906	1,016
Electricity, Gas, and Water	1,151	477	483	98	93
Construction	2,626	1,486	957	86	97
Wholesale and Retail Trade	34,228	415,419	18,156	383	270
Hotels and Restaurants	88,601	81,585	6,822	138	56
Transport, Storage and Communication	4,141	10,681	3,141	163	156
Financial Intermediation	24,139	18,481	5,491	75	92
Real Estate, Renting, and Business Services	38,856	34,446	3,808	271	331
Education	9,299	4,938	3,836	298	227
Health and Social Work	28,191	26,701	1,285	110	95
Other Community, Social, and Personal Services	40,620	38,300	2,205	58	57

Source of basic data: NSO List of Establishments, 2000 and 2002

Table 4. Share of establishments to total, by size category and industry, 2000 and 2002

	% to Total Establishments	% to Total Micro	% to Total Small	% to Total Medium	% to Total Large
Philippines (2000)	100.00	91.08	8.18	0.37	0.36
Agriculture, Hunting, and Forestry	0.41	0.22	2.27	4.14	4.22
Fishery	0.15	0.07	1.02	0.59	0.77
Mining and Quarrying	0.05	0.03	0.17	0.39	0.44
Manufacturing	15.28	14.58	21.02	36.16	41.49
Electricity, Gas, and Water	0.16	0.09	0.71	2.93	2.95
Construction	0.38	0.23	1.82	3.03	3.75
Wholesale and Retail Trade	53.27	55.70	29.83	14.27	11.06
Hotels and Restaurants	10.90	10.95	10.98	4.95	2.14
Transport, Storage and Communication	1.86	1.51	5.39	5.47	5.86
Financial Intermediation	2.94	2.42	8.64	2.67	3.55
Real Estate, Renting, and Business Services	4.93	4.75	6.47	9.48	11.90
Education	1.18	0.69	6.00	9.97	7.04
Health and Social Work	3.46	3.58	2.10	3.78	3.05
Other Community, Social, and Personal Services	5.03	5.18	3.55	2.18	1.78
Philippines (2002)	100.00	91.86	7.47	0.34	0.33
Agriculture, Hunting, and Forestry	0.37	0.19	2.26	3.72	4.38
Fishery	0.14	0.07	0.98	0.74	0.94
Mining and Quarrying	0.04	0.03	0.16	0.33	0.57
Manufacturing	15.19	14.63	20.25	33.36	38.40
Electricity, Gas, and Water	0.14	0.06	0.80	3.61	3.51
Construction	0.32	0.20	1.58	3.17	3.67
Wholesale and Retail Trade	53.66	55.88	30.02	14.10	10.20
Hotels and Restaurants	10.95	10.97	11.28	5.08	2.12
Transport, Storage, and Communication	1.75	1.44	5.19	6.00	5.90
Financial Intermediation	2.98	2.49	9.08	2.76	3.48
Real Estate, Renting, and Business Services	4.80	4.63	6.30	9.98	12.51
Education	1.15	0.66	6.34	10.97	8.58
Health and Social Work	3.48	3.59	2.12	4.05	3.59
Other Community, Social, and Personal Services	5.02	5.15	3.65	2.14	2.15

Source of basic data: NSO List of Establishments, 2000 and 2002

Table 5. Growth of establishments, by size category and industry, 2000 and 2002

	Total	Micro	Small	Medium	Large
Philippines	-0.71	-0.29	-5.10	-5.94	-5.83
Agriculture, Hunting, and Forestry	-5.86	-6.02	-5.45	-10.82	-4.05
Fishery	-5.21	-3.31	-7.32	5.41	4.26
Mining and Quarrying	-6.74	-6.71	-7.90	-13.40	7.42
Manufacturing	-1.00	-0.10	-6.86	-9.66	-9.41
Electricity, Gas, and Water	-6.55	-14.99	0.31	4.35	2.80
Construction	-8.75	-7.16	-11.61	-3.84	-6.94
Wholesale and Retail Trade	-0.35	-0.13	-4.81	-6.49	-9.55
Hotels and Restaurants	-0.49	-0.18	-3.84	-4.72	-6.46
Transport, Storage, and Communication	-3.76	-2.79	-6.88	-1.50	-5.58
Financial Intermediation	0.04	0.97	-2.71	-4.36	-6.84
Real Estate, Renting, and Business Services	-2.02	-1.47	-6.42	-3.50	-3.44
Education	-1.96	-1.86	-2.46	-1.32	3.97
Health and Social Work	-0.39	-0.18	-4.60	-2.62	2.17
Other Community, Social, and Personal Services	-0.77	-0.58	-3.81	-6.96	3.70

Source of basic data: NSO List of Establishments, 2000 and 2002

the 1990s in that small, medium, and large enterprises had been on the decline and microenterprises had been consistently, although marginally, increasing.² If one were to consider the total number of establishments for microenterprises and SMEs, it would account for 98–99 percent of the total, on average, during the period.

Most of the Philippine establishments during the period were into wholesale and retail trade (53%–54%) and manufacturing (a little over 15%). This accounted for nearly 70 percent of total Philippine establishments during the period. This period was marked by dominance of microenterprises. In addition, these two sectors accounted for about 70 percent of the total microenterprises during the period—55 percent for wholesale and retail trade and 15 percent for manufacturing (Table 4). The dominance of these two sectors was apparent in the other size categories. Moreover, as the size increases, the share of manufacturing to the total for each size category also

² See JICA and DTI (2003).

increases. This suggests that the manufacturing sector was dominant in the large-size category.

Philippine establishments during this period experienced a general decline in number. As pointed out above, this could be ascribed to the general economic condition during this time. Although the decline seems marginal at 0.17 percent, this, however, would translate into lower employment and lower output that would have been otherwise produced. Small, medium, and large enterprises had significant declines at about 5–6 percent, while microenterprises had a 0.29 percent decline. Moreover, almost all sectors experienced a decline in terms of growth during this period, except for financial intermediation. However, the growth in financial intermediation was largely ascribed to the growth of this sector in the micro-size category, as this sector had increasingly negative growths given the other size categories. The largest declines were experienced by construction (8.75%); followed by mining and quarrying (6.74%); and electricity, gas, and water (6.55%). The wholesale and retail trade and manufacturing sectors had the smallest decline in terms of growth at 0.35 percent and 1 percent, respectively.

Number of employees

The general although gradually declining trend presented above is again obvious if one were to take a look at employment in the size categories. Total employment in 2000 and 2002 declined by 4.37 percent—from 5,902,186 in 2000 to 5,397,521 in 2002 (Tables 6 and 8).

In terms of size categories, micro, small and medium enterprises' collective share to total employment was an average of about 70 percent of the total with micro, small, and large enterprises accounting for an average of 93–94 percent of total employment, while medium enterprises only accounted for 6–7 percent on average during the period. Employees of microenterprises accounted for the largest share to total employment during the period, averaging 38 percent of the total. Shares, particularly in 2000, reveal strong contributions from micro and large enterprises, where micro had 36.68 percent, small had 25.79 percent, and large had 30.47 percent. The share of microenterprises to total employment in 2002 increased to 39.84 percent of total. The rest of the size categories, however, experienced declines in shares in total employment, which were not altogether significant (Table 7).

Table 6. Number of employees, by size category and industry, 2000 and 2002

	Total	Micro	Small	Medium	Large
Philippines (2000)	5,902,186	2,165,100	1,522,227	416,686	1,798,173
Agriculture, Hunting, and Forestry	137,340	6,478	38,724	16,986	75,152
Fishery	31,185	2,227	14,346	2,248	12,364
Mining and Quarrying	17,328	1,209	2,972	1,568	11,579
Manufacturing	1,589,214	354,025	354,328	150,734	730,127
Electricity, Gas, and Water	80,595	2,746	14,451	12,850	50,548
Construction	161,487	7,602	33,429	12,863	107,593
Wholesale and Retail Trade	1,785,811	1,110,683	403,033	58,671	213,424
Hotels and Restaurants	485,098	267,731	167,152	19,173	31,042
Transport, Storage, and Communication	301,035	42,105	85,209	22,641	151,080
Financial Intermediation	262,165	75,325	106,606	11,013	69,221
Real Estate, Renting, and Business Services	430,884	106,399	107,146	40,866	176,473
Education	272,202	21,469	109,216	41,983	99,534
Health and Social Work	158,341	60,243	36,597	15,761	45,740
Other Community, Social, and Personal Services	189,501	106,858	49,018	9,329	24,296
Philippines (2002)	5,397,521	2,150,384	1,307,410	370,534	1,569,193
Agriculture, Hunting, and Forestry	126,937	5,864	33,833	13,759	73,481
Fishery	29,026	2,065	11,404	2,569	12,988
Mining and Quarrying	19,518	984	2,963	1,347	14,224
Manufacturing	1,410,777	352,736	295,031	124,921	638,089
Electricity, Gas, and Water	76,023	2,124	14,500	13,991	45,408
Construction	136,090	6,642	23,784	11,509	94,155
Wholesale and Retail Trade	1,614,058	1,107,447	337,959	51,917	116,735
Hotels and Restaurants	465,591	266,901	148,083	17,945	32,662
Transport, Storage, and Communication	280,525	39,588	73,067	21,690	146,180
Financial Intermediation	249,077	77,099	97,283	10,160	64,535
Real Estate, Renting, and Business Services	380,914	102,982	88,043	37,299	152,590
Education	269,563	20,765	103,959	40,176	04,663
Health and Social Work	154,837	60,058	33,125	15,165	46,489
Other Community, Social, and Personal Services	184,585	105,129	44,376	8,086	26,994

Source of basic data: NSO List of Establishments, 2000 and 2002

Table 7. Share of employment to total, by size category and industry, 2000 and 2002

	% to Total Establish- ments	% to Total Micro	% to Total Small	% to Total Medium	% to Total Large
Philippines (2000)	100.00	36.68	25.79	7.06	30.47
Agriculture, Hunting, and Forestry	2.33	0.30	2.54	4.08	4.18
Fishery	0.53	0.10	0.94	0.54	0.69
Mining and Quarrying	0.29	0.06	0.20	0.38	0.64
Manufacturing	26.93	16.35	23.28	36.17	40.60
Electricity, Gas, and Water	1.37	0.13	0.95	3.08	2.81
Construction	2.74	0.35	2.20	3.09	5.98
Wholesale and Retail Trade	30.26	51.30	26.48	14.08	11.87
Hotels and Restaurants	8.22	12.37	10.98	4.60	1.73
Transport, Storage, and Communication	5.10	1.94	5.60	5.43	8.40
Financial Intermediation	4.44	3.48	7.00	2.64	3.85
Real Estate, Renting, and Business Services	7.30	4.91	7.04	9.81	9.81
Education	4.61	0.99	7.17	10.08	5.54
Health and Social Work	2.68	2.78	2.40	3.78	2.54
Other Community, Social, and Personal Services	3.21	4.94	3.22	2.24	1.35
Philippines (2002)	100.00	39.84	24.22	6.86	29.07
Agriculture, Hunting, and Forestry	2.35	0.27	2.59	3.71	4.68
Fishery	0.54	0.10	0.87	0.69	0.83
Mining and Quarrying	0.36	0.05	0.23	0.36	0.91
Manufacturing	26.14	16.40	22.57	33.71	40.66
Electricity, Gas, and Water	1.41	0.10	1.11	3.78	2.89
Construction	2.52	0.31	1.82	3.11	6.00
Wholesale and Retail Trade	29.90	51.50	25.85	14.01	7.44
Hotels and Restaurants	8.63	12.41	11.33	4.84	2.08
Transport, Storage, and Communication	5.20	1.84	5.59	5.85	9.32
Financial Intermediation	4.61	3.59	7.44	2.74	4.11
Real Estate, Renting, and Business Services	7.06	4.79	6.73	10.07	9.72
Education	4.99	0.97	7.95	10.84	6.67
Health and Social Work	2.87	2.79	2.53	4.09	2.96
Other Community, Social, and Personal Services	3.42	4.89	3.39	2.18	1.72

Source of basic data: NSO List of Establishments, 2000 and 2002

Table 8. Growth rate of the number of employees, by size category and industry, 2000 and 2002

	Total	Micro	Small	Medium	Large
Philippines (2002)	-4.37	-0.34	-7.32	-5.70	-6.58
Agriculture, Hunting, and Forestry	-3.86	-4.86	-6.53	-10.00	-1.12
Fishery	-3.52	-3.71	-10.84	6.90	2.49
Mining and Quarrying	6.13	-9.78	-0.15	-7.31	10.83
Manufacturing	-5.78	-0.18	-8.75	-8.96	-6.52
Electricity, Gas, and Water	-2.88	-12.05	0.17	4.35	-5.22
Construction	-8.20	-6.53	-15.65	-5.41	-6.45
Wholesale and Retail Trade	-4.93	-0.15	-8.43	-5.93	-26.04
Hotels and Restaurants	-2.03	-0.16	-5.88	-3.26	2.58
Transport, Storage, and Communication	-3.47	-3.04	-7.40	-2.12	-1.64
Financial Intermediation	-2.53	1.17	-4.47	-3.95	-3.44
Real Estate, Renting, and Business Services	-5.98	-1.62	-9.35	-4.46	-7.01
Education	-0.49	-1.65	-2.44	-2.18	2.54
Health and Social Work	-1.11	-0.15	-4.86	-1.91	0.82
Other Community, Social, and Personal Services	-1.31	-0.81	-4.85	-6.90	5.41

Source of basic data: NSO List of Establishments, 2000 and 2002

Table 8 reveals that total employment decreased by 4.37 percent from 2000 to 2002. Size categories that contributed largely to this decline in employment were small (7.32%), medium (5.70%) and large (6.58%) enterprises. Almost all sectors experienced declines in employment except for mining and quarrying. In terms of size categories, the largest declines in microenterprises came from electricity and water (12.05%), mining and quarrying (9.78%), construction (6.53%) and agriculture (4.86 %). Meanwhile the largest declines in the small enterprises category were from fishery (10.84%), real estate and others (9.35%), manufacturing (8.75%), wholesale and retail trade (8.43%), transport storage and communication (7.40%), and agriculture (6.53%). For medium-sized firms, they were from agriculture (10%), manufacturing (8.96%), mining and quarrying (7.31%), other community and others (6.90%), wholesale and retail trade (5.93%), and construction (5.41%). For large enterprises, the significant declines were from wholesale and retail trade (26.04%), real estate (7.01%), manufacturing (6.52%), construction (6.45%), and electricity, gas, and water (5.22%).

Geographical distribution

Looking at the geographical distribution of Philippine establishments, a little over 50 percent of all establishments were found in Luzon, distributed as follows: National Capital Region or NCR (24.43%), Southern Tagalog (17.79%), and Central Luzon (10.78%) in 2000. This trend was seen again in 2002 as the three regions had over 52 percent share of the total, with the NCR at 24.10 percent, Southern Tagalog at 17.64 percent, and Central Luzon at 10.97 percent (Tables 9 and 10). Considering this short period, one can say that about one-fourth of all total establishments were found in the NCR, and that Philippine establishments were concentrated in very few provinces.

This regional concentration is evident, looking at the shares with respect to size categories. The NCR, Southern Tagalog, and Central Luzon had the highest contributions considering the size classifications. However, for large enterprises, Central Visayas's share to total large enterprises was on the average about 7-8 percent during the period, surpassing that of Central Luzon's. Table 10 reveals that on the expansion in the total number of establishments per size category, NCR contributed 22 percent of total microenterprises and 48-50 percent of large enterprises. One can therefore say that large enterprises were highly concentrated in the NCR during the period.

The general decline in the total number of establishments was evident in the negative growth rates in Table 10. Almost all regional establishments categorized by size experienced negative growths, except for Northern Mindanao, SOCCSKSARGEN¹ and the Autonomous Region for Muslim Mindanao (ARMM). The most significant growth in the number of regional establishments across size categories was experienced by ARMM where microenterprises grew by 39.48 percent, small by 65.45 percent, medium by 52.75 percent, and large by 45.77 percent.

Regional employment follows the pattern of regional distribution of establishments. Looking at Tables 11 and 12, employment was again concentrated in three regions, namely the NCR (40.06%), Southern Tagalog (15.68%), and Central Luzon (8.28%). Collectively, these regions accounted for about two-thirds of total employment. This trend is maintained in 2002 with marginal increases and decreases. Thus, these tables reveal that regional employment is largely concentrated in the NCR with an average of about 40 percent during this period.

In terms of size categories, the general trend was that microenterprises largely contributed to total employment at 36.68 percent, followed by large enterprises (30.47%), small (25.79%), and medium (7.06%). Noticeable in 2002 was the increase in microenterprise's contribution to total employment at 39.84 percent, while the rest of the size categories experienced decreases.

Table 9. Number of establishments, by size category and region, 2000 and 2002

	Total	Micro	Small	Medium	Large
Philippines (2000)	820,960	747,740	67,166	3,070	2,984
Ilocos Region	48,584	46,267	2,232	54	31
Cagayan Valley	25,163	24,185	934	21	23
Central Luzon	88,536	82,369	5,759	222	186
Southern Tagalog	146,076	136,392	8,680	500	504
Bicol Region	31,179	29,540	1,547	54	38
Western Visayas	46,346	42,878	3,200	153	115
Central Visayas	49,759	44,674	4,632	221	232
Eastern Visayas	21,399	20,096	1,225	49	29
Zamboanga Peninsula	28,783	27,178	1,515	50	40
Northern Mindanao	27,989	25,901	1,964	69	55
Davao Region	48,335	44,615	3,418	140	162
Soccsksargen ¹⁾	21,990	20,997	934	36	23
National Capital Region (NCR)	200,544	168,167	29,449	1,440	1,488
Cordillera Administrative Region (CAR)	14,565	13,799	722	24	20
Autonomous Region of Muslim Mindanao (ARMM)	5,516	5,339	160	9	8
C A R A G A	16,196	15,343	795	28	30
Philippines (2002)	1,401,708	1,291,221	101,679	4,512	4,296
Ilocos Region	48,398	46,123	2,191	54	30
Cagayan Valley	25,103	24,142	918	21	22
Central Luzon	87,873	82,004	5,473	216	180
Southern Tagalog	145,479	136,175	8,310	492	502
Bicol Region	79,687	75,753	3,758	107	69
Western Visayas	71,145	66,956	3,952	125	112
Central Visayas	137,985	126,978	10,177	429	401
Eastern Visayas	167,369	156,407	9,882	548	532
Zamboanga Peninsula	59,869	56,666	3,034	100	69
Northern Mindanao	74,130	68,675	5,079	211	165
Davao Region	97,635	89,108	7,852	332	343
Soccsksargen ^a	43,315	41,032	2,149	84	50
National Capital Region (NCR)	229,243	195,294	30,932	1,489	1,528
Cordillera Administrative Region (CAR)	42,522	39,674	2,680	93	75
Autonomous Region of Muslim Mindanao (ARMM)	53,820	49,928	3,574	149	169
C A R A G A	38,135	36,306	1,718	62	49

Source of basic data: NSO List of Establishments, 2000 and 2002

^aSOCCSKSARGEN = South Cotabato, Cotabato, Sultan Kudarat, Sarangani and General Santos City.

Table 10. Share of establishments to total, by size category and region, 2000 and 2002

	% to Total Establishment	% to Total Micro	% to Total Small	% to Total Medium	% to Total Large
Philippines (2000)	100.00	91.08	8.18	0.37	0.36
Ilocos Region	5.92	6.19	3.32	1.76	1.04
Cagayan Valley	3.07	3.23	1.39	0.68	0.77
Central Luzon	10.78	11.02	8.57	7.23	6.23
Southern Tagalog	17.79	18.24	12.92	16.29	16.89
Bicol Region	3.80	3.95	2.30	1.76	1.27
Western Visayas	5.65	5.73	4.76	4.98	3.85
Central Visayas	6.06	5.97	6.90	7.20	7.77
Eastern Visayas	2.61	2.69	1.82	1.60	0.97
Zamboanga Peninsula	3.51	3.63	2.26	1.63	1.34
Northern Mindanao	3.41	3.46	2.92	2.25	1.84
Davao Region	5.89	5.97	5.09	4.56	5.43
Soccsksargen	2.68	2.81	1.39	1.17	0.77
National Capital Region (NCR)	24.43	22.49	43.85	46.91	49.87
Cordillera Administrative Region (CAR)	1.77	1.85	1.07	0.78	0.67
Autonomous Region of Muslim Mindanao (ARMM)	0.67	0.71	0.24	0.29	0.27
C A R A G A	1.97	2.05	1.18	0.91	1.01
Philippines (2002)	100.00	92.12	7.25	0.32	0.31
Ilocos Region	5.95	6.18	3.41	2.14	1.44
Cagayan Valley	3.08	3.23	1.50	0.70	0.76
Central Luzon	10.97	11.21	8.39	6.77	6.08
Southern Tagalog	17.64	18.03	13.06	14.40	16.33
Bicol Region	3.82	3.94	2.45	1.99	1.47
Western Visayas	5.65	5.71	4.98	5.49	3.82
Central Visayas	6.06	5.98	6.90	7.70	8.43
Eastern Visayas	2.61	2.68	1.78	1.55	0.98
Zamboanga Peninsula	3.29	3.41	2.04	1.51	1.36
Northern Mindanao	4.08	4.14	3.49	3.09	2.23
Davao Region	4.42	4.41	4.53	4.34	4.88
Soccsksargen	3.26	3.39	1.87	1.33	1.59
National Capital Region (NCR)	24.10	22.43	42.49	46.58	48.41
Cordillera Administrative Region (CAR)	1.76	1.81	1.14	0.81	0.72
Autonomous Region of Muslim Mindanao (ARMM)	1.34	1.40	0.72	0.77	0.64
C A R A G A	1.97	2.03	1.25	0.85	0.87

Source of basic data: NSO List of Establishments, 2000 and 2002

Table 11. Growth of establishments, by size category and region, 2000 and 2002

	Total	Micro	Small	Medium	Large
Philippines	-0.71	-0.29	-5.10	-5.94	-5.83
Ilocos Region	-0.46	-0.32	-3.86	3.64	10.72
Cagayan Valley	-0.47	-0.42	-1.40	-4.88	-6.75
Central Luzon	0.12	0.58	-6.12	-8.96	-6.96
Southern Tagalog	-1.13	-0.86	-4.60	-11.57	-7.42
Bicol Region	-0.47	-0.38	-2.19	0.00	1.31
Western Visayas	-0.66	-0.47	-2.97	-1.32	-6.28
Central Visayas	-0.70	-0.24	-5.11	-2.75	-1.96
Eastern Visayas	-0.69	-0.35	-6.15	-7.42	-5.31
Zamboanga Peninsula	-3.80	-3.47	-9.79	-9.45	-5.13
Northern Mindanao	8.66	9.04	3.60	10.34	3.57
Davao Region	-13.93	-14.23	-10.47	-8.19	-10.76
SOCCSKSARGEN	9.58	9.54	10.14	0.00	35.13
National Capital Region (NCR)	-1.39	-0.42	-6.58	-6.27	-7.22
Cordillera Administrative Region (CAR)	-1.20	-1.13	-2.45	-4.26	-2.53
Autonomous Region of Muslim Mindanao (ARMM)	40.33	39.48	65.45	52.75	45.77
C A R A G A	-0.85	-0.72	-2.61	-9.37	-12.44

Source of basic data: NSO List of Establishments, 2000 and 2002

The growth of regional establishments had been altogether dismal during the period. The fastest growing regions during the period were ARMM (40.33%) and Northern Mindanao (8.66%). Another region that posted positive growth, albeit insignificant, was Central Luzon (0.12%). The rest of the provinces experienced negative growth during the period. The growth experiences were consistent with the general outcome on the number of establishments during the period (Table 11).

In terms of geographical distribution of employment, Tables 12, 13, and 14 revealed consistent findings as above. The largest contribution of regional employment to total was in the micro category at an average of 37 percent during the period. This was followed by large, small, and medium categories at an average of 29 percent, 25 percent, and 7 percent, respectively, during the period. Regionally, the NCR (40.06%), Southern Tagalog (15.68%), and Central Luzon (8.28%) had the three highest contributions to total employment. The trends were consistent across size categories. It was evident that the NCR

Table 12. Number of employees, by size category and region, 2000 and 2002

	Total	Micro	Small	Medium	Large
Philippines (2000)	5,902,186	2,165,100	1,522,227	416,686	1,798,173
Ilocos Region	183,467	120,615	44,654	7,424	10,774
Cagayan Valley	97,260	67,780	18,884	2,785	7,811
Central Luzon	488,644	234,451	122,236	30,675	101,282
Southern Tagalog	925,625	370,807	191,900	68,778	294,140
Bicol Region	144,305	83,698	32,491	7,116	21,000
Western Visayas	267,696	124,820	70,517	20,907	51,452
Central Visayas	400,483	129,075	108,931	30,364	132,113
Eastern Visayas	102,586	58,828	25,955	6,463	11,340
Zamboanga Peninsula	126,697	71,077	33,635	6,754	15,231
Northern Mindanao	156,947	72,598	41,528	9,497	33,324
Davao Region	326,376	129,867	74,909	18,670	102,930
SOCCKSARGEN	148,095	56,736	19,645	5,032	66,682
National Capital Region (NCR)	2,364,533	549,796	703,159	193,801	917,777
Cordillera Administrative Region (CAR)	69,509	36,297	15,131	3,235	14,846
Autonomous Region Of Muslim Mindanao (ARMM)	25,100	16,473	3,177	1,172	4,278
C A R A G A	74,863	42,182	15,475	4,013	13,193
Philippines (2002)	5,397,521	2,150,384	1,307,410	370,534	1,569,193
Ilocos Region	180,934	119,591	39,405	7,691	14,247
Cagayan Valley	94,057	66,953	17,676	2,568	6,860
Central Luzon	449,486	235,931	102,135	24,836	86,584
Southern Tagalog	865,611	364,692	167,811	54,327	278,781
Bicol Region	131,985	82,710	29,848	7,214	12,213
Western Visayas	258,480	123,395	64,159	20,807	50,119
Central Visayas	380,089	128,505	92,696	28,380	130,508
Eastern Visayas	94,621	58,475	21,079	5,581	9,486
Zamboanga Peninsula	111,682	65,841	25,731	5,595	14,515
Northern Mindanao	174,425	86,743	42,709	11,802	33,171
Davao Region	235,905	94,776	58,092	15,937	67,100
SOCCKSARGEN	126,423	70,599	24,492	5,143	26,189
National Capital Region (NCR)	2,105,159	544,389	583,971	171,525	805,274
Cordillera Administrative Region (CAR)	66,378	35,270	13,711	2,920	14,477
Autonomous Region of Muslim Mindanao (ARMM)	53,216	31,165	9,104	2,816	10,131
C A R A G A	69,070	41,349	14,791	3,392	9,538

Source of basic data: NSO List of Establishments, 2000 and 2002

Table 13. Shares of employment to total, by size category and region, 2000 and 2002 (in %)

	Total	Micro	Small	Medium	Large
Philippines (2000)	100.00	36.68	25.79	7.06	30.47
Ilocos Region	3.11	5.57	2.93	1.78	0.60
Cagayan Valley	1.65	3.13	1.24	0.67	0.43
Central Luzon	8.28	10.83	8.03	7.36	5.63
Southern Tagalog	15.68	17.13	12.61	16.51	16.36
Bicol Region	2.44	3.87	2.13	1.71	1.17
Western Visayas	4.54	5.77	4.63	5.02	2.86
Central Visayas	6.79	5.96	7.16	7.29	7.35
Eastern Visayas	1.74	2.72	1.71	1.55	0.63
Zamboanga Peninsula	2.15	3.28	2.21	1.62	0.85
Northern Mindanao	2.66	3.35	2.73	2.28	1.85
Davao Region	5.53	6.00	4.92	4.48	5.72
SOCCSKSARGEN	2.51	2.62	1.29	1.21	3.71
National Capital Region (NCR)	40.06	25.39	46.19	46.51	51.04
Cordillera Administrative Region (CAR)	1.18	1.68	0.99	0.78	0.83
Autonomous Region Of Muslim Mindanao (ARMM)	0.43	0.76	0.21	0.28	0.24
C A R A G A	1.27	1.95	1.02	0.96	0.73
Philippines (2002)	100.00	39.84	24.22	6.86	29.07
Ilocos Region	3.35	5.56	3.01	2.08	0.91
Cagayan Valley	1.74	3.11	1.35	0.69	0.44
Central Luzon	8.33	10.97	7.81	6.70	5.52
Southern Tagalog	16.04	16.96	12.84	14.66	17.77
Bicol Region	2.45	3.85	2.28	1.95	0.78
Western Visayas	4.79	5.74	4.91	5.62	3.19
Central Visayas	7.04	5.98	7.09	7.66	8.32
Eastern Visayas	1.75	2.72	1.61	1.51	0.60
Zamboanga Peninsula	2.07	3.06	1.97	1.51	0.92
Northern Mindanao	3.23	4.03	3.27	3.19	2.11
Davao Region	4.37	4.41	4.44	4.30	4.28
SOCCSKSARGEN	2.34	3.28	1.87	1.39	1.67
National Capital Region (NCR)	39.00	25.32	44.67	46.29	51.32
Cordillera Administrative Region (CAR)	1.23	1.64	1.05	0.79	0.92
Autonomous Region Of Muslim Mindanao (ARMM)	0.99	1.45	0.70	0.76	0.65
C A R A G A	1.28	1.92	1.13	0.92	0.61

Source of basic data: NSO List of Establishments, 2000 and 2002

Table 14. Growth of employment, by size category and region, between 2000 and 2002

	Total	Micro	Small	Medium	Large
Philippines	-4.37	-0.34	-7.32	-5.70	-6.58
Ilocos Region	-0.69	-0.43	-6.06	1.78	14.99
Cagayan Valley	-1.66	-0.61	-3.25	-3.97	-6.29
Central Luzon	-4.09	0.32	-8.59	-10.02	-7.54
Southern Tagalog	-3.30	-0.83	-6.49	-11.12	-2.65
Bicol Region	-4.36	-0.59	-4.15	0.69	-23.74
Western Visayas	-1.74	-0.57	-4.61	-0.24	-1.30
Central Visayas	-2.58	-0.22	-7.75	-3.32	-0.61
Eastern Visayas	-3.96	-0.30	-9.88	-7.07	-8.54
Zamboanga Peninsula	-6.11	-3.75	-12.54	-8.98	-2.38
Northern Mindanao	5.42	9.31	1.41	11.48	-0.23
Davao Region	-14.98	-14.57	-11.94	-7.61	-19.26
SOCCSKSARGEN	-7.61	11.55	11.66	1.10	-37.33
National Capital Region (NCR)	-5.64	-0.49	-8.87	-5.92	-6.33
Cordillera Administrative Region (CAR)	-2.28	-1.42	-4.81	-4.99	-1.25
Autonomous Region Of Muslim Mindanao (ARMM)	45.61	37.55	69.28	55.01	53.89
C A R A G A	-3.95	-0.99	-2.23	-8.06	-14.97

Source of basic data: NSO List of Establishments, 2000 and 2002

employment shares had been increasing during the period as the size category increases, while Southern Tagalog and Central Luzon had decreasing shares.

In terms of regional employment growth, only ARMM and Northern Mindanao posted positive growth rates at 46 percent and 5 percent, respectively. The rest of the provinces generally experienced negative growths, an outcome that was consistent with the rest of the size categories.

Value-Added

Table 15 shows the trends in value added by SMEs and their sales during selected years. It indicates the growing share of SMEs in both value-added and sales. SMEs had experienced increasing shares to total value added. Although the growth rates considering all size categories were significant at 23 percent for micro, 22 percent for small, 21 percent for medium, and 17 percent for large, the contributions of micro, small, and medium to total value added and

Table 15. Value added by Small and Medium Enterprises (SMEs)

	Total	Micro	% to Total	Small	% to Total	Medium	% to Total	Large	% to Total
Census Value Added									
1983	56,759,640	1,380,737	2.43	5,891,394	10.38	4,686,981	8.26	44,800,528	78.93
1993	310,160,818	11,013,169	3.55	44,753,813	14.43	31,283,060	10.09	223,110,776	71.93
1998	685,423,941	16,085,861	2.35	669,338,080	97.65				
<i>Average Growth Rate</i>									
1983-1993		23.078		22.479		20.904		17.415	
1993-1998		7.87		71.78					
Sales									
1983	162,950,965	1,859,281	1.14	20,369,727	12.50	13,629,635	8.36	127,092,322	77.99
1993	722,202,340	24,706,966	3.42	27,824,199	3.85	79,005,681	10.94	590,665,494	81.79
1998	1,673,254,261	31,671,529	1.89	1,641,582,732	98.11				
<i>Average Growth Rate</i>									
1983-1993		29.52		3.17		19.21		16.61	
1993-1998		5.09		126.03					

Source of basic data: National Statistics Census of Establishments, various issues

total sales were not as significant as that of large enterprises. Alone, large enterprises accounted for about three-fourths of the total value added on average and 78 percent of total sales during 1983-1993. The rest of the size categories contributed to the remaining balance.

For the 1993-1998 period, the contribution of microenterprises to total value added was 2.35 percent. This was lower than the shares in 1983 and 1993. The table also reveals that the combined value added of small, medium, and large enterprises in 1998 was 98 percent. This was also the case in total sales.

Export orientation

The manufacturing sector had the largest contribution to total exports for many years. Furthermore, this sector had the largest share in terms of census value added. There is not much change to the general trend with respect to the importance of the manufacturing sector in export orientation and census value added. The manufacturing sector continues to have the highest contribution to total exports and census value added.

Most of the data on export orientation and census value added that one encounters are rather aggregative. Tecson (1999) presented a special tabulation from the NSO, which detailed export orientation of the three-digit classification under the manufacturing sector. The special tabulation was culled from the NSO's Census of Establishments, which was undertaken in 1994. The data (Table 16) revealed that the following subsectors had highest export-to-output ratio³:

- 1) professional and scientific equipment (70.61%),
- 2) non-ferrous metal (68.97%),
- 3) electrical machinery (64.54%),
- 4) furniture, metals (56.70%), and
- 5) machinery, excluding electrical (53.25%).

Table 17 reveals that 53 percent of the manufacturing sector originated from enterprises without any foreign ownership. These wholly domestic enterprises exported 34 percent of total manufacturing exports, while enterprises with foreign equity accounted for 66 percent of total manufacturing exports. Among wholly domestic enterprises, 64 percent of manufacturing output and 44 percent of manufacturing exports originated from SMEs. On the other hand, among manufacturing sector firms with foreign ownership, 34 percent of total output and 66 percent of manufacturing exports were produced by SMEs. The data imply that a rather important segment of SMEs in the manufacturing

³ A high direct-exports-to-output ratio means that the subsector is export-oriented

Table 16. SME's^a export orientation, 1994

PSIC ^b	Industry Description	Export Orientation: Share of Exports in SME Output	Share of SMEs in Industry Exports	Share of SME Exports in Industry Output
3	Manufacturing	19.11	23.40	4.54
311	Food	22.37	48.77	10.91
312	Food, nec ^c	3.40	15.23	0.52
313	Beverage	0.05	90.30	0.45
314	Tobacco	1.93	12.23	0.24
321	Textiles	32.85	20.90	6.87
322	Wearing Apparel	54.38	40.39	21.96
323	Leather and leather products	42.17	13.03	5.49
324	Footwear	36.36	4.72	1.72
331	Wood and cork products	25.33	56.91	14.42
332	Furniture and fixtures	35.39	69.27	24.51
341	Paper and paper products	9.20	76.73	7.06
342	Printing and publishing	10.12		
351	Industrial Chemicals	16.11	10.96	1.77
352	Other Chemicals	3.15	72.03	2.27
353	Petroleum	0.72	0.00	0.00
353	Products of Petroleum and coal	0.27	0.00	0.00
355	Rubber products	10.91	21.44	2.34
356	Plastic products	7.07	67.21	4.75
361	Pottery, china and earthenware	40.70	6.64	2.70
362	Glass and glass products	12.41	24.37	3.02
363	Cement	0.04	0.00	0.00
369	Other non-metallic mineral	8.26	59.38	4.93
371	Iron and steel basic products	5.55	40.28	2.24
372	Non-ferrous metal	68.97	0.56	0.39
381	Fabricated metal products	9.55	11.57	1.10
382	Machinery excluding Electrical	53.25	3.09	1.65
383	Electrical machinery	64.54	2.76	1.78
384	Transport equipment	7.27	67.08	4.88
385	Professional and scientific equipment	70.61	35.72	25.22
386	Furniture, metals	56.70	0.00	0.00
390	Other manufactures	51.33	36.03	18.49

Source: Annual Survey of Manufacturers, 1994, National Statistics Office (Tecson 2001)

^aSME = small and medium enterprise

^bPSIC = *Philippine Standard Industrial Classification*

^cnec = not elsewhere classified

Table 17. Export orientation of SMEs^a and large enterprises with and without foreign ownership, 1994

PSIC ^b	Industry Description	Share of Direct Exports in Output	
		W/out Foreign Equity	With Foreign Equity
311	Food		
	20-99	23.44	18.67
	100+	19.24	54.21
312	Food, nec ^c		
	20-99	0	13.02
	100+	8.98	20.95
313	Beverage		
	20-99	9.07	
	100+	1.46	6.06
314	Tobacco		
	20-99		
	100+	2.22	97.91
321	Textiles		
	20-99	14.63	17.57
	100+	17.49	14.36
322	Wearing apparel		
	20-99	16.31	32.37
	100+	18.57	20.27
323	Leather and leather products		
	20-99	20.59	
	100+	4.49	50.29
324	Footwear		
	20-99	4.36	2.05
	100+	79.2	
331	Wood and cork products		
	20-99	15.68	43.53
	100+	3.44	100.64
332	Furniture and fixtures		
	20-99	37.33	100
	100+	45.22	25.16
341	Paper and paper products		
	20-99	9.68	52.14
	100+	34.62	24.38
342	Printing and publishing		
	20-99	19.23	85.6
	100+	2.66	55.86

Table 17. (continued)

351	Industrial chemicals		
	20-99	7.32	10.44
	100+	29.85	12.76
352	Other chemicals		
	20-99	4.38	3.66
	100+	11.11	8.6
353	Petroleum		
	20-99		
	100+		2.59
353	Products of petroleum and coal		
	20-99		
	100+	12.89	
355	Rubber products		
	20-99	1.8	2.32
	100+	9.83	41.54
356	Plastic products		
	20-99	5.68	10.06
	100+	15.56	80.8
361	Pottery, china, and earthenware		
	20-99	0.54	
	100+	8.91	92.3
362	Glass and glass products		
	20-99	5.68	10.06
	100+	71.59	1.49
363	Cement		
	20-99		
	100+	3.01	85.02
369	Other non-metallic mineral		
	20-99	12.77	16.99
	100+	18.29	16.37
371	Iron and steel basic products		
	20-99	6.48	51.11
	100+	4.81	2.27
372	Non-ferrous metal		
	20-99	4.91	99.48
	100+		0.85

Table 17. (continued)

381	Fabricated metal products		
	20-99	9.76	7.1
	100+	13.59	41.06
382	Machinery excluding electrical		
	20-99	13.46	7.03
	100+	2.05	12.57
383	Electrical machinery		
	20-99	35.17	80.6
	100+	9.65	22.92
384	Transport equipment		
	20-99	5.98	1.46
	100+	2.73	33.43
385	Professional and scientific equipment		
	20-99		63.74
	100+		96.77
386	Furniture, metals		
	20-99	5.89	
	100+		
390	Other manufactures		
	20-99	16.78	36.67
	100+	24.64	32.07

Source: Annual Survey of Manufacturers, 1994, NSO (Tecson 2001)

^aSMEs = small and medium enterprises

^bPSIC = *Philippine Standard Industrial Classification*

^cnec = not elsewhere classified

sector is able to compete successfully in exports market. Moreover, there were SMEs with foreign ownership that had high degree of export orientation. These export-oriented industries were as follows:

- furniture and fixtures (100%),
- non-ferrous metal products (99%),
- electrical machinery (80%),
- professional and scientific equipment printing and publishing (56%),
- paper and paper products (52%),
- iron and iron products (51%),
- wood and cork products (43%),
- other manufactures (33%), and
- wearing apparel (32%).

There were also industries with SMEs without foreign equity with a high degree of export orientation, such as furniture and fixtures (37%), electrical machinery (35%), food (23%), and leather and leather products (21%).

Japanese SMEs

SMEs have played a very important role in the Japanese economy. They have been regarded and relied on throughout the years as promoting dynamism in the economy. Their flexibility and versatility allowed them to adjust faster and more effectively to changing business environments than larger enterprises. This is probably the reason for the relatively constant share⁴ of SMEs in the total number of enterprises in Japan for the period 1986-1999, fluctuating only from a high of 99.7 percent in 1999 to a low of 99.4 percent in 1991 and 1996 (Table 18). Its share of employment for business establishments has also been consistent during the period although the range of fluctuation is slightly larger—from 77.6 percent in 1996 to 80.6 percent in 1999 (Table 19).

The manufacturing sector⁵ was the third largest employer of labor among all types of industries in 1999 (Tables 19 and 20). The sector contributed 21 percent to total employment. SME employment in this sector accounted for just under two-thirds of total employment at 65 percent. This trend was evident in other major sectors as well. Employment was concentrated in the SMEs, with shares to total industry employment ranging from 70 percent to 77 percent (Table 20). The manufacturing industry has also the greatest value added compared to the other industries of wholesaling and retailing, services, and construction. For these reasons, most analysis on the contribution of SMEs in the development of the economy has focused on the manufacturing industry.

On the other hand, Table 22 reveals that while value added from all industries had increased from 1998 to 2000, the contributions of SMEs and large enterprises to total manufacturing value added decreased. The value added from large enterprises steadily increased between 1998 and 2000 while the SMEs' value added experienced a very slight dip in 1999 but surpassed the 1998 level in 2000. SME's contribution to total value added was 22 percent on the average, while the contribution coming from large enterprises averaged 16.5 percent during the period.

⁴ This is defined as the sum of the number of companies and the number of self-employed.

⁵ As reported, the manufacturing sector includes 'construction' and the residual 'other non-primary industries.'

Table 18. Number of business enterprises by industry and size (private), selected years

Industry	Year	SMEs			of which small enterprises			Large Enterprises			Total
		No.	% of total	No.	% of total	No.	% of total	No.	% of total	No.	% of total
Construction	1986	528,117	99.9	499,741	94.6	417	0.1	528,534	100.0		
	1991	545,844	99.9	514,412	94.2	525	0.1	546,369	100.0		
	1996	581,745	99.9	547,328	94.0	547	0.1	582,292	100.0		
	1999	555,372	99.9	526,027	94.6	475	0.1	555,847	100.0		
Manufacturing	1986	776,173	99.7	700,845	90.0	2,607	0.3	778,780	100.0		
	1991	738,511	99.6	660,080	89.0	2,904	0.4	741,415	100.0		
	1996	664,946	99.6	593,823	88.9	2,764	0.4	667,710	100.0		
	1999	605,212	99.6	537,430	88.4	2,414	0.4	607,626	100.0		
Wholesaling	1986	322,211	98.7	214,350	65.7	4,116	1.3	326,327	100.0		
	1991	327,207	98.6	220,183	66.3	4,803	1.4	332,010	100.0		
	1996	284,831	98.3	194,448	67.1	4,829	1.7	289,660	100.0		
	1999	293,903	99.2	203,261	68.6	2,259	0.8	296,162	100.0		
Retailing	1986	1,442,841	99.6	1,319,367	91.0	6,382	0.4	1,449,223	100.0		
	1991	1,280,940	99.4	1,155,933	89.7	7,098	0.6	1,288,038	100.0		
	1996	1,196,240	99.4	1,062,801	88.3	7,239	0.6	1,203,479	100.0		
	1999	1,084,209	99.7	945,211	86.9	3,784	0.3	1,087,993	100.0		

Table 18. (Continued)

Industry	Year	SMEs			of which small enterprises			Large Enterprises			Total
		No.	% of total	No.	% of total	No.	% of total	No.	% of total	No.	% of total
Food services	1986	773,092	99.8	718,387	92.8	1,189	0.2	774,281	100.0		
	1991	762,318	99.8	697,743	91.3	1,652	0.2	763,970	100.0		
	1996	744,501	99.8	678,841	91.0	1,254	0.2	745,755	100.0		
	1999	714,754	99.9	639,231	89.4	642	0.1	715,396	100.0		
Services	1986	1,115,974	99.2	966,272	85.9	8,559	0.8	1,124,533	100.0		
	1991	1,150,837	98.9	972,439	83.6	12,507	1.1	1,163,344	100.0		
	1996	1,191,833	99.0	1,023,372	85.0	12,071	1.0	1,203,904	100.0		
	1999	1,181,827	99.7	1,001,806	84.5	3,881	0.3	1,185,708	100.0		
Other non-	1986	368,720	99.8	346,882	93.9	849	0.2	369,569	100.0		
Primary	1991	397,932	99.7	372,598	93.4	1,031	0.3	398,963	100.0		
Industries	1996	408,826	99.8	382,963	93.4	1,016	0.2	409,842	100.0		
	1999	401,487	99.8	375,815	93.4	885	0.2	402,372	100.0		
Non-primary	1986	5,327,128	99.5	476,584	89.1	24,119	0.5	5,351,247	100.0		
industry	1991	5,203,589	99.4	4,593,388	87.8	30,520	0.6	5,234,109	100.0		
Total	1996	5,072,922	99.4	4,483,576	87.9	29,720	0.6	5,102,642	100.0		
	1999	4,836,764	99.7	4,228,781	87.2	14,340	0.3	4,851,104	100.0		

Source: 2002 White Paper on Small and Medium Enterprises in Japan. Figures were compiled and were from the Ministry of Public Management, Home Affairs, Posts and Telecommunications, Establishment and Enterprise Census of Japan.

Table 19. Number of persons engaged by industry and size (private), selected years

Industry	Year	SMEs			of which small enterprises			Large Enterprises			Total	
		No. of persons	% of total	No. of persons	% of total	No. of persons	% of total	No. of persons	% of total	No of persons	% of total	% of total
Mining	1991	65,921	85.0	32,759	42.2	11,663	15.0	77,584	100.0	77,584	100.0	
	1994	63,273	88.029	29,992	41.7	8,612	12.0	71,885	100.0	71,885	100.0	
	1996	58,713	91.4	28,642	44.6	5,525	8.6	64,238	100.0	64,238	100.0	
	1999	51,787	94.3	26,296	47.9	3,147	5.7	54,934	100.0	54,934	100.0	
Construction	1991	5,039,071	95.4	2,922,103	55.3	242,768	4.6	5,281,839	100.0	5,281,839	100.0	
	1994	4,820,498	95.4	2,806,465	55.5	233,832	4.6	5,054,330	100.0	5,054,330	100.0	
	1996	5,527,373	95.7	3,181,202	55.1	247,115	4.3	5,774,488	100.0	5,774,488	100.0	
	1999	4,873,754	95.8	2,915,619	57.3	215,746	4.2	5,089,500	100.0	5,089,500	100.0	
Manufacturing	1991	10,396,256	73.8	3,897,626	27.7	3,690,946	26.2	14,087,202	100.0	14,087,202	100.0	
	1994	9,737,039	73.2	3,532,463	26.5	3,571,040	26.8	13,308,079	100.0	13,308,079	100.0	
	1996	9,575,970	74.1	3,470,343	26.9	3,346,064	25.9	12,922,034	100.0	12,922,034	100.0	
	1999	8,533,118	74.5	3,010,168	26.3	2,919,199	25.5	11,452,317	100.0	11,452,317	100.0	
Wholesaling, retailing, and food services	1991	14,579,168	86.4	4,641,527	27.5	2,295,779	13.6	16,874,947	100.0	16,874,947	100.0	
	1994	14,391,759	83.9	4,469,829	26.1	2,753,293	16.1	17,145,052	100.0	17,145,052	100.0	
	1996	15,146,015	83.2	4,279,041	23.5	3,063,046	16.8	18,209,061	100.0	18,209,061	100.0	
	1999	14,451,835	83.8	3,861,848	22.4	2,793,056	16.2	17,244,891	100.0	17,244,891	100.0	
Finance and	1991	1,750,233	84.7	500,751	24.2	317,007	15.3	2,067,240	100.0	2,067,240	100.0	

Table 19. (continued)

Industry	Year	SMEs				Large Enterprises				Total
		of which small enterprises								
		No. of persons	% of total	No. of persons	% of total	No. of persons	% of total	No. of persons	% of total	
Insurance	1994	1,694,732	86.1	519,976	26.4	272,863	13.9	1,967,595	100.0	
	1996	1,648,542	84.1	551,806	28.2	311,503	15.9	1,960,045	100.0	
	1999	1,489,879	86.5	524,130	30.4	233,503	13.5	1,723,382	100.0	
Real estate	1991	891,743	97.0	706,020	76.8	27,608	3.0	919,351	100.0	
	1994	813,796	96.6	642,737	76.3	28,500	3.4	842,296	100.0	
	1996	895,952	96.5	705,173	76.0	32,502	3.5	928,454	100.0	
Transport and Tele	1999	838,459	96.4	657,292	75.6	30,965	3.6	869,424	100.0	
	1991	2,874,884	87.4	655,236	19.9	413,377	12.6	3,288,261	100.0	
	1994	2,870,890	87.37	660,072	20.2	401,820	12.3	3,272,710	100.0	
Communications	1996	3,033,446	87.6	688,481	19.9	431,235	12.4	3,464,681	100.0	
	1999	2,894,590	89.0	674,757	20.7	359,356	11.0	3,253,946	100.0	
Electricity, gas, and water	1991	146,905	73.5	13,266	6.6	53,020	26.5	199,925	100.0	
	1994	153,418	73.2	14,206	6.8	56,303	26.8	209,721	100.0	
	1996	157,515	71.0	14,420	6.5	64,490	29.0	222,005	100.0	
Utilities	1999	153,713	71.6	13,826	6.4	60,837	28.4	214,550	100.0	
	1991	7,655,113	63.8	2,196,262	18.3	4,340,365	36.2	11,995,478	100.0	
	1994	7,728,340	62.9	2,210,460	18.0	4,563,799	37.1	12,292,139	100.0	

Table 19. (continued)

Industry	Year	of which small enterprises						Total	
		SMEs		Large Enterprises					
		No. of persons	% of total	No. of persons	% of total	No of persons	% of total		
Non-primary Industry	1996	8,449,050	61.2	2,252,758	16.3	5,352,714	38.8	13,801,764	100.0
	1999	9,907,646	72.4	2,151,365	15.7	3,779,723	27.6	13,687,369	100.0
	1991	43,399,294	79.2	15,565,550	28.4	11,392,533	20.8	54,791,827	100.0
	1994	42,273,745	78.0	14,886,200	27.5	11,890,062	22.0	54,163,807	100.0
Total	1996	44,492,576	77.6	15,171,886	26.5	12,854,194	22.4	57,346,770	100.0
	1999	43,194,781	80.6	13,835,301	25.8	10,395,532	19.4	53,590,313	100.0

Source: 2002 White Paper on Small and Medium Enterprises in Japan. Figures were compiled and were from the Ministry of Public Management, Home Affairs, Posts and Telecommunications, Establishment and Enterprise Census of Japan.

Table 20. Number of employees by industry, 1999

Industries	SMEs		Large Enterprises		Total	
	No. of Employees	% of total	No. of Employees	% of total	No. of Employees	% of total
Manufacturing and others	13,987,603	64.9	7,577,497	35.1	21,565,100	100.00
Wholesale	2,733,853	70.9	1,120,608	29.1	3,854,461	100.00
Retail	7,835,166	72.2	3,012,074	27.8	10,847,240	100.00
Services	6,640,797	76.9	1,997,153	23.1	8,637,950	100.00
Total (non-primary industries)	31,197,419	69.5	13,707,332	30.5	44,904,751	100.00

Source: Ministry of Public Management, Home Affairs, Posts and Telecommunications, Establishment and Enterprise Census of Japan (1999).

Looking at the major sectors of manufacturing, wholesaling and retailing, and services, the manufacturing sector had experienced increasing value added and decreasing shares to total manufacturing value added (Table 22)—i.e., 28 percent on average for small enterprises and 19 percent on average for large enterprises during the period. For this sector, SMEs contributed largely to total manufacturing value added. The wholesaling and retailing sector's value added was also increasing (Table 23). Still, for this sector, SMEs had a higher contribution to total industry value added, 13.5 percent for SMEs and 10.3 percent for large enterprises; and contribution to total value added was decreasing for both SMEs and large enterprises. For services, the period was witness to an increasing value added for both SMEs and large enterprises (Table 24). Compared to manufacturing and wholesaling and retailing, SMEs in the services sector had a higher share to total industry value added at a rather consistent 30.6 percent on average, while that of large enterprises was at 22.3 percent on average. Large enterprises experienced increasing shares during this period. The value-added ratio for manufacturing, and for all industries for that matter, revealed a declining trend during the three-year period. This could be an indication of the effect that globalization and the resulting shift of production activities outside Japan had on the quality of production in the country.

A study made on the entry of small and medium enterprises in relation to economic dynamism in Japan⁶ has shown that SMEs of the smallest size group (1-4 employees) saw a decline in their number beginning mid-1980s. The larger SMEs (5-299 employees), on the other hand, grew in number—

⁶ Kawai and Urata (2001).

Table 21. Main financial indicators, profit status and main financial ratios of business corporations for all industries, selected years

Size	SMEs ^a			Large Enterprises		
	1998	1999	2000	1998	1999	2000
Item/Fiscal Year						
Sales ^b	658,563	66,794	691,347	722,744	716,670	743,680
Total assets ^b	572,430	534,977	544,438	740,370	7,490,938	765,071
Value added ^b	153,151	148,034	153,404	117,262	119,697	123,225
(Personal costs)	123,197	122,792	124,055	80,158	79,354	78,482
(Interest expenses)	10,081	7,122	6,757	8,129	7,320	6,799
No. of workers ^c (including officers)	31,661	32,168	33,549	12,094	12,175	11,820
Equity ratio ^d	9.4	13.4	19.5	26.8	28.7	30.1
Ratio of ordinary profit to sales ^d	0.9	1.1	1.7	2.2	2.7	3.3
Total capital turnover	1.2	1.2	1.3	1.0	1.0	1.0
Interest rate on borrowing	3.0	2.2	2.4	2.6	2.4	2.4
Value added ratio ^d	23.3	22.2	22.2	16.2	16.7	16.6
Labor productivity ^e	587	557	552	986	999	1,059
Capital-labor ratio ^e	821	820	756	2,193	2,197	2,258
Ratio of fixed assets to long-term capital ^d	90.7	91.7	85.4	93.2	93.2	96.6
Population	2,429,434	2,478,437	2,516,513	31,036	31,475	31,886

Source: Ministry of Finance, *Financial Statements Statistics of Corporation by Industry*^aSMEs = small and medium enterprises^bSales, Total Assets and Value Added (including personnel costs, interest expenses and discount charges) are in billion Yen^cNumber of workers are in thousands^dFigures for other financial ratios indicate percentages^eLabor productivity and capital-labor ratio are in ten thousand Yen

Table 22. Main financial indicators, profit status and main financial ratios of business corporations for manufacturing, selected years

Size	SMEs ^a			Large Enterprises			
	Item/Fiscal Year	1998	1999	2000	1998	1999	2000
Sales ^b		123,825	129,039	140,594	262,669	266,215	280,388
Total assets ^b		104,865	107,097	118,515	279,576	288,146	300,221
Value added ^b		37,088	37,058	38,372	50,603	51,798	53,719
(Personal costs)		30,093	31,337	31,585	37,389	36,788	36,262
(Interest expenses)		1,367	1,430	1,304	1,959	1,732	1,602
No. of workers (including officers) ^c		7,395	7,908	8,013	5,216	5,081	4,935
Equity ratio ^d		26.1	23.2	29.8	40.5	41.5	41.9
Ratio of ordinary profit to sales ^d		1.2	1.5	2.5	2.9	3.5	4.6
Total capital turnover		1.2	1.2	1.2	0.9	0.9	1.0
Interest rate on borrowing		2.4	2.6	2.3	2.4	2.1	2.1
Value added ratio ^d		30.0	28.7	27.3	19.3	19.5	19.2
Labor productivity ^e		588	543	554	983	1,032	1,102
Capital-labor ratio ^e		597	547	563	1,552	1,604	1,643
Ratio of fixed assets to long-term capital ^d		75.6	80.0	71.2	78.6	79.1	83.3
Population		440,103	440,101	438,401	8,777	8,936	9,040

Source: Ministry of Finance, *Financial Statements Statistics of Corporation by Industry*

^aSMEs = small and medium enterprises

^bSales, Total Assets and Value Added (including personnel costs, interest expenses, and discount charges) are in billion yen

^cNumber of workers (including officers) are in thousands

^dFigures for other financial ratios indicate percentages

^eLabor productivity and capital-labor ratio are in ten thousand yen

Table 23. Main Financial indicators, profit status and main financial ratios of business corporations for wholesaling/retailing, selected years

Size	SMEs ^a			Large Enterprises		
Item/Fiscal Year	1998	1999	2000	1998	1999	2000
Sales ^b	258,633	283,462	277,348	283,861	266,998	276,235
Total assets ^b	172,515	151,979	148,114	149,339	142,447	146,551
Value added ^b	35,906	37,323	37,658	23,639	23,351	23,521
(Personal costs)	30,776	31,216	31,028	16,311	15,927	15,392
(Interest expenses)	1,826	1,841	1,597	1,597	1,238	1,161
No. of workers (including officers) ^c	8,383	8,867	9,056	9,056	3,414	3,253
Equity ratio ^d	10.7	16.0	16.4	16.4	21.7	22.1
Ratio of ordinary profit to sales ^d	0.3	0.6	0.9	0.9	1.3	1.5
Total capital turnover	1.6	1.9	1.8	1.8	1.8	1.9
Interest rate on borrowing	2.0	2.3	2.1	2.1	2.1	2.1
Value added ratio ^d	13.9	13.2	13.6	13.6	8.7	8.5
Labor productivity ^e	541	524	520	520	698	737
Capital-labor ratio ^e	606	595	583	583	944	992
Ratio of fixed assets to long-term capital ^d	90.5	85.1	83.4	83.4	97.6	101.9
Population	772,980	782,283	790,614	790,614	12,506	12,691

Source: Ministry of Finance, *Financial Statements Statistics of Corporation by Industry*^aSMEs = small and medium enterprises^bSales, Total Assets and Value Added (including personnel costs and interest expenses and discount charges) are in billion yen^cNumber of workers (including officers) are in thousands^dFigures for other financial ratios indicate percentages^eLabor productivity and capital-labor ratio are in thousand yen

Table 24. Main financial indicators, profit status and main financial ratios of business corporations for services, selected years

Size	Large Enterprises					
Item/ Fiscal Year	SMEs ^a					
	1998	1999	2000	1998	1999	2000
Sales ^b	90,690	82,630	95,596	74,834	84,914	87,950
Total assets ^b	83,613	82,745	82,368	93,098	102,805	102,710
Value added ^b	27,790	25,651	29,218	15,971	19,493	19,977
(Personal costs)	22,373	21,335	22,778	11,740	14,004	13,708
(Interest expenses)	1,490	1,169	1,339	1,059	936	869
No. of workers (including officers) ^c	6,450	6,068	7,021	2,117	2,561	2,578
Equity ratio ^d	8.6	7.5	15.5	13.0	11.2	21.5
Ratio of ordinary profit to sales ^d	1.2	1.6	2.1	2.1	2.8	3.2
Total capital turnover	1.1	1.0	1.2	0.8	0.9	0.9
Interest rate on borrowing	3.1	2.6	3.2	1.9	1.7	1.7
Value added ratio ^d	30.6	31.0	30.6	21.3	23.0	22.7
Labor productivity ^e	495	494	481	776	779	794
Capital-labor ratio ^e	750	870	688	2,185	1,731	1,662
Ratio of fixed assets to long-term capital ^d	103.5	95.0	92.9	112.9	128.7	110.0
Population	396,037	410,236	427,779	14,530	14,982	15,485

Source: Ministry of Finance, *Financial Statements Statistics of Corporation by Industry*

^aSMEs = small and medium enterprises

^bSales, Total Assets and Value Added (including personnel costs, interest expenses, and discount charges) are in billion yen

^cNumber of workers (including officers) are in thousands

^dFigures for other financial ratios indicate percentages

^eLabor productivity and capital-labor ratio are in ten thousand yen

increasing from 2.1 million to 2.4 million during 1957-1996. This lends support to the theory that the post-World War II environment had successfully caused a shift from micro SMEs to relatively larger SMEs.

Japanese SMEs also played an important role in making subcontracting popular. In the 1987 survey done by the SME Agency, 55.8% of firms engaged in manufacturing worked as subcontractors. Large firms are very dependent on the SME subcontractors for parts, components, and processes that are either too costly for them to undertake on their own or are too diverse to be handled by management. In addition, SMEs have an important position in a number of regional production networks, or clusters, that are the source of strength of economic activity for a number of regions in Japan. In fact, subcontracting arrangements are found to be more successful in such clusters.

SMEs and their Contribution to the Economy

The literature on Philippine SMEs has been diverse and profuse. The late 1950s to the early 1970s had investigations that largely focused on describing the broad features and the special characteristics of SMEs. Early investigators using aggregative data inferred that small enterprises are less capital-intensive than large enterprises, and that capital intensity appeared to be industry-specific rather than firm-size specific. The 1970s to the 1990s had studies on the role of SMEs in employment provision, reflecting the growing realization that development policies had failed to deal effectively with the problems of unemployment and poverty, particularly in developing economies, i.e., Vepa (1971 and 1983). In addition, the 1990s gave research focus on issues about SMEs playing in an increasingly integrated global economy.

Although this position may not be grounded on economic efficiency⁷, SMEs have, time and again, been regarded as important in employment creation, particularly in an economy with abundant unskilled labor. One therefore could expect that where SMEs account for a truly large share of macroeconomic activity, the contribution of SMEs to aggregate output and employment growth could be substantial or even profound. Given SMEs' low capital requirement they are believed to stimulate the growth of numerous indigenous enterprises with wide regional dispersal so a more equitable income distribution can ensue. In addition, SMEs can be instrumental in "sustaining a broad and diversified private sector" (Humphrey & Schmitz, 1995).

⁷ It has been argued that public policy should be designed to encourage the growth of SMEs because of the increase in employment and improvement in income distribution that would ensue. This raises the question of efficiency of SMEs. If these are as efficient as large enterprises, then there is no problem. But if SMEs are less efficient producers than large enterprises, then employment is being bought at the expense of output and the value of the trade-off has to be explicitly considered.

International experience indicates that even under the most competitive conditions, unorganized and small business enterprises not only provide major employment opportunities but also survive alongside the highly organized sector. This is supported by figures from SMEs in Asia, where they account for 95 percent of establishments in Bangladesh, 98 percent in Thailand, 93 percent in Malaysia, 70 percent in Indonesia and 80 percent in the Philippines (Das 2003).

SMEs also have a role to play in export promotion. The literature acknowledges that SMEs play a significant role in the first or early phase of an export-oriented industrialization strategy by supplying low-cost, labor-intensive products such as textiles, garments, leather goods, and other consumer products. As SMEs begin to modernize, they became active in producing light engineering goods, simple machinery, machine tools, domestic appliances, and construction hardware. At the time of this writing, SMEs are exporting a wide variety of products and they continue to be crucial in generating and diversifying exports. Although the developing countries' exports are mostly labor-intensive, as economies of the region are undergoing industrial restructuring of varying kinds with emphasis on the private sector as the engine of growth, the importance of SMEs in exports has taken on a new dimension, but has not altogether changed.

A major implication of a rather dated study still resonates today. Hoselitz (1959) and Anderson (1982) documented firm-growth patterns, and highlighted a relationship between the development process and firm-size contribution to aggregate growth. According to Hoselitz, the first phase of development is usually characterized by the predominance of "household industries," while the second phase is characterized by accelerating growth of SMEs. Lastly, the third phase is marked by the contraction of household industries, which is supplanted by large enterprises at this stage.

SMEs make a valuable contribution as subcontractors to large enterprises, which often tend to be transnational corporations (TNCs). They produce parts and components for large enterprises using local resources and skills. In light of economic fluctuations, they act as shock absorbers for the large enterprises, adjusting their own employment and production levels to reflect changes in demand and supply conditions. In these ways, they add to the flexibility and viability not only of the large enterprise sector but also of the entire economy (Dhungana 2003).

The literature presents development phases that indirectly underscore the firm-size contribution to the overall economy. In particular, one can look to the second and third phases as having the most impact on the economy. Relatively recent investigations posited that the growth of SMEs and their

eventual graduation into large enterprises will have positive impacts on the economy in that this process of evolution and graduation can help improve the entrepreneurial and managerial class and even boost capital formation. Such processes can create the basis for transformation of an economy—from one using traditional and outmoded techniques to one using modern and efficient technology (Hooley and Ahmad 1990).

The Philippine SME Development Experience and the Historical Policy Environment

This section deals with the development experience of Philippine SMEs from the 1940s to the present. It presents major policies that were set in place with the objective (both directly and indirectly) of furthering the development of SMEs. This section also deals with how the historical policy environment may have influenced the effectiveness (even ineffectiveness) of policies in question.

The Philippine industrial development experience foregrounds the discussion on specific SME development policies and programs. This is because SME policies that have been set in place may have been in light of major industrial development policies of the Philippines. Thus, the Philippine SME development experience will be discussed under the overarching Philippine industrial development experience.

Philippine industrial development experience: An overview⁸

The 1935 Philippine Constitution first recorded the national commitment to industrial progress. The Philippine government, accordingly, set out policies with the objective of setting the Philippine economy on course to industrial progress. The succeeding periods in Philippine economic history have been witnesses to the general persuasion that industrial progress is integral to economic advance. The common thread that binds industrial policies across time periods was the emphasis on policies on expansion of exports, increases in foreign investments, development of the private sector, and enhancement of domestic linkages.

The period from 1946 to mid-1960s was marked with the positive impacts of reconstruction programs in response to the negative impacts of World War II. The recurring themes of this period were the country's overvalued exchange rate and the import-substitution strategies adopted by the national government. Throughout this period, the government set programs in place to encourage domestic investment, particularly the regulation of interest rates. During this time, the government saw the importance of not only encouraging

⁸ The Philippines' industrial development experience is not discussed in light of the political and social conditions of the periods in question.

domestic investment, but also foreign investments. Policymakers thus set out specialized incentives to lure foreign investments.

The 1950s was witness to a good number of growing industries. The government then set up the Industrial Guarantee and Loan Fund (IGLF), with fund infusion from the *United States Agency for International Development* (USAID), which fuelled growing industries. National incentive policies were set in place to support selected industries. As examples, the Basic Industries Law provided tax exemption for machinery importations for industries like food, plywood, veneer and textiles; the Mining Act provided support for the mining industries; and the Textile Act was set to aid textile companies. During this period, the Investments Incentives Act granted fiscal and other incentives for priority firms registered with the Board of Investments, specifically for those introducing new products and processes and for those expanding capacities for domestic and export requirements.

The liberalization of import controls and the devaluation of exchange rates, which were resorted to in the 1950s, resulted in the influx of imported manufactured goods, which had adversely affected the manufacturing sector. Consequently, the latter half of the 1960s saw a major shift in the Philippines' industrialization program. The strategy shifted from import-substitution production to the establishment of export-oriented industries. Policies were set in place to support the foreign exchange requirements of imported raw materials, primarily agriculture and mineral-based commodities.

The 1970s had seen the continued emphasis on exports expansion of Philippine industrial policy. The Export Incentive Act was enacted during this period. This Act was deemed complementary to the investment incentives policy set in place by the national government. Additional incentives were also granted to export-oriented industries and provided for rural locators in light of industrial dispersal policy. Hence, export-oriented industries bloomed, but there were few locators to the countryside because of inadequate infrastructure required for their operations.

The economic development in the latter half of the 1980s were undoubtedly brought about by the transition from martial rule and the democratic reforms that were set in place. As a result of positive political developments, this period, particularly during the Corazon Aquino regime, was witness to a wide range of economic-related reforms and government reforms and reorganization. There was even an emphasis on the government's commitment for private sector development. This emphasis was declared in the 1987 Philippine Constitution.

Major government reforms and structuring programs were geared toward reinforcing the Philippines' industrialization program. For instance, foreign

direct investments (FDIs) were encouraged and foreign investments in the Philippines were permitted in virtually all areas of economic activity. It was also notable that structural adjustment programs were instituted for capital-intensive industries. Policymakers during this time had also instituted reform programs based on development principles. Notably, the industrial dispersal program to address poverty, employment, and distribution of income was considered. The trade liberalization, tariff reduction, and deregulation of interest rates to enhance competition, furthered international trade, and encouraged domestic investment, respectively. Privatization programs to remove not only government intervention in many government industries, but also to transfer control and ownership were promoted. Clustering and estate development programs promoted grouping of industries, which can provide more value-added services, facilitate economies of scale, and utilize industrial infrastructure. Although these programs had strong developmental bases, it could be said that these programs were very much in line with the period's industrialization program.

Significant economic strides were experienced during the 1990s, which was essentially the Ramos period. When the Ramos government assumed leadership in 1992, the major policy thrust was toward revitalizing the economy and renewed attention to a focused *Social Reform Agenda*. The goal set by the 1993-1998 *Medium Term Development Plan* was jumpstarting and pushing the economy to the "newly industrializing country" (NIC) status in 2000. Dubbed as the Philippines 2000 strategy, the Plan envisioned bringing improved quality of life for every Filipino through global excellence and people empowerment. Global excellence meant producing world-class products and services in both domestic and international markets and expanding markets and opportunities, which would thus facilitate job creation, improve labor skills and managerial techniques, and other innovations. People empowerment was deemed attainable through development of human resources by education, training, improved basic services in health and nutrition, increased access to productive resources, and the diffusion of technology. Liberalization and deregulation programs were also undertaken in light of the government's industrial development thrust.

Investment strategies and export expansion programs were also set in place. Two investment strategies to meet the NIC status were pursued: first was a strategy that would encourage inflows of FDIs, and second, a strategy that would adopt integrated development assistance for small-scale enterprises. For exports' expansion, the Export Development Act was enacted in 1994. This Act stipulated that the "government and the private sector shall jointly transform the Philippines into an exporting nation, that exporting is not just

a sectoral concern but the key to national survival and the means through which the economic goals of increased employment and enhanced incomes can be expeditiously achieved." Moreover, export winners, market positioning, and specific action plans were identified as part of the *Philippine Export Development Plan (1993-1998)*, which set forth the basic programs of the export program. Export expansion programs underscored export expansion as a driver of economic growth and as a facilitator of trade-driven investments and technology transfer that could also lead to a shift from labor- to skills-intensive industries.

The 1997 Asian Financial Crisis dealt the Philippine economy with a heavy blow. Although the Philippines was one of the least affected in the Asian region during the immediate aftermath of the crisis, this situation was, however, reversed during the Estrada administration. The industrialization policy, which may have partly taken into account the impact of the financial crisis, gave emphasis to the development of rural industries and village enterprises and stressed that clustering of industries was the key strategy intended for industrial growth.

The industrial development strategy during 2001-2004 is anchored on private sector development and on the capacity of domestic industries to compete globally in terms of exports and support services. It emphasizes the need to increase the value-added of industries, diversifies strategies in terms of products and markets, develops a strong local base, and enhances domestic linkages. It also acknowledges that a macroeconomic framework that promotes competitiveness, efficiency, innovation, and entrepreneurship is fundamental to private sector development. It also puts in context the national strategy to achieve bigger goals of employment generation, countryside development, and upgrading of living standards.

SME development policy experience

As previously mentioned, the Philippine industrial development policy experience foregrounds the discussion on the SME development policy experience. Although the discussion on industrial policy remained on the broad level, it nevertheless suggested that these policies have had positive impacts on SME development. One can also explore the possibility that some policies and programs have been partial to large enterprises.

In almost all countries, there is either a separate policy statement for SMEs (or for micro or cottage industries) or a general industrial policy statement with some portions of it relating to this sector.

In many developing economies, SMEs contribute significantly to GDP growth, employment generation, and poverty alleviation. However, SMEs

face a number of problems and constraints that include the following, among others:

- Lower productivity and outdated technology,
- Lack of skilled labor and managerial skill,
- Constraints on infrastructure,
- Low economies of scale,
- Lack of modern marketing,
- High cost of domestic credit and lack of foreign investment, and
- Increased competition.

1960s

Industrial policies after World War II have slowly but substantially changed throughout the years. From 1946 to mid-1960s, the development of the industrial sector was achieved through a conscious strategy of import substitution catering to the domestic market. The government embarked on a program to rehabilitate the economy during the early post-war period. Focus was on large-scale enterprises and import-intensive industries. Policies included import controls, low interest rate, low foreign exchange rate, and specialized incentives to attract foreign investments.

The 1960s was witness to sparse policies and programs crucial to SME development. Only one notable policy and one program centrally focused on small enterprises. The Cottage Industries Act was the only outstanding policy during this period. It was the first policy to recognize the importance of small enterprises in the grand scheme of industrial development. With this Act, tax incentives were extended to small enterprises registered with the National Cottage Development Authority. As for government programs, the one that had the most impact on SME development during this period was the training and service provision programs facilitated by the University of the Philippines. With the support of the Netherlands government, the state university was able to address the growing needs of small enterprises in running their small businesses.

1970s

By the second half of the 1960s, when traditional exports like coconut, gold, and chromite could no longer support foreign exchange requirements of the growing imports, the government shifted from import-substitution strategy to boosting export-oriented industries. Thus, the creation of the Investments and Incentives Act was passed into law with the Board of Investments as lead agency and in 1970, the Export Incentives Act was enacted.

The importance of SMEs has been recognized at the onset of 1970s amidst the worst oil crisis that crippled energy-intensive industries. Formal planning for the development of SMEs came about after an International Labor Organization (ILO) mission in the early 1970s. For the first time, SMEs were given emphasis in the *Philippine Development Plan (1972-1976)*. The general features, support or developmental programs were as follows:

- Substantial increase of financial resources available to SMEs,
- Provision of technical assistance on a regional basis, and
- Establishment of the National Cottage Industries Development Authority (NACIDA) to implement and coordinate all assistance programs of SMEs.

Accordingly, the 1970s is hailed as the growth period for SMEs. Below are several reasons why SMEs grew in number in the 1970s and why this period is hailed as the growth era for SMEs:

- 1) A number of credit programs were made available to SMEs and loans from multilateral lending agencies were infused into the sector. In particular, long-term supervised credit was made available by the Social Security System (SSS) to SMEs. Loans from the World Bank-International Bank for Reconstruction and Development (IBRD) were used to reorient the IGLF for relending to SMEs. Loans from the Development Bank of the Philippines (DBP) were also extended to SMEs.
- 2) The Medium and Small Industries Coordinated Action Program (MASICAP) was created to mobilize SME creation. This program served as a link between entrepreneurs and financing institutions.
- 3) The Department of Industry was created in 1974. It took over the MASICAP and soon after established the Small Business Assistance Centers (SBAC) to provide SMEs services in the regional areas. Funding support for the establishment of the centers came from the World Bank-IBRD.
- 4) The Commission on Small and Medium Industries was formed during this time. It governed the operations of agencies and the implementation of programs in small enterprise development. This central organization existed until 1981 and its functions and programs were assumed by other agencies thereafter.
- 5) The 1979 Investment Promotion Act, among others, provided support to SMEs, particularly in nontraditional export sectors to promote employment. This Act introduced training and other services into SME programs.

Relatively speaking, however, despite the increase in the number of SMEs during the period, household industries and the SMEs did not grow as significantly as large enterprises did. Hence, the perception that the 1970s is the growth era for SMEs is a misnomer. One can look to three reasons behind this eventuality. *First*, in spite of the incentives and the services extended to SMEs during this period, very few SMEs made use of the incentives and services that were available to them. *Second*, incentives and investments during this period favored big enterprises. *Third and last*, formal lending bodies had very little involvement in SMEs because of the perceived risks and the high costs associated in processing and supervising the projects.

1980s

The above discussion on broad industrial policies during the 1980s, particularly during the Corazon Aquino administration, may point to an implicit preference for large enterprises. The incentives extended to SMEs went through the same route as incentives extended to large enterprises. Although there was a categorical development focus on SMEs and countryside development, the liberalization efforts during this period placed pressures on SMEs that had difficulty in coping with spiraling interests and the more competitive business environment.

Important SME Development Strategies (1988-1992) adopted by the Corazon Aquino administration included the following:

- 1) *Strategies on Financing.* The strategy aimed to ease SMEs' access to financing through reduction of paperwork and processing requirements, review of interest rates, and matching of programs to SME needs.
- 2) *Strategies on Market Improvement.* The strategy aimed to improve market access and to expand the domestic markets of SME products. This objective was to be achieved through provision of common market facilities, subcontracting linkages, market intelligence and information access, identification of local market centers, and rural transport facilities. The strategy also aimed to provide support to exporters through financing and guarantees, improved shipping services, further training to exporters, and improvement of exporting procedures.
- 3) *Strategies on Improving Technology Transfer.* The strategy aimed to improve production through transfer of technology. This objective was to be attained through the creation of technology centers and common service facilities, provision of information on applied

production systems, provision of awards and incentives to outstanding entrepreneurs and designers, and creation of new products with greater indigenous values. The utilization of available local raw materials was also emphasized.

- 4) *Strategies on Entrepreneurship*. The strategy aimed to encourage micro industries as catalyst for entrepreneurship.

There were also SME support programs instituted during the period. These programs were largely on private sector development, regional enterprise development, and entrepreneurship. These programs were funded by international agencies such as the USAID⁹ and *Canadian International Development Agency (CIDA)*¹⁰.

In 1987, the Omnibus Investment Act was enacted as the key legislation for investments generation, whether foreign or local. Fiscal and other forms of incentives were given to projects identified under the Investment Priority Plan. A major policy of the Act was to encourage SMEs by providing assistance in the preparation of feasibility studies and sourcing of financial packages. Those investments locating in "less developed areas" were given additional incentives.

Toward the decentralization of SMEs to the countryside, the Board of Investments was very active in coordinating with the local entrepreneurs and government units in investment promotion.

1990s–Present

SME policies in the 1990s were more focused and sweeping. Clearly, policies in the 1990s drew upon the developmental experiences of SMEs in the past. The general SME development strategies adopted during this period were on market access, export expansion, identification of specialization, entrepreneurship and management, technology and quality systems upgrade, and domestic linkages.

An important legislation that formally acknowledged the role of SMEs was the Magna Carta for Small Enterprises passed into law in 1991 (RA 6977) and amended in 1997 (RA 8289). The Magna Carta was a landmark legislation that reflected the objective to foster a dynamic SME sector, particularly rural and agriculture-based manufacturing ventures.

Three principles in setting the pace for small and medium enterprise development served as guides for the Magna Carta. These are

⁹ http://pdf.usaid.gov/pdf_docs/PDAAQ431.pdf

¹⁰ See David Winder's article for a comprehensive overview of how development agencies have partnered with civil society in southeast Asian countries.

- 1) minimal set of rules and simplification of procedures and requirements,
- 2) participation of private sector in the implementation of SME policies and programs, and
- 3) coordination of government efforts.

There are three major provisions in the Magna Carta, namely,

- 1) creation of the Small and Medium Enterprise Development Council (SMEDC), the primary agency responsible for facilitating and coordinating all national SME programs including programs with foreign funding;
- 2) creation of the *Small Business Guarantee and Finance Corporation*, which provides alternative modes of financing for small enterprises, including but not limited to direct and indirect project lending, venture capital, financial leasing, secondary mortgage, and rediscounting of loan papers to small businesses; and
- 3) 8 percent mandatory allocation to SMEs (6% for small enterprises and 2% for medium enterprises).

The first RA that acknowledged the role of women entrepreneurs was also enacted during this period. RA 7882 which provided assistance to women was passed into law on February 20, 1995. This particular legislation recognized the special role of women in development and supported women entrepreneurs who were engaged in manufacturing, processing, service, and trading businesses. Under this program, government financing institutions (GFIs) like the Land Bank of the Philippines (LBP) and the Development Bank of the Philippines (DBP) were mandated to provide assistance to

- 1) nongovernment organizations (NGOs) engaged in developing women's enterprises to a limit of PHP 2 million, provided that the NGO has an operating track record of one year;
- 2) existing women enterprises to the upper limit of PHP 50,000; and
- 3) potential women entrepreneurs with sufficient training up to a limit of PHP 25,000 each.

Considering all the inroads regarding formal SME development programs, various challenges in human resource development, technology and research and development (R&D), and access to financing, to name but a few, remained during this period. These concerns were addressed in the Philippine SME Development Strategy (1998). The 1998 development strategy had four guiding principles for SME development, namely, viability, sustainability, private sector initiatives, and market-driven responses. The strategy also

hinged on sound partnership between the government and the private sector, the complementarity to be ensured by three governing bodies on enterprise development, such as

- 1) the Export Development Council (EDC), which oversees the implementation of the Philippine Export Development Plan;
- 2) the Industry Development Council (IDC), which implements the Philippine Industrial Development Plan and develops enterprises with high technology requirements; and
- 3) the SMEDC, which oversees policies and programs on SMEs and coordinates with both EDC and IDC in drawing up its priority industries.

Accordingly, the development strategy prioritized four strategic imperatives in SME development. These are as follows:

1. *Narrowing the focus on identified priority sectors.* Efforts to focus on "vital few" that demonstrated strong growth and export potential.
2. *Promoting mutually beneficial linkages among small and large firms.* This strategy promoted industrial-subcontracting exchange schemes; the strengthening of SME associations; and the establishment of linkages and cooperation between small, medium, and large firms.
3. *Strengthening technology and R&D initiatives.* This strategy aimed to boost agencies' efforts in examining and controlling technologies that would benefit SMEs, promoting the use of quality standards, and fast-tracking the full operationalization of the APEC Center for Technology Exchange and Training for SMEs (ACTETSME) as a resource center for information networking, mobilization of training opportunities, and upgrading technical know-how. It also aimed to create, expand, and improve curricular training programs in entrepreneurship, management, and technical skills for SMEs and develop appropriate materials for such training. The identification of human resource development (HRD) requirements in specific industries and the provision of facilities/resources for skills training in special economic zones were parts of the strategy.
4. *Improving access to finance.* This strategy aimed to develop innovative financing schemes using nontraditional sources and schemes such as cooperatives and associations, and equity financing and venture capital, respectively.

The latter part of the 1990s saw an intensified focus on export expansion. The 1999–2001 PEDP provided the guide to boosting export performance and

laying the groundwork to developing a sustainable and globally competitive export industry. It emphasized the supplementation and synergy among various programs and initiatives to create a unified and cohesive agenda. The Plan defined roles and commitments of both government and the private sector. It emphasized the need to implement what, for some time now, have remained mostly on paper, and to evaluate such efforts with clear objectives. The EDC was to oversee the implementation of the Plan.

The export-led agenda is supported by the following general strategies:

1. *Provision of a macroeconomic environment that promotes competitiveness, efficiency, and entrepreneurship.* This included maintenance of a low and stable domestic inflation rate, competitive exchange rate, and favorable interest rate policy.
2. *Improving market access and market presence.* The strategy was to open up new markets by acceding to various multilateral agreements such as the AFTA, APEC, and WTO.
3. *Developing a competitive export base.* The PEDP presented a comprehensive Export Policy Agenda and outlined specific policy directions and initiatives necessary to support the export drive. These specific policy directions and initiatives are generally on:
 - Financing;
 - Investment and incentives;
 - Cost of doing business;
 - Agricultural policies;
 - Technology agenda;
 - Education and training;
 - Employment policy, labor, and productivity;
 - Competition policy, liberalization, and international commitments; and
 - Institutional framework

The PEDP also laid out programs on the following:

- Clustering of industries
- Formulating a policy framework for service exports
- Developing backward linkages for exports
- Promotion of “global” companies: Competitiveness upgrading
- Product search program
- Promotion of standards such as ISO 9000 and 14000 series
- Promotion of information management
- Conduct of bilateral and multilateral programs
- Investment promotion
- Identification of materials support clusters

4. *Information as a core trade development service.* The Plan called for the strengthening of primary focal points for delivering information services related to export such as the Philippine Trade Information and Network Systems (PHILTINS) and the One-Stop Export Information Assistance Center (EXPONET). It also aims to link up electronically all DTI offices and commercial posts around the world to facilitate information exchange.

Another initiative during the period worth mentioning is the finalization of the SME development strategy in 2000 by the SMEDC. SMEDC is the country's primary agency responsible for the promotion and growth of SMEs and the 2000 development strategy defined specific actions to address SME concerns regarding the following:

1. *Finance.* Increase and widen the access of SMEs. Promote active participation of industry/trade/ professional associations and provincial SMEDCs in helping SMEs access financing from banks, holding SME financing fairs, and establishment of venture capital corporations.
2. *Information.* Operationalize pro-active, efficient, comprehensive, and reliable information delivery systems for competitive SME planning and increased productivity.
3. *Align databases according to SME needs.* Promote information technology (IT) and e-commerce. Speed up the development of websites among industry and local associations, and government agencies and syndicate hyperlinking of their databases. Develop complete "one-stop" SME website.
4. *Marketing.* Expand market share of selected sectors such as garments.
5. *Promote furniture, processed food, gifts, toys, and household things (GTH), and services sectors.* Pursue trade promotions such as fairs and missions and promote IT/e-commerce in doing business.
6. *Human resource development.* Increase the number of competent owners-managers and workers in SMEs. Conduct benchmarking, documentation of best approaches in human resource development, policy advocacy, training needs assessment, and client targeting.
7. *Technology.* Enhance productivity and competitiveness of SMEs through the effective and judicious application of technologies and related resources.
8. *Upgrade database systems on technologies (including experts' services) for SMEs.* Match technology requirements of SMEs with existing programs/resources and conduct benchmarking activities.

After more than two decades of attention and support, SMEs have experienced highs and lows through the Asian crisis and political changes. The sector's capacity to live up to its promise as an engine of growth has been undermined by many impediments. With the exception of a few export-oriented firms here and there, the majority was characterized by low levels of productivity and efficiency; inability to attain economies of scale; and not enough power to influence prices, volumes, distributions, and markets. They have remained challenged in the areas of human resource development, technology, access to financing, and in R&D.

SMEs had been given attention in the medium-term development plans through various initiatives that address constraints to SME growth. Furthermore, the *Long-Term SME Development Plan* has been formulated to boost SME performance in the long term and lay the groundwork for developing sustainable and globally competitive SME sector well beyond the programs already in place. It shall map out the all the various programs and initiatives that have either been started or thought of before, to create a unified and cohesive agenda. It shall implement programs based on available resources and build on some realistic and potential support. It shall be framed on the basis of consensus-building and ownership of the Plan of the various stakeholders involved.

The role of micro enterprises

The Philippines, like other developing economies in the ASEAN region, has a large and dynamic underground sector commonly referred to as the informal sector. The informal sector has always been characterized as home-based in the urban areas and community-based in the countryside. This sector has employed indigenous skills and raw materials, catered to limited markets, and served as intermittent or supplementary source of livelihood to a lot of households. Over time, some have grown to become SMEs while others remained as they were, perpetuating a traditional craft with decreasing supply of raw materials.

Recognizing the potential of the informal sector, not only as a source of government revenue but also as provider of jobs in the countryside, the Congress passed the first Countryside and Barangay Business Enterprises (CBBEs) law or Kalakalan 20 in 1989. The applicability of the incentives under the law expired in 1999. It was not successful as expected. The National Economic and Development Authority (NEDA) reported that CBBEs faced problems in financing, access to raw materials, skilled labor, and high CBBE fees. The laws and its benefits were not properly disseminated to the intended beneficiaries by local government units. The second CBBE law was

passed on July 24, 1998. In the second law, CBBEs were defined as enterprises having assets of PHP 500,000 and below. The law, which took effect for a period of five years, provided for the promotion of this sector without bureaucratic restrictions. Exemptions from government rules and regulations were granted to CBBEs. These incentives were for any business entity with members or employees not more than 20. Registrants were required to pay a fee of about PHP 1,000 per 100,000 of assets.

The Japanese SME Development Experience and the Historical Policy Environment

It is a well-established fact that Japan hosts the largest number of small and medium enterprises (SMEs) among industrialized countries (Yamawaki 2001). This distinct feature of the Japanese economy has made it the subject of many studies on economic development especially since it provides a stark contrast to the economy of the United States, which is mostly driven by large enterprises. This lends support to the claim that there is truly no unique pattern of development and as what might work for one country, might not work for another.

Notwithstanding this caveat, it would be a mistake for anyone who is attempting to improve its country's policies in the development of SMEs to overlook the experience of SME policy development of Japan. For although there is uncertainty if these policies will work given that all countries are facing different conditions and have their own unique attributes, the success of Japanese SMEs in keeping the Japanese economy afloat is very apparent that it is hard to resist the idea that there should be something worth noting from the Japanese experience. For this reason, we included the historical review of Japan's SME policies in relation to the country's economic development in this paper. As one would observe, the strength of the SME policies of the Japanese government lies in its reactive nature. This means that policies concerning SMEs are quick to adjust to the current environment that SMEs are facing at the time that the policies are drawn.

The reconstruction period (1945–1954)

Most of the SMEs in Japan began their operations during 1945–1954, which is also called the Reconstruction Period of Japan. Since large enterprises take a longer time to restart their operations, SMEs responded faster to provide the needs of the people during that time. This is not to say that problems related to operations were less for these SMEs. On the contrary, SMEs faced numerous external difficulties such as lack of materials for production, severe inflation, and preferred distribution of materials to weighty, large-scale industries as the

government then was hoping to revive the economy. SMEs also had internal problems such as low level of management, lack of technology and/or funding, and aimless investment and production.

As a first measure to help out SMEs, the Japanese government established the Small and Medium Enterprise Agency (SMEA) in 1948, a year after passing the Act Concerning Prohibition of Private Monopoly and Maintenance of Fair Trade and the Law for Elimination of Excessive Concentration of Economic Power. With the SMEA in place, the basic tools on financial resource, cooperatives, management consulting and guidance, and taxation to aid SMEs were also carried out.

In 1949, the Law on the Cooperative Association of Small and Medium Enterprises was passed with the purpose of correcting the social and economic disadvantages of SMEs. Through this law, SMEs proceeded to form cooperatives and groupings that increased their competitive stance against bigger enterprises. In the same year, the National Life Finance Corporation was established to aid SMEs that had been in difficult financial situations by supplying them with short-term non-collateralized loans. Similarly, the Japan Finance Corporation for Small Business was established in 1953 with government equity to supply fixed, long-term, and low-interest funds for SMEs, which general private institutions had difficulty in supplying. Finally, the Small and Medium Enterprise Credit Insurance Law and the Credit Guarantee Association Law were passed in 1950 and 1953, respectively, to further strengthen the financial position of SMEs.

In the area of management consulting and guidance, the three first measures carried out were the Management Consulting System (1948), the Consulting Desk for SMEs (1948), and the Registration System of SMEs Consultant (1952), all of which were deemed important for modernizing and rationalizing SMEs management. It is worth noting that even from the start subsidies were given for municipal governments to promote the guidance program. Finally, as a way of improving the financial accounting of the SMEs, the "Blue>Returns" system of taxation was introduced in 1949. Under this system, SMEs were given tax merits if their tax returns were made with a certain quick formula of bookkeeping. This solved the problem of the incomplete bookkeeping of SMEs which became the practice after the war for fear of being overtaxed by the government.

The high-growth period, the first stage (1955–1962)

With the generous treatment given to enterprises throughout the reconstruction period, the Japanese economy was able to recover to almost the pre-World War II level. SMEs and large enterprises alike were very active.

Each additional production only spurred more additional production such that the period was characterized as a high-growth period. However, in the course of this fast growth, large enterprises and SMEs went in two different paces of growth in terms of productivity, wages, technology, and financing ability. Hence, the period was also characterized by the “dual industrial structure” of the ‘advanced large-scale enterprises’ on one hand, and the ‘delayed SMEs’ on the other (SME Agency 2002). It is in the context of this dual industrial structure that measures on SMEs were drawn during the period.

As a result, in the area of financial support for SMEs, the Law on Financial Assistance for Promoting Small and Medium Enterprises was enacted in 1956 with the aim of improving the productivity of SMEs through the use of modern equipment. Through this law, municipal governments started loaning funds necessary for modernizing equipment in their areas. Strengthening of SME organizations was also included in the agenda and the Law Concerning the Organization of SMEs was enacted in 1957 to establish an organization that would help businesses adjust their activities. Finally, two laws relating to management consulting and guidance for SMEs were passed. One had the aim of broadly diffusing management programs by the government (the Law on Organizing Commerce and Industry Association enacted in 1960), and the other had the goal of preparing a systematic and efficient scheme of guidance for the rationalization of management and improvement in technology for SMEs whereby municipal governments play an active role.

Aside from the traditional problems of providing financial resources, promoting cooperatives, and giving guidance and management, the government also implemented countermeasures to diffuse the subcontracting division of labor that developed during this high-growth period between large or “parent enterprises” and SMEs especially in the industries of electrical machinery and transportation machinery. For although this relationship of subcontracting, which was to typify the Japanese SMEs, improved the efficiency and progress of technology—both for the large enterprises and SMEs through specialization of tasks—many parent enterprises took advantage of their predominant position over subcontractors and engaged in unfair practices such as delaying or reducing payment for subcontractors or infringing their benefits. To prevent such abuses by large enterprises, the Law on the Prevention of Delay in the Payment of Subcontracting Charges and Related Matters (the Subcontractors’ Payment Law) was enacted in 1956.

The high-growth period, the second stage (1963–1972)

The 1960s witnessed the dawn of the opening of the Japanese market for trading and foreign investors. During this period, the promotion of SMEs was

considered as a minimum requirement for achieving the balanced development of the national economy. Measures to develop SMEs during this period were geared toward upgrading the industrial structure and strengthening the international competitiveness of SMEs.

The first law to be enacted was the SME Basic Law, which aimed to eliminate perceived disadvantages faced by SMEs, support their self-help efforts, improve their productivity and trading conditions, and improve the social status of their employees. The SME Basic Law was important in that it stipulated general descriptions of SMEs and consolidated in a single document all preceding laws that had categorized SMEs measure by measure. This made it easier for specific measures regarding SMEs to be decided and implemented later on.

Another important law was the SME Modernization Promotion Law (or simply, the Promotion Law). This aimed to improve the productivity of SMEs by implementing a modernization plan for industries that involved SMEs in a higher percentage and those that can improve its international competitiveness or overall industrial structure when assistance to individual SMEs is given. The Law on Financial and Other Assistance for Small Business Modernization was also promulgated in 1963 to facilitate the promotion of upgrading industrial structure (ex., joint businesses or grouping of factories or stores) and the modernization of equipment when such business was carried out in the form of a cooperative. A loan for upgrading expenditure was made available by the Japan Small Business Promotion Corporation, which was established with government investment in 1967.

A peculiar law, the Law on Ensuring the Receipt of Orders from the Government and Other Public Agencies by Small and Medium Enterprises, was enacted in 1966 with the aim of correcting the business disadvantages of SMEs and as a response to the recession that developed in 1964. Under this law, the government is obliged to set up a target amount of orders (official demands priority) for SMEs year by year. Also to correct the disadvantages of SMEs, amendments on the Law on the Prevention of Delay in the Payment of Subcontracting Charges and Related Matters were made to ensure that subcontracting enterprises were well protected from abusive parent enterprises. Another law for subcontractors was enacted in 1970—the Law on the Promotion of Subcontracting Small and Medium Enterprises—to support the modernization of subcontracting enterprises, which was becoming more important as international competition became stiffer due to the deregulation in capital transactions.

During this period, small-scale enterprises also received greater attention with two measures carried out specifically for them. The first was to improve

their management skills (through the provision on management consultant system in the SME Basic Law), and the second was to provide retirement money for the small-enterprise entrepreneur (through the Small-Enterprise Mutual Relief Projects Law of 1965).

Finally, in response to the needs for a system to assist SMEs facing difficulty in obtaining funds from the open stock market, the Small Business Investment Company Limited Law was enacted in 1963, which made public capital available for long-term use.

The stable-growth period (1973–1984)

As the first oil crisis hit the country in 1973, the Japanese economy shifted from having high growth to having stable growth. As a response to this change, SME policies changed from that of promoting modernization in equipment and management resources to that of developing “soft” management resources, which involved improving technical skills, manpower resource, and information.

As a result, three institutions were established during this period:

- 1) the Institute for Small Business Management and Technology, which was established in 1980 with the aim of developing human resources,
- 2) the Information Center for Small and Medium Enterprises, which was opened in the Small Business Corporation to provide information services for management improvement, and
- 3) the Regional Information Centers for Small and Medium Enterprises, which were opened in prefectures also with the aim of providing information that would improve management skills of SMEs.

Transition period, the first stage (1985–1999)

As the yen drastically revalued from 1985 onward, and with a depression taking place, the competitiveness of certain types of industries and particular regions where such industries agglomerated started to fall apart. The government was quick to respond by enacting the Temporary Law concerning Measures for Changing Business for Specific Small and Medium Enterprises in 1986. This temporary law specified the type of industries that would receive special aid during this period and provided assistance to those who wanted to convert their businesses during this sluggish period. The law also promoted the conversion of SMEs in certain regions heavily affected by the depression and yen revaluation.

With the economic bubble finally bursting in 1992, the inflexibility of the Japanese economy evidenced by the decrease in the start-up rate and the increase in the closure rate as well as the increasing unemployment during this period became the subject of concern (Kawai and Urata 2001). In an attempt

to correct this problem, the Temporary Law Concerning Measures for the Promotion of the Creative Business Activities of Small and Medium Enterprises was enacted in 1995 in the hopes of stimulating SMEs and individuals entering into new businesses or investing in research and development, without necessarily specifying a particular type of industry to be the recipient of such services.

It was also in this period that the SME Modernization Promotion Law—enacted in 1963 mainly to encourage industry-wide, large-scale benefits and the modernization of the equipment of SMEs—was combined with the Temporary Law Concerning Measures for Smooth Adaptation to Structural Changes in Economy by Advancement of Specific Small and Medium Enterprises to New Fields, etc. This latter law was enacted in 1993 with limited subjects of assistance. The combination of the two laws resulted to the Law on Supporting Business Innovation of Small and Medium Enterprises enacted in 1999. This new law aimed to assist SMEs in competing in the new environment that require advanced IT, reduced costs, greater product quality, and improved product marketability.

Transition period, the second stage (2000–)

Until the end of 1999, the Japanese government based its SME policies on the former SME Basic Law enacted in 1963. The premise of the basic law was that the SMEs were (a) small in size but large in number, (b) old-fashioned and undifferentiated, and (c) particularly weak and as such needed special policies to support their growth. As a result, conventional SME policies had been basically aimed at closing the gap between SMEs and large enterprises through pursuing the scale merit of SMEs while developing a uniform modernization policy for each industry.

However, with the changing environment brought about by the growth and maturation of the economy, diversification of consumer needs, the IT revolution, and the progress of globalization, the traditional view of SMEs and the past policy tools no longer fit the actual situation of SMEs. Instead of focusing on the disadvantages of SMEs caused by their size, modern policies now build on the strengths of SMEs that are mainly due to their mobility and flexibility in providing small-lot production of a variety of products that are in demand in the current quick-changing economic environment. Also, the recent decline of the start-up rate, which has now gone even below the closure rate, is provoking concern that it may hamper the metabolism and labor-absorbing capacity of the economy.

It was against this backdrop that the new SME Basic Law, which was a revision and restructuring of the conventional SME policies drawn from the

Table 25. Summary of basic differences in SME Basic Law

	Previous SME Basic Law	New SME Basic Law
Policy Concept	Rectify the gap between Large Enterprises & Small and Medium Enterprises in terms of productivity	Developing a wide range of independent SMEs for greater economic vitality <ul style="list-style-type: none"> • creation of new businesses • promotion of market competition • increase of attractive job opportunities • vitalization of regional economy
Policy System	<ul style="list-style-type: none"> • Upgrading/improving productivity • Improving trading conditions • Finance and taxation 	<ul style="list-style-type: none"> • Supporting self-help for ambitious enterprises • Strengthening of management base • Facilitating apt responses by enterprise for abrupt environmental change (providing necessary safety net), ex., facilitating change of business, provision of mutual relief system, and legal system of bankruptcy • Finance and taxation (i.e., establishing various ways to supply fund including direct financing)
Definition ^a	(1) Manufacturing <ul style="list-style-type: none"> • Capital size: 100 or less • Employees: 300 or less (2) Wholesale <ul style="list-style-type: none"> • Capital size: 30 or less • Employees: 100 or less (3) Retail <ul style="list-style-type: none"> • Capital size: 10 or less • Employees: 10 or less (4) Services <ul style="list-style-type: none"> • Capital size: 10 or less • Employees: 50 or less 	(1) Manufacturing <ul style="list-style-type: none"> • Capital size: 300 or less • Employees: 300 or less (2) Wholesale <ul style="list-style-type: none"> • Capital size: 100 or less • Employees: 100 or less (3) Retail <ul style="list-style-type: none"> • Capital size: 50 or less • Employees: 50 or less (4) Services <ul style="list-style-type: none"> • Capital size: 50 or less • Employees: 100 or less

Note: ^aCapital size is in million Yen

Source: Small and Medium Enterprise Agency. www.sme.ne.jp/policies02_kaiseigaiyo/kaiseigaiyo.html

SME Basic Law, was drafted in December 1999. Table 25 summarizes the basic differences of the previous SME Basic Law and the new SME Basic Law.

As can be seen from the table, the key thrusts of the new Basic Law for SMEs are *first*, to promote self-sustaining enterprises by promoting business innovation and new business start-ups; *second*, to enrich business resources by strengthening the management base of SMEs; and *third*, offer a safety net by facilitating adaptation to economic and social changes.

For the first goal, it was acknowledged that the economy could be revitalized by venture businesses led by entrepreneurial managers who can boldly develop new products and services or new production methods or management methods by taking risks. However, it was well recognized that the risks for creating new businesses were great that policies should be made to support daring enterprises in their self-help efforts. It was for this reason that new capital markets called "MOTHERS" started operating in the Japanese financial market from November 1999 and "Nasdaq Japan" from June of 2000. Both measures expanded options for SMEs in raising funds for their business activities. To promote the development of the bond market available to SMEs, a credit guarantee system for the issue of corporate bonds or privately placed bonds by SMEs was also introduced. Finally, to support technological development, the entire government provided subsidies for new business development and spent money on research entrusted to SMEs along with the established Small Business Innovation Research System (SBIR), which offered consistent support up to the commercialization phase.

On the second goal of strengthening the management base of SMEs, the government planned to do this by (a) supplementing SMEs' vulnerable managerial resources, and (b) improving their business environment. With the conventional view of developing business activities through improvement of material managerial resources being replaced by the recognition of the increasing importance of non-material managerial resources, the government is now seeking the cooperation of the private sector in providing business expertise, technologies, and information and human resources. As an illustration, the Japanese government has established support centers that provide so-called "One-Stop" assistance services in terms of both funds and non-material services on each national, prefectural, and local level. By integrating and setting up networks of local public entities and various existing private SME support organizations to offer information and advice on policy measures, and by assisting with business and technological problems of SMEs in one place, support centers are able to make the most out of the skills and abilities of professionals in the private sector. Finally, in the area of human resource development, the government has strengthened the position of the SME Management Consultant system, which previously only gave complementary assistance in public business diagnoses, by giving it the role of certifying private business consultants with wide-ranging knowledge of SME businesses in general and advanced consultation skills.

Notwithstanding the capability of SMEs to be self-sustaining, the government still recognizes the occurrence of unexpected events outside

the control of SMEs. These include a sudden change in the trade structure or exchange rate, restrictions in the supply of raw materials, the occurrence of a great disaster, or a chain-reaction bankruptcy triggered by the collapse of a large enterprise that may damage SMEs' businesses through no fault of their own. In such cases, emergency relief measures are carried out by the government as a safety net to stabilize business.

Among these measures are long implemented financial measures against disasters, and measures to prevent chain-reaction bankruptcies. The government has also sped up corporate rehabilitation procedures by reviewing the Bankruptcy Law, which was criticized as being difficult to apply to SMEs. In addition, a new corporate rehabilitation scheme, the Civil Rehabilitation Law, was also introduced. In consideration of the recent frequency of both bankruptcies of large enterprises and major natural disasters in the country, the Japanese government also has plans of further increasing and strengthening safety measures especially in the areas of finance and credit guarantee, so that SMEs can deal with such situation more effectively and promptly.

It has often been said, and with good reason, that policy development is one thing and implementation is another. It remains to be seen therefore, what the result of all these policies on SMEs have been in Japan. Due to the time and data constraints, however, the analysis regarding this matter would be limited to seeing the current status of Japanese SMEs. In particular, the profile of their size, use of labor, and value added as well as other indicators presented before may be used as measures of the dynamism (or lack of it) that SMEs provide to the economy.

Japanese SMEs best practices

If there is anything to be envied about the experience of Japanese SMEs that has called much attention, it would be their wide use of government-supported subcontracting and clustering.

Subcontracting (Shitauke)

The development of SMEs' linkages with larger enterprises has played a significant role in the highly successful business practices of the vertically integrated Japanese "keiretsu" financial-industrial groups during most of the post-war period. Similarly, linkages appear to have been important in the recent successes of township and village enterprises (TVE) in China. Another quite different synergistic relationship, based on both horizontal and vertical linkages, is represented by the kind of local cooperative/competitive development that is common for a long time in Europe and

North America, but only recently dignified with the titles “industrial district” and “cluster.”¹¹

Subcontracting SMEs are those that have integral links with a larger foreign firm, or to a domestic firm that is exporting. Subcontracting and ancillarization have helped the dispersal of industry and growth of SMEs and rural nonfarm sector in many countries. The most successful example of subcontracting from large urban areas to small rural entrepreneurs is in Japan. The division of responsibility and resources in keeping with its economic propensity has given Japan an unparalleled global edge. Its success is attributed to expanding demand, limited capital, low basic skills, and paternalistic relationships—i.e., big businesses share the production process, technology, and innovation with SMEs.

In the Japanese economy, subcontracting has been regarded as an important source of efficiency and competitiveness for industries such as textiles, general machinery, electric machinery, and automobiles (Kimura 2001). By dividing the production process into small, specialized tasks, larger firms called ‘parent firms’ were able to exploit the efficiency of each individual subcontractor by allowing them to choose the scale of production appropriate for their tasks.

Large Japanese firms have been particularly active in ‘internationalizing’ their subcontracting networks through Asia in recent years. This has had the effect of increasingly integrating the traditional manufacturing part of the Japanese economy with its Asian suppliers. This is not a static process. As each economy becomes more developed and as costs rise, subcontractors need to move on to another lower cost base, or to move up the market to higher quality subcontracting. This brings forth a raft of issues. Firms, for one, must always think about how to remain competitive while governments must consider how to ensure a reliable and efficient subcontractor industry, and how to help their subcontracting SMEs adjust and remain competitive.

Thailand, Malaysia, and Indonesia have adopted the Japanese model with variations to suit each nation’s cultural and social environment. In Thailand, large companies are allowed to develop ancillaries, which can operate within the same factory premises and yet are entitled to have independent recruitment, wage structure, and service conditions.

According to Japan’s MITI, subcontracting is defined as follows: “A contractual arrangement between a firm and a ‘parent’ firm with larger capital or larger number of employees. The former firm is commissioned to produce products, parts, attachments, materials, or components used as inputs in the

¹¹ Robert McIntyre (2001), p. 5.

parent firm's production, or to produce or repair facilities, equipment, tools and others, which the parent firm uses in production. When a firm purchases non-customized parts, components, and others through a usual marketing channel, it is not regarded as subcontracting. In subcontracting, a parent firm orders the work directly to a subcontractor with assigned plan, quality, specification, form, design, or others."

From these discussions, it seems that all countries engage in subcontracting in one way or the other. What makes the Japanese practice of subcontracting special is its prevalence and almost default arrangement in the production of labor-intensive or multi-layered production goods. How did this come to be?

In the study on the evolution of subcontracting processes in Japan, one would find that the traditional view of explaining it is through the Marxian view that sees large firms as having monopsonistic power in determining prices, imposing requirements on product quality and delivery, and using small firms as buffer for business fluctuations. However, in the 1970s and 1980s, this traditional view of the dualistic structure in labor and capital markets for small and large firms started to break down with the increase in confidence of the Japanese on their economy. This is when the efficiency-enhancing nature of the subcontracting system was highlighted and was used to rationalize its wide usage. Among the acknowledged benefits of subcontracting were

- (1) it saves costs to search and select new suppliers,
- (2) it is a good way of enhancing quality and reducing costs of the parent firm,
- (3) it successfully provides incentives for subcontractors' investment on relation-specific assets,
- (4) it offers an efficient risk-sharing system, and
- (5) it sometimes is a good way of maintaining relationship by a certain amount of shareholding (Kimura 2001).

On the other hand, the historical explanation of the emergence of subcontracting as a basic production arrangement is that in the latter half of the 1940s and 1950s, the development of the dualistic structure of large enterprises and SMEs led large firms, who were the ones with greater direct access to foreign technology and export marketing channel, to subcontract SMEs. SMEs then had an abundant supply of labor, probably due to the disrupting effect of the war. This situation was complemented by the government's active promotion of SMEs through policies on financial arrangements (especially on compensating liquidity constraints), managerial

practice and technology, cooperative organizations, modernization scheme through advice, tax concessions, and protection against competition given to certain industries.

During the high-growth period of 1955–1973, SMEs were able to benefit from technological assistance from their parent firms, thanks to the long-term character of subcontracting arrangements. This resulted in their financial stability during this period. However, after 1973, the Japanese economy faced slower growth rates and scarcity of labor prevailed while SMEs were gaining human capital, improving their technologies, and becoming more vigorous in their entrepreneurship such that the financial sector gradually removed their liquidity constraints. In the 1980s, as the globalization of Japanese firms progressed, SMEs faced difficulties in finding new customers when their parent firms transferred production locations in other countries. Nevertheless, a minority was lucky enough to get foreign direct investments leading to their growth and graduation from subcontracting arrangements.

So what factors increase the likelihood of subcontracting arrangements to be undertaken in the present times? First of all, mention must be made of the varying importance of subcontracting from industry to industry. Labor-intensive production processes such as textiles and clothing, and multi-layered vertical production flows such as machinery industries are the ones that extensively use subcontracting arrangements.

The result of a regression model which used information from the 1994 Basic Survey of Business Structure and Activity compiled by MITI revealed that: first, firm size is inversely associated with the likelihood of firms to engage in subcontracting activities; second, larger firms are less likely to accept work as a subcontractor; and third, the probability of hiring subcontractors increases as firm size increases (Kimura 2001). However, the aforementioned regression result does not preclude the fact that small firms employ subcontractors.

Firms using subcontractors de-internalize a part of their activities and usually concentrate in the downstream activities of the value chain while firms working as a subcontractor concentrate on production activities. In addition, firms utilizing subcontractors tend to internalize exporting activities and R&D while firms working as a subcontractor are likely to de-internalize these activities. Finally, affiliates of foreign firms with a high proportion of foreign shares are more likely to use subcontractors and unlikely to work as subcontractors. The study ends with a note that although subcontracting continues to be prevalent in the Japanese industrial organization, it is no longer viewed as a necessary source of strength of firms in the 1990s.

Nonetheless, the importance of subcontracting still remains if only for being effective in keeping the economy alive through supporting the entry of firms in certain industries. Since parent firms often encourage their employees to start new business and to be engaged in subcontracting relationships with them, new firms can avoid substantial initial investment because it allows them to specialize in a particular process that they are competitive in. With a consistent pool of small enterprises specializing in specific tasks, clustering is also likely to be formed.

Clustering¹²

Along with the large number of SMEs and the wide use of subcontracting arrangements, clustering is also an important feature of Japan's industrial organization. This claim is supported by the fact that in the 1996 survey of the Small and Medium Enterprise Agency¹³, a total of 537 clusters are reported to exist throughout Japan (see Table 26 for breakdown), which is quite an appreciable number of groups of firms.

Clusters are generally defined as geographic concentrations of interconnected companies and institutions in a particular business field (Porter 1990, 1998). However, not all clusters are the same and their distinctions result from the historical circumstances, demand conditions, supporting industries, and competitive conditions that brought about their evolution. Nonetheless, in a study of 14 major cases of manufacturing clusters in Japan that have shown high propensities to export, some common characteristics were found to have caused the birth of these clusters. Yamawaki (2001) provides a summary of the cluster development experience of the 14 manufacturing clusters in Japan which is replicated in Table 27 below.

One of the basic drivers of cluster formation is the historical context surrounding the region in which these clusters are formed. A great number of clusters were either:

- (1) already known for the products that they specialized in even before they modernized their manufacturing systems (ex., Kiryuu, Komatsu, Tsubame, and Nishiwaki); or
- (2) lucky to chanced upon unexpected contractions in supply of other countries of the product they were manufacturing (ex. Tsubame's

¹² This section is largely based on Yamawaki (2001).

¹³ As presented by Yamawaki in page 14 of his paper *The Evolution of and Structure of Industrial Clusters in Japan*.

success in exporting silverware was partly caused by the contraction of such in the US and Europe, while Gifu's success in apparel can be traced from the sale of used-clothes in front of the train station after WW II), or

- (3) responding to an increase in demand for the items they specialized in (ex., Ishikawa and Itabashi).

The availability of raw materials—either in the cities themselves (ex., Seto) or in neighboring cities (ex., Gifu and Sanjo)—also contributed to the development of clusters in some locations.

Table 26. Number of clusters, average cluster size, and average firm size, by industry, 1996

Industry	Number of clusters	Number of firms/cluster	Employment/Cluster	Employment/firm
Food processing	83 (15.5%)	82	1,260	15.37
Textiles	126 (23.5%)	241	1,518	6.30
Clothing	34 (6.3%)	208	4,986	23.97
Wood products and furniture	78 (14.5%)	102	823	8.07
Clay, stone, and glass products	62 (11.5%)	125	920	7.36
Machinery	56 (10.4%)	128	1,986	15.52
Miscellaneous	98 (18.2%)	111	1,175	10.59
Total	537 (100%)	145	1,496	10.32

Source: Yamawaki (2001)

Table 27. Summary of cluster development experience of 14 Japanese locations¹⁴

Location (Prefecture)	Products	Startup Period	Key Initial Conditions	Key Features in Industrial Organization
Kiryuu (Gunma)	Silk, man-made silk, and synthetic fabrics and weaves	1600s (Edo Period)	Historical cluster (silk) Foreign technology, imported lacquard loom	Extensive subcontracting Coexistence of firms with complementary skills and capabilities
Ishikawa	Synthetic fabrics	mid-1960s	High demand growth for polyester after 1966 Regional government policy to promote the synthetic textile industry	Extensive subcontracting Coexistence of firms with complementary skills and capabilities
Fukui	Synthetic fabric	Early 1900s (Meiji)	Technology transfer from other cluster in Japan (Kiryuu) Prefecture government helped nurture the industry through its operation of technology center between 1910-1930	Extensive subcontracting Coexistence of firms with complementary skills and capabilities
Komatsu (Ishikawa)	Silk General machinery for construction machinery	1640 1921	Historical cluster (silk) Existence of a large assembler	Network of supporting and related industries Vertically structured subcontracting system for a large assembler (Komatsu)
Nishiwaki (Hyogo)	Cotton fabric	1793	Historical cluster (cotton fabrics) Technology transfer from other clusters in Japan	Extensive subcontracting Coexistence of firms with complementary skills and capabilities

¹⁴ Yamawaki, 2001, pages 6-8.

Table 27. (continued)

Location (Prefecture)	Products	Startup Period	Key Initial Conditions	Key Features in Industrial Organization
Gifu (Gifu)	Apparel	Late 1940s	Historical circumstances Prior existence of related industries nearby Availability of large pools of female workers in the region	Extensive subcontracting Extensive use of female part-time workers
Seto (Aichi)	Ceramic novelty goods	1100s (Heian)	Historical cluster (ceramics) Access to high-quality raw materials	Extensive subcontracting Coexistence of firms with complementary skills and capabilities
Morodomi (Saga)	Furniture	1955	Construction of a new bridge connected two neighboring cities Reduction in transport costs Expansion of viable economic area	Subcontracting
Ota (Gunma)	Automobile parts	1918	Existence of large assemblers (Nakajima in pre-war period) and Fuji Heavy Industries (in the post-war period) Prior existence of supporting industries inherited by Fuji Heavy Industries	Hierarchically structured assembler- supplier relationship A large cluster formed with other assemblers (Nissan Diesel in Ota; Daihatsu and Hino in Gunma; Nissan, Honda, and Isuzu in neighboring regions)
Itabashi (Tokyo)	Binoculars	Early 1900s (Meiji)	Foreign technology imported from Zeiss, Germany Large military demand during the Korean war Prior existence of related industries (optical equipment)	Existence of several integrated markets Extensive subcontracting Coexistence of firms with complementary skills and capabilities

Table 27. (continued)

Location (Prefecture)	Products	Startup Period	Key Initial Conditions	Key Features in Industrial Organization
Tsubame (Niigata)	Silverware, kitchenware, and metal household ware	1600s (Edo)	Historical cluster (Japanese-style nails) Import substitution during the World War I Repositioned by diversifying into household wares during the 1960s to circumvent VERs ^a in the US market	Hierarchically structure subcontracting system Coexistence of firms with complementary skills and capabilities
Sanjo (Niigata)	Hand tools	Late 1940s	Geographic proximity to other cluster (Tsubame) Prior existence of related and supporting industries in the neighboring cluster	Extensive subcontracting Coexistence of firms with complementary skills and capabilities
Seki (Gifu)	Cutlery	1100s (Kamakura)	Historical cluster (sword forging) Importance of geographic location as a hub connecting major cities Repositioned into cutlery production after the Meiji government banned the making of swords	Extensive subcontracting Coexistence of firms with complementary skills and competencies
Sabae (Fukui)	Eyeglass frames	1910s (Meiji)	Technology transfer from other clusters in Japan (Tokyo and Osaka) Regional government policy to develop the region's economy	Extensive subcontracting Coexistence of firms with complementary skills and capabilities

Source: Yamawaki (2001)

^aVERs = Voluntary Export Restraints

The second factor that can also be linked to historical circumstance is the presence of large assemblers that manufacture products through assembly-type operations, stimulating the entry and growth of other firms to supply parts and related products to them. Examples of this would be the machinery cluster in Komatsu, which influenced firms in the area to shift from producing silk to producing construction machinery. There is also the automotive parts cluster in Ota wherein the conversion of a part of Nakajima Aircraft (divested after WW II) to Fuji Heavy Industries resulted in the formation of a network of auto part suppliers in the city.

The third factor, which is also related to the availability of raw material in the region, is the prior existence of supporting industries where clusters form. This was also exhibited by Nakajima Aircraft when it nurtured such network of supporting related industries before the war so that Fuji Heavy Industries did not have too much difficulty especially in recruiting labor fit for its production. The binocular clusters of Itabashi is also an illustration of this important factor, having optical equipment and precision instrument manufacturers in the region prior to its rise as a major producer of binoculars, which attracted makers to enter the region. As mentioned earlier, supporting industries need not be in the region themselves to spur the formation of clusters, as the cases of the hand tool cluster in Sanjo and the apparel cluster in Gifu demonstrated. The presence of such related industries in its neighboring cities (i.e., the silverware industry in Tsubame, which made use of special skills in metal working, forging, processing, and polishing supporting the cluster in Sanjo, while the thriving textile industries in nearby cities supporting the cluster in Gifu) can also result to such clustering.

The fourth factor leading to the formation of clusters is the availability of pooled labor market for part-time workers. This was exhibited by the apparel cluster in Gifu, which made use of a large pool of part-time female workers who offered the needed skills while minimizing the disadvantages caused by cyclical demand. The same can be said about the textile clusters in Ishikawa and Fukui, both of which were situated in agricultural sectors and took advantage of the existence of a large pool of part-time workers. It must be stated, however, that the skills offered by these laborers are lower than those of regular workers because they normally work as subcontractors for first-tier and/or second-tier suppliers that mostly require labor-intensive work.

The fifth factor, which was well illustrated by the furniture cluster in Morodomi, is the reduction in transportation cost. With the building of the toll bridge over the Chikugo River around 1955, Morodomi was connected to the city of Ohkawa, which was already a major producer of furniture then and was in search of new locations to expand its manufacturing base. With

the new bridge significantly reducing transportation costs between these two cities, furniture makers in Ohkawa moved into Morodomi and invested in new capacity. The number of furniture firms in Morodomi further increased in 1966 when the toll of the bridge was eliminated.

The sixth factor, from which the Philippines can learn, is the regional government policy on supporting cluster formation. The best example of this is the Ishikawa and Fukui prefectures, both of which took the initiatives to nurture and modernize their textile industries in order to develop their regional economies. Fukui's prefecture was also responsible for the birth of the eyeglass frames clusters in Sabae having designed its startup. Probably the most important policy tools used by Japan's prefecture governments were the establishment of public testing and research centers as well as technology centers that guide and foster the technological developments of particular products. Between 1894 and 1926, a total of 41 public testing and research centers and technology centers were established in different prefectures to promote technological development in textiles, ceramics, agriculture, chemicals, and food. The importance of such centers in providing (a) technological guidance and consulting, (b) testing and inspection, (c) R&D, (d) seminars, and (e) dissemination of information on latest technologies and products has always been recognized. The establishment of such centers continued in subsequent periods leading to the opening of 46 centers during 1927-1945 and another 57 centers during 1946-1964. It is worthwhile to note the increased importance of local institutions such as local trade associations, wholesaler associations, local chambers of commerce, and prefectural technical centers in this product and technological information dissemination in ensuring the success of a number of businesses worldwide.

Finally, technology transfer from other locations, whether foreign or domestic, has also proven to be an important cause of cluster formation. The textile clusters in Fukui and Nishiwaki imported technologies from other textile clusters in Japan. The same applies to Sabae's eyeglass frame cluster, which imported the related technologies and skills from Tokyo and Osaka. With regards to importing foreign technologies Kiryu (which procured the Jacquard technology from abroad) and Itabashi (which imported technology related to the production of binoculars from Germany) are the most noteworthy.

The seven factors are by no means substitutes for one another and, in many cases, have actually been found to be complementary to each other. Nor is the list exhaustive of the possible reasons for cluster formation but are merely what seem to be the most important factors causing the birth of the 14 major clusters selected. These factors are consistent with those derived from

the experiences of the US and Europe on clustering. It is distinctively Japanese, though, in the sense that it

- makes extensive use of subcontracting;
- encourages a hierarchical relationship between manufacturers and multiple layers of suppliers;
- supports the proliferation of small size suppliers;
- gives prime importance to on-the-job-training;
- is characterized by a low degree of labor mobility of skilled workers between firms;
- prefers internal labor markets to external labor markets to allocate human resources; and
- engages the establishment of various institutions such as trade associations, business associations, and wholesalers associations in its information campaign (Yamawaki 2001).

Clustering arrangement definitely brings benefit to member firms which contribute to its lasting appeal. According to Marshall (1920) and Krugman (1991), the three distinctive sources of advantage of concentrate production are (a) labor market pooling, (b) specialized inputs, and (c) technological spillovers. In a questionnaire survey conducted by the Small and Medium Enterprise Agency of Japan (SMEA) in 1996¹⁵ among 537 clusters, it has been found that member firms perceived advantages received from the clusters to which they belong, and these are summarized in Table 28.

Survey results confirm two distinctive sources that were laid out by Marshall (1920) and Krugman (1991) as being applicable to the Japanese experience: specialized inputs (represented by the category "specialization/division of labor") and technological spillovers (represented by the category "diffusion of technology and technological cooperation"). This suggests that agglomeration occurs in the Japanese clusters because it can support suppliers that possess specialized complementary skills. Through division of labor, manufacturers benefit from the existence of specialized suppliers because they can choose the optimal combinations of technologies for a wide range of products especially in a changing global economic environment characterized by individualistic consumers demanding a wide variety of high-quality products to be provided in the shortest time possible.¹⁶ Although the advantage of division of labor can also be exhibited by subcontracting firms that are not necessarily situated in the same location,

¹⁵ Presented as Table 3 in Yamawaki (2001).

¹⁶ The Yokohama Industrial Institute (1991)

Table 28. Sources of advantage in Japan's clusters, by industry (%)

Advantages (Note: respondents are not restricted to choose only one)	All industries	Textile and clothing	Wood products and furniture	Stone, clay, and glass	Metal products and machinery
Ease of procurement	42.3	23.9	50.7	59.3	50.0
Access to labor market	6.8	5.1	5.5	3.7	8.0
Availability of skilled workers and engineers	10.0	9.4	13.7	5.6	8.0
Specialization/division of labor	42.6	53.6	47.9	31.5	64.0
Access to supplier/ subcontractor	24.2	30.4	23.3	13.0	38.0
Access to customer base	10.8	11.6	12.3	13.0	6.0
Competitive environment	19.5	16.7	20.5	25.9	14.0
Diffusion of technology and technological cooperation	31.2	37.6	26.0	46.4	16.0
Opportunity for business alliance	11.9	8.0	13.7	14.8	10.0
Access to market information	24.8	29.0	16.4	16.7	24.0
Regional policy	27.4	26.8	23.3	20.4	28.0
No advantage	2.8	2.9	1.4	1.9	0.0
Number of clusters in sample	471	138	73	54	50

Source: Yamawaki (2001)

the benefits of efficient organization are enjoyed more if firms are located near each other. Another major motivation for forming clusters is the benefit of technology and information spilling over between nearby firms. As pointed out earlier, the importance of regional institutions in facilitating spillovers is not trivial. This is why public technical centers are actively engaged in offering technical consulting services and seminars and disseminating information on new technology and product in its prefectures. Likewise, local chambers of commerce, trade associations, and business organizations coordinate business activities within clusters and provide market and technical information.

The reason why, based on the results of the SMEA survey, a pooled labor market for skilled workers is not an important source of advantage in Japanese clusters may be explained by the way skills are created and developed in Japanese firms and how these skills are allocated among firms in Japan. It is a common notion that on-the-job training is the most commonly used method to train workers in Japanese corporations (Koike 1988) because of the widespread belief that most skills are learned only by doing. Hence, most of the skills that a laborer learns from a certain firm are usually specific only to that firm or even plant where this was learned. This in turn explains why the possible advantage of labor pooling is not commonly perceived by Japanese firms since to become an advantage for the cluster, skilled workers must be mobile and be able to use their skills in other firms. As a result, internal markets (of being "stucked" to a certain skill) become the avenue by which firms choose their laborers and at the same time, influence the workers to stay with the same firm until retirement.

SMEs in the Global Economy

Over the past years, the Philippine government has intensified its effort to provide policy climate and support mechanisms for SMEs. The roles of SMEs in employment generation and wealth creation have been emphasized and acknowledged as evidenced by the intensification of development policies for SMEs. If one is to compare the assistance the government has extended to the SME sector during the years after World War II until around the mid-1980s, the government has done a remarkable job in acknowledging the importance of SMEs through SME promotion.

The period from 1940s to the 1990s saw the proliferation of SME support programs but with little positive results. Beginning in the late 1980s and early 1990s, there were significant efforts to intensify SME programs. The Philippine government passed Republic Act (RA) 6977, or the Magna Carta for SMEs, to address the problem of uncoordinated programs for SMEs. The law established two major SME institutions: the SME Development Council or

simply SMED Council; and the Small Business Guarantee Finance Corporation or SBGFC. In terms of access to low-cost financing, some PHP 164.2 billion was set aside for the SME Enterprise Credit by the end of 2002. This amount set aside for just that year was about 10 times more than the previous bank lending channeled to SMEs of only PHP 16.1 billion over 40 years prior to the promulgation of RA 6977 in 1991. The Philippine government has also continued to pursue programs to help SMEs in finding market niches and in providing human resource training. The establishment of the APEC ACTETSME signaled its commitment to build better operating environment for the sector.

Presently, however, Philippine SMEs still face the same challenges that have long been pointed out in researches and studies. These challenges can be broadly categorized under the themes of inefficient organization, weak management skills, inferior labor skills, and lack of access to raw inputs and technology. These concerns have been regarded by many as primary factors in the rather static state of SMEs across time. Furthermore, domestic SME issues and concerns are not entirely separate from issues related to globalization, trade liberalization, and SMEs. With the impacts of globalization and its manifestations, additional measures have been perceived as priorities to strengthen the SME sector.

To further develop the SME sector, it is necessary to facilitate the transfer of technology to SMEs by suitable arrangements such as, for example, regional information networks, subcontracting and networking, and the provision of timely and adequate finance to SMEs. Adequate backward and forward linkages need to be established between small and large units in terms of subcontracting, production sharing, and manufacture of parts. Suitable measures should be taken to enhance the access of the SME sector to information particularly those relating to external markets and foreign investment. The process of industrialization should be extended to the countryside because much of the existing growth of SMEs has taken place in and around the metropolitan areas. Undesirable tariffs and nontariff restrictions on their products must be removed to enhance the export potential of SMEs since SMEs are most vulnerable to trade protectionism and exchange rate fluctuations (Tecson 1999).

At the national level, the development of SMEs calls for various policies, including the following:

- *Marketing.* Sectors with a competitive advantage need to be identified and sector-specific innovative marketing support devised. SMEs need to be promoted as ideal destinations for franchising and outsourcing.
- *Technology.* Technology upgrading becomes a key parameter of competitiveness. It is necessary to focus on enhancing technology

information through a technology bank and facilitate technology transfers through soft financing and capital subsidy scheme.

- *Infrastructure.* Power, water, industrial estates, roads, telecommunications, and a clean environment are some of the more critical aspects of infrastructure for doing business. Production and commerce are heavily dependent on these inputs. Improvement in infrastructure facilities for SMEs is necessary to enhance their efficiency and productivity.
- *Clusters.* Clusters have the potential to be springboards of core competencies. The creation of common facilities, upgrading of infrastructure, demonstration projects, capacity building, strengthening of association, targeted credit delivery, and brand building are activities that is suggested to be built around clusters. Moreover, development has to be accorded priority for existing clusters while potential clusters would have to be identified and an appropriate action plan worked out for their integrated development. The program needs adequate infrastructure support for the clusters and active involvement of industry associations in the maintenance of their services.
- *Access to information.* Databases on market-related and financing-related information need to be identified and made accessible in a user-friendly manner.
- *Innovative financing techniques.* There is a need to develop innovative financing measures such as setting up venture capital funds, leasing companies, mortgage finance companies, factoring companies, trade credit suppliers, and microfinance.
- *Microfinance.* The development of microfinance promotes economic growth, thereby contributing to poverty alleviation. Not only does financial development foster economic growth and create employment opportunities for the poor, but it also helps to mobilize savings.

SMEs, globalization, and international trade

Globalization is an inevitable and irreversible process. With the impacts and manifestations of globalizations, economies worldwide need to deal with the imperatives of globalization, capitalizing on its positive aspects and mitigating the negative ones. Accordingly, globalization has enhanced the opportunities for success, but it has also posed new risks to developing countries.

Globalization has many faces but it is first understood in economic and financial terms. In this sense, it deals with the broadening and deepening

linkages of national economies into a worldwide market for goods, services, and especially capital. Perhaps the most prominent aspect of globalization is the rapid integration of production and financial markets over the last decade. As a result of a revolution in telecommunications and information technologies, the last 15 years have dramatic increases in trade linkages and cross-border capital flows, as well as radical changes in the form, structure, and location of production.

It has to be underscored that the process of globalization and liberalization has assisted firms in operating across national boundaries, affecting thereby the pace and the whole process of industrial development. There is increasing realization that the opening of global markets through trade liberalization is not only making it easier for firms to extend their operations beyond national boundaries but also providing greater potential for expansion and growth. However, not all countries benefit from globalization and liberalization. This is because the situation requires competitive capacity and additional resources for investment, in addition to technological and marketing linkages to promote rapidly changing and high-quality products and services. This is where the importance of international and global production network lies. It is essential that all countries and economies be somehow linked and integrated into such production networks so that sustainable regional and global production structures could be created for everyone to play mutually beneficial economic roles.

Despite the adverse effects of the economic crisis in 1997, countries worldwide continued with their commitment to liberalization and globalization. SMEs account for a large percentage of industrial establishments in Asia. Currently, these SMEs are facing a serious shortage of capital, markets, and professional management, to name a few. Accordingly, countries in Asia have started and continued special programs for the development and technology upgrading of a SMEs. These programs provide emphasis on the development of both physical infrastructure, especially public utility, research and development, and technical-oriented infrastructure, which are particularly needed by the SMEs. Moreover, countries also continued efforts to move from resource-based and labor-intensive types of industries to skill- and knowledge-based and medium- and high-technology industries. They also liberalized foreign investment policies to attract more of a widely accepted FDIs and portfolio investment. (Nunnenkamp, 2001)

As globalization is likely to continue at an accelerated pace, the implications for industrial development and restructuring in line with the requirements of globalization are wide-ranging and include both opportunities and challenges. Consequently, and especially in the context of promoting SMEs through the

bilateral partnership and cooperation with Japan, the critical long-term policy challenge is how to manage globalization and create new sources of growth by increasing SME exports. The enormous potential for SMEs to contribute to economic development will be undermined if SMEs will not be able to take advantage of the attendant opportunities and competitive pressures that a global economy brings.

There are SMEs that are either not growth-oriented or do not succeed in growing and have no international activity (Tecson 2001). These SMEs make a rather static contribution to the economy. Although they employ a significant proportion of people, they do not contribute a lot to employment growth. Many only have a relatively short life expectancy, about 3-5 years, although this depends on the economy. Many of these SMEs are at risk in the midst of increasing international competition. The main issue that governments face is how to assist them to be competitive.

Evidence suggests that a high percentage of net job creation and a much longer-term economic dynamism are attributable to a small proportion of SMEs that are growth-oriented and entrepreneurial. Providing these SMEs with international opportunities is important because they are potentially a major source of longer-term sustainable economic growth. At present most of the international entrepreneurial SMEs are in more advanced economies, but this is likely to change. In many cases, most of the products produced by these SMEs have a strong services element; an important implication, therefore, is internationalization requires some form of physical presence through FDIs, or by alliances and franchises.

Evidence also reveals that a small percentage of manufacturing SMEs are engaged in international activity. Economically they are important because they make a significant contribution to exports, and thus to GDP. In theory, open regionalism will open further opportunities for increased trade, and even more contribution to economic growth. In practice, there is a long way to go to free trade. However, inroads have been experienced in terms of reduction of trade impediments to these SMEs. The main issue for SMEs is how to identify and take advantage of opportunities and how to resolve or avoid impediments quickly and cheaply.

Below are issues that need to be considered and addressed:

- *Access to markets.* Relatively minor impediments can be a major barrier to SME international trade. The impediments may be attributable to cultural differences and business practices, as much as to intentional government policy.
- *Simplified standardized customs procedures.* A standardized customs procedures and electronic submission and handling of documents

have been effective in reducing transactions costs associated with SME international trade.

- *Human resource development.* SMEs engaged in international trade need better management skills, especially in areas of risk management, cultural understanding, export management, and trade financing.
- *Swift resolution of disputes.* SMEs cannot usually afford to engage in prolonged and expensive legal disputes; unless disputed issues can be resolved quickly it is of little use.
- *Trade finance and credit guarantee.* SMEs frequently have difficulty in obtaining trade finance and credit guarantees at rates approximating the real risk. Some economies have specialist SME credit providers or programs to help address the problem.
- *Trade facilitators.* A number of private sector companies play an important role in facilitating SME trade. For example, trading companies, such as the Japanese Sogo Sosha, play an important role in linking SME suppliers to larger markets. Even SMEs themselves can often act as specialist facilitators to other SMEs or via networking group.
- *Export promotion and assistance.* Many economies in the region provide export assistance to increase the competitiveness of their SME exporters. It is possible for these measures to have distorting effects on the pattern of trade and resource use.

As discussed earlier, there is either a separate policy statement for SMEs or a general industrial policy with a portion of it relating to this sector. There is a ministry or a department in charge of the industry and a host of other institutions dealing with or extending support to SMEs. However, there is a need for individual economies to set up focal points for SMEs at the national level, which are linked to other similar focal points in neighboring countries in the region and even outside the region. Such linkages provide for quick and efficient information exchange on trade and investment opportunities for SMEs. Such focal points could also provide training and information on sources of technology and finance and act as instigators for setting up and strengthening linkages among SMEs under cooperative marketing and joint manufacturing arrangements and linkages of various kinds between SMEs and large enterprises, both domestic and foreign. Governments in developing countries should adopt a comprehensive set of selective support measures for linkages between SMEs and large enterprises. Business associations should also figure in facilitating such linkages, as well as networking of SMEs. This is because networking can play an important role in supporting SMEs

in marketing their products. Networking is of many types. However, vertical (aimed at finding complementary activities in the development of a new product) and knowledge networks (associations geared at solving a common technology or market information) are more relevant in the current context.

The globalization process has called for a drastic reorientation in domestic economic policy issues, calling for a change in the government's role toward SMEs. One of the principal measures in support of the SMEs would have to involve the attenuation of macroeconomic and sectoral policy biases against them, which have accumulated over the years in developing economies. The elements of these policies and their consequences are fairly well known. Trade and exchange rate policies in support of rapid industrialization efforts often give rise to overvalued exchange rates, which make the exports of SMEs non-competitive in international markets. Tariffs and taxation are important policy elements in all countries. However, it has been found that in most cases they benefit large enterprises and not SMEs. It has been established that import regimes (including tariff rates) are inherently biased in favor of large industry. As far as tax concessions are concerned, only in few countries like India does tax exemption from central excise tax seem to be directed to SMEs. In most other countries, tax exemptions seem to be given based on considerations other than size. Investment incentives are generally scale-based, favoring large enterprises and projects and capital-intensive production techniques over small-scale and labor-intensive technologies. Macroeconomic policies also tend to protect large enterprises against competition from SMEs.

Philippine Exportable Products to Japan

Selected Philippine-Japan bilateral trade statistics

Recent Philippine-Japan bilateral trade statistics (Table 29) reveal that Philippine exports to Japan is growing at a slower rate than total Philippine exports during the period 1998-2002. While overall Philippine exports grew by an average of 8 percent during this period, exports to Japan grew by only 5 percent. The growth in total Philippine exports was largely attributed to the strong export performance of industrial manufactures.

During this period, the dominant Philippine export to Japan is industrial manufactures, with a share of 73 percent. This was followed by machineries (8.18%), food and food preparations (8%), resource-based products (6.52%), consumer manufactures (6.38%), and special transactions (5.73%).

It is important to mention that the largest contributor to the share of industrial manufactures is electronics, which accounts for around 60 percent of the total. The strong performance of the electronics sector, as expected, comes

Table 29. Total Philippine exports to Japan: shares and growth rates, 1998–2002 (%)

Product Category	Contribution of RP's Export to Japan to Total RP Exports	Average Contribution of RP's Export to Japan to Total RP Exports	Total Philippine Exports (Growth)	Exports to Japan (Growth)
Total		14.63	7.67	5.25
Consumer manufactures	6.38	8.22	-1.21	-2.21
Food and food preparations	8.00	30.7	1.01	-0.82
Processed foods	0.76	7.04	0.25	-2.78
Fresh foods	4.34	60.35	4.66	2.97
Marine products	2.91	35.71	-0.43	-5.11
Tuna	0.52	16.74	-0.97	-0.1
Shrimps and prawns	1.93	71.27	2.23	-1.87
Resourced-based products	6.52	18.02	-4.92	-8.32
Industrial manufactures	73.36	14.29	11.54	8.32
Electronics	60.24	13.26	14.68	11.51
Components/devices (semiconductors)	33.19	9.91	13.92	8.3
Electronic data processing	21.51	24.11	24.33	18.78
Telecommunications	1.44	33.06	-15.49	38.63
Automotive electronics	1.76	28.29	9.26	31.55
Consumer electronics	1.40	15.98	8.3	-11.31
Machineries/transport equipment/apparatus and parts	8.18	34.4	12.15	3.84
Transport Equipment	7.07	34.67	11.78	2.65
Automotive parts	6.41	35.43	11.53	3.18
Special transactions	5.73	19.73	10.98	9.28

Source: Tradeline Philippines, DTI (Palanca-Tan 2003),

from semiconductor exports and electronic data processing. Fresh produce and vegetables contributed a little more than half to the share of foods and food preparations, while marine products, mainly shrimps and prawn, accounted for about 3 percent. Tuna export has been in the decline in recent years.

Looking at the growth of Philippine exports to Japan, only three major sectors experienced positive export growth. These are special transactions (9.28%), industrial manufactures (8.32%), and machineries (3.84%). The rest of the major sectors had declines in exports. Although food and food preparations posted negative growth, it is noteworthy to mention that fresh produce (under foods and food preparations) had positive export growth at 2.97 percent. This, however, could not help alleviate the performance of its major sector.

How important is the Japanese market to Philippine exporters?

According to Palanca-Tan (2003), "Japan absorbed about 15 percent of Philippine exports in 1998-2002. It is the single biggest buyer of Philippine shrimps and prawns (71%) and fresh fruits and vegetables (60%). A fourth to a third of Philippine exports of transport equipment and automotive parts as well as electronic products such as data processing, telecommunications and automotive electronics are destined for Japan." However, Japan has a remarkably lower share of about 10% in the Philippines' semiconductor exports. Even smaller are the shares of Japan in Philippine processed food (7%) exports and consumer goods (8%) exports.

Prospects for Philippine exports to Japan

Palanca-Tan (2003) has presented and identified Philippine exportable products to Japan. The methodology used was that of Balassa's (1965) revealed comparative advantage (RCA) index. Moreover, an import index was employed to identify products that the Japanese source externally. Products that are prospects for export to Japan, therefore, are those having an import index greater than 1, with Philippine RCA greater than one, and with Philippine RCA greater than Japan RCA. Table 30 lists these products.

One can also look at products that are intensively imported by Japan for which the Philippines does not have any competitive advantage. This means that Japan's Import Index is greater than one and the Philippine RCA is less than one. Looking at the list, "non-ferrous base metal," "tobacco unmanufactured," and "textile etc. products nes" (Table 31) appear to be promising exportable products as their RCAs are close to one.

Adopting a World Bank approach to determine which Philippine products are in the optimal position to be demanded in Japan, Palanca-Tan (2003) listed

Table 30. Philippine exportable products to Japan: Japan's import index > 1 and Philippine RCA^a > 1, 1999

Commodity	Japan's Import Index	Philippine RCA
031 Fish fresh simply preserved	5.02	1.37
032 Fish etc. tinned prepared	4.06	3.49
051 Fruit fresh nuts fresh dry	1.06	4.02
053 Fruit preserved prepared	1.64	3.28
241 Fuel wood charcoal	2.29	2.68
281 Iron ore concentrates	4.78	2.42
284 Non-ferrous metal scrap	1.38	1.36
285 Silver platinum ores	2.09	2.03
292 Crude vegetable materials nes	1.21	1.16
632 Wood manufacture nes	1.33	1.26
714 Office machine	1.09	4.45
831 Travel goods, handbags	2.64	3.98
841 Cloth not fur	1.51	2.02
864 Watches, clocks	1.64	2.12
899 Other manufacturing goods	1.28	1.06
941 Zoo animals, pets	1.21	1.04

Source of data: NAPES Database (Palanca-Tan 2003)

^aRCA = revealed comparative advantage

Philippine products with increasing export share to Japanese imports. Apart from supplying information regarding which products can be successfully exported to Japan, the approach can also be used to determine which products have a stagnant demand, have lost its market share, and can still compete with products in the importing country. To classify a products category, the share of Philippine products in Japan imports and how this is growing vis-a-vis Japan's imports is investigated. Table 32 lists 76 exported products with an increasing share in Japanese imports. Close to three-fourths are electronics, automotive, and other industrial manufactures (circuits, resistors, capacitors, switches). Few agricultural products (namely, fresh and dried bananas, dried and salted fish), and consumer manufactures (e.g., curtains and other furnishings, babies' garments and clothes, knitted garments, wood furniture, trousers, t-shirts, and vests) can be found in the list.

Table 31. Philippine exportable products to Japan: Japan's import index > 1 and Philippine RCA^a < 1, 1999

Commodity	Japan's Import Index	Philippine RCA
054 Veg. etc. fresh simply preserved	1.63	0.20
055 Veg. etc. preserved prepared	2.18	0.21
081 Animal feedstuff	1.74	0.24
099 Food preparations nes	1.05	0.33
112 Alcoholic beverage	1.12	0.21
121 Tobacco, unmanufactured	1.36	0.87
243 Wood shaped	2.06	0.13
251 Pulp waste paper	1.42	0.31
276 Other crude minerals	2.31	0.24
283 Non-ferrous base material ore conc.	4.47	0.99
291 Crude animal matter nes	2.98	0.35
332 Petroleum products	1.10	0.23
341 Gas, natural, manufactured	4.10	0.12
521 Coal petroleum, etc. chemicals	2.05	0.17
656 Textile, etc. products nes	1.58	0.81
657 Floor cover tapestry, etc.	1.14	0.15
661 Cement, etc. building products	1.24	0.57
851 Foot wear	1.05	0.52
897 Gold silver jewelry	1.06	0.24

Source of data: Palanca-Tan (2003), NAPES Database

^aRCA = revealed comparative advantage

Trade cooperation with Japan: Policy implications

Trade cooperation between the Philippines and Japan, and the attendant goal of export expansion for both sides, will undoubtedly have beneficial impacts on the economy. One way by which trade cooperation with Japan can potentially help Philippine SMEs is by way of Japan's opening its doors to Philippine exports, particularly those products produced by SMEs. However, Philippine-Japan bilateral trade statistics presented above do not appear encouraging to Philippine SMEs. This is because exportable products, and even potential exportable ones, appear to be generally produced by large manufacturing firms. This is true for products of industrial manufactures, particularly electronics, which account for a large percentage of Philippine exports to Japan. In addition, the fresh produce and vegetables and marine products that

Table 32. Share of Philippine exports in Japan's imports, 2000 (%)

SITC^a Code	Product Description	Share of Philippine Exports in Japan's Imports (2000)
4223	Coconut oil, fractions	100.252
8122	Ceramic plumbing fixtures	47.494
0573	Bananas, fresh or dried	32.216
7722	Printed circuits	31.398
7526	Input or output units	29.008
7621	Motor vehicle radio receiver	26.563
7831	Public transport passenger vehicle	21.669
7768	Electronic components, parts, crystals	20.158
7723	Electric resistors, parts	15.310
3343	Gas oils	13.832
5799	Other plastic waste, scrap	11.944
8713	Non-optic microscope, etc.	10.922
7786	Electrical capacitors	10.892
6585	Curtains, other furnishings	9.659
8932	Builders' ware, plastics	9.487
6899	Base metal, nes, waste, scrap	9.486
7764	Electronic microcircuits	6.664
6649	Glass, nes	5.260
7843	Other parts, motor vehicles	5.236
8999	Manufactured goods, nes	4.797
7489	Parts, nes, shafts, etc.	4.174
0351	Fish, dried, salted	4.074
5817	Fittings for tube, plastic	3.983
8931	Plastic containers, etc.	3.806
7725	Switch apparatus, <1000v	3.552
2882	Other non-ferrous metal waste	2.865
6214	Vulcanized rubber tubes, pipes	2.760
6996	Articles iron, steel, nes	2.652
6931	Stranded wire, cable, etc.	2.555
7249	Parts, textile, domestic washing machines	2.434
7413	Industrial furnaces, etc., parts	2.332
8714	Compound optical microscopes	2.158
8732	Revolution counters, meters, etc.	1.963
7169	Parts, nes. Rotating, electrical plant	1.529
8841	Optic fiber, lens, etc., unmounted	1.457

Table 32. (continued)

SITC^a Code	Product Description	Share of Philippine Exports in Japan's Imports (2000)
7712	Other elec. power machines, parts	1.446
6211	Compounded rubber, unvulcanized	1.283
7479	Parts for taps, cocks, etc.	1.178
7783	Automotive electrical equip	1.153
5822	Other plate, sheet, etc.	1.081
8451	Babies' garments, cloths, accessories	0.963
6359	Manufactured articles wood, nes	0.890
7782	Electric lamps, bulbs, etc.	0.741
8459	Other garments knitted	0.647
6795	Tube, pipe fittings, iron, steel	0.613
8215	Furniture, nes, of wood	0.598
8746	Automatic control instrument	0.569
5821	Plastic sheet, etc., self-adhesives	0.557
6991	Locks, safes, strong boxes	0.549
8426	Trousers, breeches, etc.	0.545
5541	Soap	0.523
8454	T-shirts, other vests, knit	0.387
7641	Line telephone, etc., equipment	0.370
5163	Ethers, inorganic acid, etc	0.276
8813	Photo, cinema Equipment, nes	0.226
5225	Zinc, chromium, iron, etc., oxide	0.208
7281	Machine-tools, specialized for particular industries	0.204
8744	Instruments, analysis, etc.	0.179
7161	Electric motors <=37.5w	0.154
6581	Sacks, bags, textile material	0.153
6644	Float, ground, polished glass	0.137
6624	Non-refractory brick, etc.	0.125
7788	Elect machinery, equip, nes	0.119
6935	Metal fencing, gauze, etc.	0.115
7373	Welding, brazing, etc. machine	0.096
6942	Screws, bolts, nuts, iron, steel	0.096
6421	Containers, etc. of paper	0.077
7522	Digital computers	0.075
5137	Monocarboxylic acids, derivatives	0.072

Table 32. (continued)

SITC ^a Code	Product Description	Share of Philippine Exports in Japan's Imports (2000)
8742	Drawing, measuring instrument	0.072
7456	Spraying machinery, etc.	0.066
8843	Lenses, prisms, etc., mounted	0.048
5989	Chemical products, etc., nes	0.043
7259	Parts, paper mill, etc. machine	0.013
7311	Machine tools, metal removal	0.012
7929	Parts, nes, aircraft, equip	0.008
5429	Medicaments, nes	0.006
5985	Chemical elements for electronics	0.001

Source: Palanca-Tan (2003)

^aSITC = *Standard International Trade Classification*

nes = not elsewhere specified

Japan imports from the Philippines come mainly from large firms such as Dole, Del Monte, Marsman Drysdale, and other multinational corporations in the Philippines. These are firms that have close contacts with Japanese *sogoshas* (trading companies such as Marubeni, Mitsubishi and Mitsui, etc.), which act as liaison to Japanese importers.

The economic benefits of more active intra-regional trade and investment flows, in general, and bilateral trade agreements in particular, as a means to spur the growth of a modern, export-oriented SME sector remains to be fully realized. The pursuit of regional cooperation in SME development is based on the premise that this will enable SMEs to take advantage of economies of scale and scope. At the national level, cooperatives have historically been viewed as an instrument that allows SMEs to achieve economies of scale in marketing and purchasing. Regional cooperation can extend this process, enabling national SMEs to take advantage of scale economies more effectively. Subcontracting systems at a regional level can be employed, thus promoting closer interface and interdependence between large enterprises and SMEs. However, it is essential to identify priority industries in devising cooperation measures.

Specific SMEs with export potential¹⁷ could be identified. Once identified, each industry could be closely evaluated to see where and how it needs assistance in product development, standardization, technology upgrading, and skills development. Once these industries are identified for assistance,

¹⁷ Preferably those that can draw from all available resources, including the grass roots, and which are appropriate for their scale of operations,

initiatives could be launched to develop arrangements through which market identification schemes can be designed for complementary exports. In forging linkages between large industries and SMEs, specific industries from Japan can be studied to learn and understand how such linkages were developed, the risks they encountered, and reasons for their success. Technology flow, technical and financial assistance, improved supply and marketing arrangements, promotion of industrial activities, and training of personnel are a few areas where such schemes may be formulated to foster such cooperation.

Cooperation measures would have to be supplemented and complemented by measures at the national level, particularly by removing barriers that hinder SME growth. These measures would broadly include removal of obstacles in obtaining access to inputs such as technology, credit, and training; reforming tariff structures and removing quotas; introducing realistic interest rates; and dismantling physical controls on size and output. Four specific areas where cooperation can be enhanced are as follows:

- New and emerging technologies for SME development,
- Support to SME entrepreneurs and managers for enterprise development,
- Skills development for SME growth, and
- Mobilization of financial resources as both fixed and working capital.

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6 Prospects of Services Trade Liberalization in the Japan-RP Bilateral Agreement

Gloria O. Pasadilla¹

Introduction

While multilateral trading rules have focused on creating a free flow of goods across countries for over 50 years, it was only in the last decade or so that the spotlight has focused on services. No doubt, this is in recognition of the increased contribution of services to economic output. Estimates show that total measurable trade stood at some USD 2.3 trillion at the end of 2000, representing 7.6 percent of world output and over a third of total trade in goods and services (OECD 2001). This figure highlights the commercial significance of the sector worldwide and of the need to progressively remove impediments to services trade and investments.

Although member countries of the Organization for Economic Co-operation and Development (OECD) dominate global trade and investment in services, developing countries are catching up. In the Philippines, services now take the largest share in gross national product (GNP), outpacing industry and agriculture. From 1999 to 2002, the services sector had an average share of 43 percent, compared to industry sector's 32 percent and agriculture sector's 19 percent. Along with other developing countries, the Philippines, thus, has an interest in gaining more market access in services trade, particularly for its rapidly expanding labor force.

In the domestic front, the liberalization of services trade also takes on greater urgency because of the high interlink of services with other sectors of the economy. Since an inefficient services sector acts like a prohibitive tax on the national economy, the economic cost of protecting an inefficient services sector even exceeds the cost of protectionism in the goods sector. For this reason, the Philippines has undertaken regulatory reforms in finance, telecommunications,

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transport, and energy in recent years to increase competition in services sector and to improve the competitiveness of manufacturing and agriculture sectors in the world market. These regulatory and market reforms are not viewed as "concessions" to other countries but as preconditions for actualizing the country's tiger potential.

Undoubtedly, more should be done. Investments are required to upgrade and catch up with the rapid pace of technologies, regulatory reforms that had begun need to be improved, and other services sectors that have yet to benefit from the reforms and competition have to experience them. With this view, the Japan-Philippines bilateral agreement negotiations should act as a catalyst. It is not because services trade would be a concession to Japan but because the country itself needs much-needed investments in this sector to improve efficiency for the rest of the economy.

This paper offers an overview of services trade. It avoids the discussion of why choose bilateral and not multilateral in liberalizing services trade and why with Japan, on the assumption that other papers are tackling these important questions. Suffice it to say that should there be a political decision to sign a trade agreement with Japan or with any other country, it is best that services trade is included in the discussion. Complementarities between services trade liberalization and liberalization of trade in goods make it counterproductive to negotiate in one and not the other.

The paper starts with a discussion on the nature of the services sector, the achievement under the multilateral agreement on services or the General Agreement on Trade in Services (GATS) and the many challenges that remain for greater liberalization. One of these major challenges is that services trade liberalization often involves administrative and institutional reforms that usually require a more extended time frame than in the liberalization of trade in goods. Section 2 tackles regional trade agreements and gives a broad overview of the similarities and differences in these various agreements on liberalization in services trade. Section 3 analyses how liberalizing these preferential trade agreements (PTAs) have been compared to the WTO for Singapore, Japan, and the Philippines. Section 4 describes the situation for various services sectors, analyzing the common types of restrictions or trade barriers in each, and the possible progress for the movement of natural persons (Mode 4) negotiations.

Overview of Trade in Services

What are services and why would services trade liberalization be desirable? What is the role of this sector in a country's development? These are basic questions that must be answered before entering a bilateral agreement with

an avowed goal of opening more access to goods and services markets. To many of us, analysis of services trade is markedly different from the usual analysis of goods trade. Despite the similarities, there are many nuances that need to be grasped to appreciate the difficulties of liberalization commitments in services trade.

Services are usually portrayed as intangible, invisible, and perishable—requiring simultaneous production and consumption. This definition is open to criticism because some services may be tangible (e.g., computer software program on a diskette), visible (e.g., theater production), or storable (e.g., automatic telephone answering systems). It may not even require face-to-face contact between producers and consumers (e.g., architectural design).² Because of the difficulty of giving exact definition of services, many empirical analyses on services do not use a dogmatic definition, but simply list activities that should be considered as part of services.

For purposes of the Uruguay Round negotiations in services, the WTO Classification List of Services Sector (Appendix 1) was used as basis for the “positive list” of sectoral commitments by members.³ Many countries, however, were flexible as to the services sector they included in their schedule of commitments, which either were not in the WTO List or appeared there as a more aggregated sector. The WTO Classification List was also the basis for the JSEPA services negotiations, and for other regional trading agreements that follow the GATS approach.

Role of services in development

It is widely recognized that efficient services are vital to economic development. Services not only provide direct benefits to consumers, but are also critical elements for the international competitiveness of the industrial and agricultural sectors of the economy. Poor transport and storage facilities increase losses in agricultural output, substandard communication networks

² Other categories of services include *private* or *public*, *intermediate* or *final*, *knowledge-based* or *tertiary* services. *Intermediate* services can be *distributive services* (wholesale/retail trade, transport, storage and warehousing, communications) or *producer services* (financial, business and professional services), while *final* services can be further subdivided into *social services* (health, education, sanitary services) and *personal services* (household services, recreational and cultural services, hotels and restaurants). Examples of *knowledge-based services* are insurance, professional technical services, information technology, advertising, motion pictures, education, health care and some governmental services. Meanwhile, *tertiary services* are leasing, shipping, distribution, franchising, retail trade, travel, some social services, and most entertainment and personal services. *Knowledge-based services* are characterized by relatively high human-capital content and are often customized. *Tertiary services* are more conventional service activities characterized by lower human capital requirement and more standardized production methods (UNCTAD and World Bank 1994).

³ The WTO Classification List, in turn, was based on the UN Central Product Classification (UNCPC) system, which provides a highly disaggregated services classification.

increase operating costs, and poor financial intermediation leads to higher cost of borrowing— all of which impinge on the sector's competitiveness in the global market. Just like trade in goods, restrictions on services trade reduce welfare by creating a wedge between domestic and foreign prices leading to a net welfare loss to the economy. Significantly, because services are typically inputs to production, the higher price and the poor quality of services act as implicit tax on production. Thus, with the liberalization of goods trade, if the services sector is not liberalized at the same time, the reduction in nominal tariffs on manufactured products results in a reduced or even negative rate of protection for some industries.

This explains why many countries have pursued unilateral liberalization and competition-increasing policies in services. Anecdotal evidence of the benefits of liberalization abound. For example, Chile, Mexico, or Singapore have reduced operating costs or saved time for exporters by introducing competition in the provision of port services. Deregulation in telecommunications in Peru, Philippines, or Venezuela remarkably increased the density of phone users and reduced connection installation waiting time at a rate which decades of strict government regulation and/or ownership have not achieved. In the Philippines, phone installation waiting time was reduced from 6-8 years to only a few days or weeks. Consumer banking services and risk management in many domestic markets improved because of entry and competition from foreign banks.

Multilateral rules on services

While unilateral market liberalization and strengthening of regulatory institutions in services are, in themselves, good for the economy, multilateral engagement creates additional benefits through the usual political economy argument of trade. The idea is that improved access for a country's exports to foreign markets that comes out of international negotiations increases support for liberalization and helps fight against the opposition of those who benefit from protectionist policies. For services, the multilateral rules that regulate trade are contained in the GATS which, along with the General Agreement on Tariffs and Trade (GATT) and Trade-Related Aspects of Intellectual Property Rights (TRIPS), provide the pillars for the WTO.

The GATS encompasses not only cross-border trade in services but also the movement of capital and labor for the provision of services. The reason is that, unlike goods that are normally traded by crossing borders, some services trade, because of the required simultaneous presence of service provider and consumer, can never take place unless the movement of factors of production is allowed. Thus, the GATS accounts for four different modes of supply, namely,

(i) cross-border trade, (ii) consumption abroad, (iii) commercial presence, and (iv) movement of individuals. Mode 1 is analogous to cross-border trade in goods, for example, when computer software is purchased and downloaded directly through the internet. Mode 2 takes place when the consumer travels to the territory of the service supplier and consumes services in that territory, for example, when a patient from one country travels to another for medical treatment. Mode 3 (commercial presence) involves the movement of capital, which is particularly relevant for services, like most banking services, which cannot be traded except through establishment in the country of the consumer. Finally, Mode 4 occurs when independent service providers or employees of multinational companies (MNCs) temporarily move to another country. Note that individuals who migrate permanently to another country are not covered by Mode 4. In theory, the GATS is an instrument that could facilitate modal bargaining so that developed countries get greater access to capital (Mode 3) in exchange for improved temporary access for service providers (Mode 4) from developing countries in which there are surplus labor.

The GATS agreement is implemented through the listing of horizontal and specific sectoral commitments in the Members' Schedule. Horizontal commitments on the four modes of supply services apply to all sectors, while specific commitments apply only to listed services sectors and subsectors. This listing of sectors committed for liberalization is the *positive list approach* of the GATS. In addition, countries have to list the non-conforming measures present in the domestic laws and the regulations that affect "market access" and "national treatment" of foreign service providers for such measures to be WTO-compatible (see Appendix 2 for a sample of sector commitment in the GATS by the Philippines). This is the *negative list approach* in the GATS schedule. Thus, the GATS is a combination of both the *positive and negative list approaches*.

"National treatment" for foreign service suppliers is conventionally defined as treatment no less favorable than that accorded to *like* domestic services and service suppliers. An example of a measure that requires listing under national treatment is government subsidies granted to certain service sectors, which would not be extended to *like* services provided by foreign suppliers. On the other hand, GATS does not define "market access" but rather explicitly prohibits six measures that are considered market access restrictions. These are limitations on the

- (1) number of service suppliers,
- (2) value of transactions or assets,
- (3) total quantity of service output,
- (4) number of natural persons that may be employed,

- (5) type of legal entity that permits a service supplier to supply a service, and
- (6) foreign shareholding or the absolute value of foreign investment.

These six measures would only be considered as WTO-compatible if explicitly listed in the country schedule.

There are, however, many criticisms of GATS that explain the relatively little services liberalization attributable to it after the Uruguay Round of trade negotiations. First, its liberalizing effect comes, not from the tearing down of trade barriers, but mostly from the "standstill" effect of commitments on government regulatory measures; that is, the listing down of non-conforming measures to market access and national treatment helped forestall the introduction of new distortions or barriers. The bad news is that this is not foolproof measure, especially if, as what happened in the GATS negotiations, developing countries bound their commitments at a more restrictive level than what is actually applied. Note that with many countries adopting unilateral liberalization in services trade, certain services sectors would have faced a relatively more liberal regime, yet the Members' Schedule might not have reflected this but, instead, the more restrictive ones.⁴ For example, in the Philippines, the actual foreign investment limit in banking is 60 percent, yet what is bound in the GATS schedule is a 49 percent cap in foreign shareholding. The implication of this strategy is that the "standstill" only applies to the more restrictive bound commitments. There is, therefore, a potential for developing countries to roll back their unilateral liberalization to a lower level of openness.

Besides the more restrictive bound commitments, another problem with the GATS was the *positive list* approach in the specific sector commitments. The analysis of GATS schedule of commitments of different countries concludes that most countries have listed only a small part of their services sector. What is more, of these committed sectors, numerous non-conforming measures with national treatment and market access have been listed as limitations to the country's commitments. The GATT Secretariat reports that the commitments of industrialized countries are only about 50 percent of their maximum sector-mode commitments, while the commitments of developing countries are only 17 percent of their potential maximum

⁴ The reason countries opt for a more restrictive commitment than what is applied is usually for greater policy flexibility. That is, should the domestic regime require greater restriction on, for example, movement of capital and labor, the government would have the freedom to do so without violating its WTO commitments. Another reason, presumably, is to withhold some bargaining chips for future rounds of negotiations in order to negotiate for greater access in other sectors, like other services sectors or manufactured or agricultural goods.

(Hoekman 1995). The number of commitments without any limitations or qualifications constitutes only about 25 percent of the total commitments of industrialized countries, and 7 percent of developing and less-developed countries. These numbers illustrate how far away WTO members are from attaining “free trade” in services and the magnitude of the liberalizing task that remains (Hoekman and Primo Braga 1997).

Challenges in Further Liberalization

While successive rounds of negotiations in services trade are envisioned in the WTO, there are a number of challenges for further trade liberalization. These challenges are again due to the nature of the services sector and to the paucity of data that could aid in the proper analysis of services trade liberalization.

Measures affecting services trade are mostly non-transparent

Unlike in goods trade, most barriers to services trade are not to be found at the border, but are rather hidden deep in domestic regulation. They are typically nontariff, regulatory measures, or legislative and administrative practices. Therefore, they are less transparent than tariffs and quotas, and their restrictive impact is more difficult to assess. For example, domestic regulatory environment can be legal barriers to the entry of professional, legal, or accounting services through nonrecognition of diplomas. Or they can be restrictions on FDI such as local content requirements, or joint venture requirements, or a variety of domestic regulations such as technical standards, licensing, and qualification requirements. Table 1 lists some of the typical measures that affect market access and national treatment across the four modes of supplying services. The fact is that most governments still have to grapple with all the measures in place in their national economy and understand how they affect trade in services.

It is important to recognize that many domestic measures, which may tend to increase cost for foreign providers of services, would be impossible to eliminate. Consider licensing procedures for medical doctors, for example. No matter how concerned about economic efficiency a government is, it is impossible to conceive that it would auction off professional licenses to foreign doctors on the basis of the highest bidder, or simply impose a tariff on any foreigner who claims to be a doctor. In this and in other similar cases, governments have to impose a screening or licensing procedure. The issue in services liberalization is not in preventing justifiable domestic regulations to exist but in ensuring that the cost is kept to a minimum while still maximizing consumer protection.

Table 1. Restrictive measures affecting services

	Market Access	National Treatment	Others
Mode 1 Cross-border trade	Quantitative restrictions (limit quantity, market share, foreign exchange access)	Price-based measures (tariffs, taxes, and subsidies giving domestic supplier price advantage)	Government procurement policies, discriminatory access to distribution networks
Mode 2 Consumption abroad	Requirements relating to travel documentation, entry visas	Limits on foreign currency available to the traveler, travel tax, regulations relating to transborder medical insurance, rules on recognition of educational certificates obtained abroad, restrictions on freedom of movement (in country of destination)	General consumer regulations
Mode 3 Commercial presence	Total or partial prohibition of foreign direct investments, restriction on the geographic location of foreign-services affiliates, restrictions on the number of foreign firms in the market	Limits to the scope of business operations and access to local finance, performance requirements, rules relating to external financial transfers, tax measures	General regulatory framework for services transactions (including prudential regulations, competition policies, consumer protection laws, and intellectual property rights)
Mode 4 Movement of natural persons	Visa, residence permits, work permits, licensing requirements, recognition of diplomas	Restrictions on rights of dependents, restrictions on overseas remittances, taxation, restrictions on benefits enjoyed by foreign workers, discrimination against foreign workers in the workplace	Rules relating to repatriation, cultural barriers

Source: UNCTAD (1994).

Limitations in services data

Severe limitations of data on services compound the problem because without good data, the economic cost of restricted market access to the domestic economy and of potential welfare to be gained from liberalization is hard to quantify. Without good data, government decisions to liberalize services trade are difficult to justify and sell to the general constituencies.

The traditional source of data on services is the country's Balance of Payments statistics. Conventionally, services are recorded in the non-merchandise trade portion of the current account. In the 5th edition of the Balance of Payments Manual, however, the International Monetary Fund (IMF) explicitly identifies sectors belonging to services, namely, transportation; travel; communications; construction; insurance; financial; computer and information; royalties and license fees; other business services; personnel, cultural and recreational; and government services for newly industrializing economies. Though this gives an improved reporting of services activities, it is still not completely in consonance with how the WTO categorizes services trade. First, identified cross-border services trade does not capture the labor income of nationals working abroad under Mode 4 of services supply, but only those income that are remitted back to the country of origin. Second, it excludes sales of MNCs through foreign affiliates (Mode 3) that are established in the host country. Third, the reported value of merchandise trade, because they are reported on a free-on-board (FOB) basis, incorporates the value of the services required to bring the good to the customs frontier of the exporting economy. To augment the data derived from the balance of payments, some OECD member countries have started to collect data on sales of affiliates in host countries.

Perception of external incursion on domestic regulations and denationalization

Because most barriers to services trade are embedded in regulations affecting the domestic market, services trade liberalization, at times, implies changing legislations or the rules of government departments that may be unrelated to trade. For example, if educational services were to be liberalized, this would mean, among others, changing some regulations in the department of education, culture, and sports that traditionally have not had any dealing with the WTO. Because of this, liberalization can be perceived as an external incursion on domestic affairs by international organizations. For many countries, commitments to GATS have involved passing of new laws, repealing of old ones that contain measures that violate their multilateral commitments, or even changing the Constitution. This becomes very challenging because not

many governments are thrilled about the prospects of going into a protracted executive-legislative tussle, unless the gains are indisputable and backed by solid data and analysis.

In addition, many of the sectors that are usually in need of liberalization are those that have been the traditional preserve of governments, either because of scale economies or because of social or nonmarket objectives (e.g., national security or public service concerns). These sectors include water or electricity, transportation and telecommunications, education, and health. Often, the impact of denationalization of certain cultural industries adds to the complexity of liberalization efforts in services trade. Fortunately, faced with shrinking government budgets, opening up of some of these services sectors in developing economies to foreign providers have become relatively more acceptable, though difficulties remain, particularly in education and health services.

Free-rider problem in multilateral liberalization

Arguably, part of the difficulties in the multilateral liberalization efforts through the GATS is that any commitment made is automatically extended to all members, creating free-riding incentives to some countries. To a certain extent, commitments become "costly" because some countries, through liberalized trade under the GATS, obtain access to the domestic market of a WTO member-country, which benefits very little from trade with these countries, and that these free-riding countries are enabled to compete with the domestic service suppliers. This partly explains the proliferation of regional trade agreements in the 1990s, which in many respects, especially in the area of services trade liberalization, complement the multilateral agreements. In significant ways, many regional trade agreements have extended the country commitments beyond what many governments have been willing to commit in the WTO.

Preferential Trade Agreements

The prevalence of preferential or regional trade agreements can be explained by several reasons. One reason is like-mindedness of governments, especially if these countries have similar cultures, level of development, and geographic proximity. Such like-mindedness makes negotiations—for example on mutual recognition agreements for standards and qualifications, as well as regulatory cooperation—easier and more practicable. Thus, for example, mutual recognition of education and professional qualifications is relatively easier in the EU, which is comprised of fairly homogeneous economies, than in a multilateral setting. Another reason is that monitoring of preferential

agreements is less costly than multilateral efforts because of the limited number of countries involved. Trade-offs across issues and sectors are also easier to carry out without the complications of having to protect the domestic market from competitors from free-riding countries. Regional or preferential liberalization, likewise, can be a building block for multilateral liberalization because exposure to competition in the regional market could help prepare firms for global competition through some sort of "learning-by-doing." If the experience is altogether positive, regional liberalization paves the way for the political acceptability of multilateral liberalization.

PTAs imply privileged access, which can take different forms. For example, countries can allocate a larger proportion of quota to a preferred source (e.g., number of individual service providers allowed inside the country, or number of branches or firms allowed to operate). They can relax restrictions on foreign ownership or type of legal entity on a preferential basis. Mexico, for instance, eliminated ownership restrictions for financial institutions that are established in Canada and the US (Mattoo and Fink 2002). There could be discrimination through taxes and subsidies, or waiving of qualification and licensing requirements for those from preferred countries.

One issue of concern with regard to preferential trade is trade diversion. In the context of services, trade diversion takes place if the most efficient service provider is precluded from participating in the domestic market because of special preferences given to less efficient ones. Some, however, contend that trade diversion applies only to certain types of services, particularly *infrastructure-type* services like financial, telecommunications, energy, and transport, which require large amounts of capital to operate, and large economies of scale to produce to be efficiently supplied (Stephenson 2002). Preferential liberalization of these activities would, therefore, not make good economic sense as it would limit the ability of a country to draw upon the most efficient suppliers, unless those bound commitments are extended to other WTO members on a Most Favored Nation (MFN) basis.

For other types of services like *business-type* services,⁵ and particularly professional services, the preferential route would be useful because to develop a common set of criteria for the recognition of the equivalence of standards, diplomas, educational and professional training, among a smaller set of countries is easier. Similarly, for *social-type* services (e.g., education, health) or recreational and cultural services that are typically quite sensitive to certain national concerns, the PTAs can facilitate deeper liberalization because

⁵ Examples include distribution, professional services, tourism, construction/engineering services, and environmental services.

it is easier to liberalize these sectors among countries that have comparable levels of development, consumer preferences, and backgrounds.⁶

The relative ease in preferential trade negotiations is partly the reason why, while multilateral liberalization has not expanded deeply despite the GATS, many countries have been able to bind services commitments in their regional agreements on a more comprehensive scale (Stephenson 2002). This is particularly true in the NAFTA and in many Latin American preferential agreements, as well as in the ASEAN where most of the commitments are dubbed as "WTO-plus." Regional or preferential services trade agreements have pushed the liberalization process forward at a deeper level and a faster pace than at the multilateral level.

Approaches to liberalization of services

Many regional trade agreements have innovated over the multilateral approach and followed an "integrated" approach, incorporating disciplines on investment, government procurement, movement of natural persons, competition policy, intellectual property rights, and technical barriers to trade that apply to both trade in goods and services alike. From a legal point of view, the integrated approach has led to a legal structure that is coherent and seamless with respect to the application of trade rules (Stephenson 2002), unlike the WTO agreements where agreements are merely tacked on to earlier ones.

Two approaches to services liberalization can be discerned among the different trade agreements.⁷ These are the "NAFTA-type" or negative list approach and the "GATS based" or positive list approach.⁸ Table 2 shows that all trade agreements in the Western Hemisphere, except *Mercosur*, have been inspired by the NAFTA approach, while the ASEAN Framework Agreement for Services remains in the GATS mold.

⁶ Mattoo and Fink (2002) argue that multilateral liberalization is still superior to preferential trade liberalization in terms of its effect on overall economic welfare. But, if multilateral liberalization is elusive to attain, regional or preferential trade in services is better than no liberalization at all.

⁷ Stephenson (2002 and 1999) gives an excellent discussion of various regional trading agreements, particularly those in the Western Hemisphere. Stephenson (1999) gives a thorough comparison of the negative and positive list approaches in terms of (i) principles, (ii) provisions and disciplines, (iii) negotiating modality, (iv) market access, and (v) exceptions. This section draws a lot from these two papers.

⁸ As discussed previously, GATS actually combines both positive and negative listing approaches. The positive list is for the sectors committed, while the negative list is for the non-conforming measures affecting market access and national treatment. Here, the use of positive list as being associated with GATS essentially refers to the listing of sectoral commitments.

Table 2. Approaches to services liberalization

Positive List Approach	Negative List Approach
ASEAN (1997)	Andean Community (1998)
<i>Mercosur</i> (1997) ^a	CARICOM (1998)
	Central America–Panama (2001)
	Chile–Canada (1997)
	Chile–Mexico (1998)
	Chile–Central America (2000)
	Group of Three (1995)
	Mexico–Bolivia (1995)
	Mexico–Costa Rica (1995)
	Mexico–Nicaragua (1998)
	Mexico–Northern Triangle (2001)
	NAFTA (1994)

^a Mercosur has a hybrid-type approach. It follows the GATS approach but with a transparency provision or the required listing of all existing restrictions in services sectors (whether included in the positive list or not). Furthermore, it has a status quo provision proscribing the introduction of any new restrictions. This amounts to essentially a NAFTA type of approach.

Source: Stephenson (2002)

The NAFTA-type (negative list) approach does not require the negotiation of schedules of sectoral commitments because liberalization is guaranteed for all sectors and for all service suppliers from partner countries. Cross-border trade in services and commercial presence are free of restraint for all sectors unless specified otherwise in the lists of reservations. Such lists of reservations contain measures that are not in conformity with the core disciplines of the agreement, primarily the MFN, national treatment, right of cross-border supply, and the removal of discriminatory quantitative restrictions. Thus, these PTAs apply the disciplines on services trade from the “top-down” perspective to cover the entire universe of service activities.

In contrast, GATS-type (positive list) approach carry out liberalization through a “bottom-up” approach in which gradual liberalization is carried out through incremental rounds of negotiated commitments, subscribed in schedules of commitments. The disciplines of national treatment and market access are of specific application, that is, they apply only to service sectors included in national schedules of commitments. On the other hand, MFN and transparency disciplines have general application across all service sectors.

These two approaches have different implications in terms of transparency, stability of commitments, and trade liberalization that is summarized in Table 3. In terms of transparency, GATS-type is inherently a non-transparent approach compared to NAFTA-type, particularly because of its specific application (as opposed to universal application in the other) and the non-listing of non-

conforming measures for sectors that have not been committed. It also provides less stability in commitments because the listing allowed for a bind that is more restrictive than what is actually applied. Furthermore, in NAFTA-type PTAs, many provisions already contain an inherently liberalizing bias. For example, they do not require local presence as a condition for foreign providers to provide a service, allow firms and individuals to determine the cost-efficient way possible to carry out their trade, and eliminated citizenship or permanent residency requirement to license or certify professional service providers of another member. The Rules of Origin (ROO) requirement is, likewise, more liberal requiring only substantial business activities and registration with legal domicile in a member country.

Table 3. GATS vs. NAFTA types of approaches

	GATS approach	NAFTA approach
Application	Specific service sectors (for market access and national treatment)	Universal
Transparency	Less transparent. No information on market access or regulatory practice on non-listed sectors and on listed sectors but with ‘unbound’ mode of supply commitments. Many barriers are not ‘caught’ by the schedule.	More transparent. All non-conforming measures and reservations must be listed. List of reservations is at the level of regulatory practice; divided between discriminatory and nondiscriminatory measures with the former being subject to eventual removal.
Stability	Binding can be more restrictive than status quo (or less than actual practice). Allows for the possibility of changing regulatory practice to a more restrictive level.	List of reservations and existing restrictions reflect actual level of application. Many agreements with NAFTA model also have explicit status quo provision, precluding introduction of new restrictions on services trade.
Liberalization	Merely amount to ‘standstill’ bindings. Few sectoral commitment plus many limitations and qualifications in those few commitments.	Theoretically, it can be the same as GATS approach. But in actual agreements, commitments tend to be more aggressive.

Source: Adapted from Stephenson (2002). Analysis of Japan, Singapore, and Philippine Services Commitments

Analysis of Japan, Singapore, and Philippine Services Commitments

Within Asia, PTAs in services have taken shape through the ASEAN Framework Agreement for Services (AFAS),⁹ which was signed in 1995 and, for the moment, through the JSEPA. Both agreements are patterned after the GATS.

Right from the start, the ASEAN trade integration does not follow the NAFTA, not only on the approach in services liberalization, but also in the fact that the ASEAN agreements are being drawn up separately instead of being negotiated as one integrated whole. In this, it is closely following the footsteps of the WTO. In the listings of commitments, ASEAN members inscribe only commitments that go beyond the GATS, thus enabling an easy and rapid identification of the GATS-plus element of regional services liberalization. Progressive rounds of GATS-plus negotiations aim to achieve the "free flow of trade in services within ASEAN by 2020." Philippine sectoral commitments in the WTO and AFAS are listed in Table 4, while a more detailed list of commitments for the AFAS is in Appendix 3. Evidently, as is true in other regional agreements, more sectors have been committed for liberalization in the AFAS than in the WTO. However, to fully understand the liberalizing content of the commitment, an analysis of the modal commitments is necessary because, often, the commitment in the sector is nullified by the very restrictive commitment in the mode of supply.

Table 4. Philippine commitments in WTO and AFAS

Industry/Groups	WTO	AFAS
Business services		x
Communications services	X	x
Construction and related engineering services		x
Distribution services		
Educational services		
Environmental services		
Financial Services	X	x
Health-related and social services		
Tourism and travel-related services	X	x
Recreational, cultural, and sporting services		
Transport services	X	x

Source: Author's compilation based on Philippine Schedule of Services Commitments in WTO-GATS and ASEAN-AFAS.

⁹ The signatories to the AFAS are Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand, and Vietnam.

In the JSEPA that was signed in 2002, both Japan and Singapore, likewise, expanded their commitments beyond WTO. Japan committed a total of 135 sectors and subsectors, while Singapore committed 139. Like AFAS and GATS, progressive liberalization is envisioned through periodic review and negotiations, but unlike AFAS, the JSEPA was negotiated as one integrated free trade agreement—covering both goods and services and including disciplines on investments, intellectual property rights, government procurement, movement of natural persons, and competition policy. Table 5 shows the similarities and differences among the three agreements—AFAS, NAFTA, and JSEPA. In most respects, AFAS and JSEPA are almost identical. In NAFTA, FDI is not included as a mode of supply in the services agreement. Instead, a separate chapter is drawn up specifically to address investment issues. Likewise, JSEPA has a similar set of separate chapters covering investments, movement of natural persons, competition policy, and others.

JSEPA and AFAS are similar in terms of discipline governing mutual recognition. Members or parties to the agreement are authorized to accord recognition of education or experience or licenses granted in another member state, either autonomously or based upon an agreement or arrangement. In contrast, such recognition is mandated in NAFTA whenever the home country can demonstrate, to the satisfaction of the host country, that its standards adequately fulfill the host country's legitimate objectives.

Quantifying the specific commitments

How liberalizing have the preferential trading agreements been? To assess the schedules, a quantitative measure is required that allows for cross-country and cross-Agreement comparisons. This section follows Hoekman's (1995) methodology of quantifying the extent to which measures have been bound. The result does not actually give an assessment of the liberalization implied by the specific commitments in the sense of reducing discrimination and enhancing market access since virtually all commitments are of a standstill nature. Rather, it gives an idea about the extent to which Japan, Singapore, and the Philippines were willing to bind the status quo in the different trade agreements.

Hoekman (1995) methodology used the 155 non-overlapping service sectors in the Group of Negotiations in Services (GNS) classification list, while this paper used only 145 by removing the ambiguous category, "others," in the different sectors. Multiplying each service sector by the four modes of supply, Hoekman has 620 possible commitments each for market access and national treatment, while the analysis here has a maximum of 580 sector modes.

Table 5. Comparison of three preferential trade agreements

	ASEAN-AFAS		Japan-Singapore	NAFTA
Title	ASEAN Framework Agreement on Services under the Association of South East Asian Nations Free Trade Area		Japan-Singapore Economic Partnership Agreement	North American Free Trade Agreement
Members	Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, Thailand, and Vietnam		Japan, Singapore	United States, Mexico, Canada
Entered into force	1995		2002	1994
Objective	To eliminate substantially restrictions to trade in services among member states (by expanding the depth and scope of liberalization beyond the GATS) with the aim to realizing a free-trade area in services		To remove barriers to trade in services between the Parties	Eliminate barriers to trade and facilitate cross-border movement of goods and services between the Parties; to promote competition; to increase investment opportunities in the territories of the Parties
Sectoral coverage	Sectors covered according to scheduled commitments		Sectors covered according to scheduled commitments	All service sectors (except air services) as well as measures relating to cross-border trade in services
Negotiating modality	Liberalization to be gradual, and carried out through rounds of negotiated commitments, the results to be made available to all members under a "positive list" approach		Liberalization carried out through rounds of negotiated commitments, the results to be made available under a "positive list" approach.	Liberalization carried out through a "negative list" approach. All measures are subject to liberalization except those part of the country's list. Non-conforming measures to general liberalization principles should be listed.

Table 5. (continued)

	ASEAN-AFAS	Japan-Singapore	NAFTA
1. Most-Favored Nation (MFN)	May be made subject to sectoral exemptions	Automatic MFN benefit granted to parties from other agreements signed after the JSEPA (Article 63, para. 4a).	Automatic MFN benefit granted to Parties
2. National treatment	Covers only scheduled sectors subject to bound commitments	Covers only scheduled sectors subject to bound commitments	Universal principle covering all measures and sectors except those in the negative list.
3. Transparency	Not in Treaty	Parties shall make public all measures affecting the operation of the Agreement (Article 2)	Parties shall make public all measures affecting the Agreement.
4. Market access	Provisions on services on cross-border basis and on establishment basis must be scheduled	Provisions on services on cross-border basis and on establishment basis must be scheduled	Universal principle applying to all services sectors except those in the list schedule of exemptions.
5. Treatment of investment	Commercial presence covered by specific sectoral commitments	Separate investment disciplines contained in a different chapter. Commercial presence covered by specific sectoral commitments.	Covered in a separate chapter; not part of mode of services.
6. Safeguards	Provisions exist for Emergency Safeguard Measures for Article XII and Restrictions to Safeguard the Balance of Payments	Provisions exist to safeguard the Balance of Payments and solve external financial difficulties.	Provisions exist to safeguard the Balance of Payments and solve external financial difficulties.
7. Monopoly practices	Not covered	Disciplines over monopoly practices.	Disciplines over monopoly practices, especially government monopoly.

Table 5. (continued)

	ASEAN-AFAS	Japan-Singapore	NAFTA
8. Recognition of title	Each member state may recognize the education or experience obtained, requirements met, or licenses or certifications granted in another member state. Such recognition may be based upon an agreement or arrangement with the member state concerned or may be accorded autonomously.	Parties may recognize the education or experience obtained, requirements met, or licenses or certifications granted in the other Party. Recognition may be based upon an agreement or arrangement with the Party or may be accorded autonomously (Article 93). Established Joint Committee on Mutual Recognition of Professional Qualifications.	No obligation to accord recognition to education, experience, licenses or certifications obtained in the territory of another Party. But Parties shall afford another an adequate opportunity to demonstrate why the education, etc. should be recognized. (Note: In practice, private certification groups are establishing harmonization criteria)
9. Rule of Origin (Denial of Benefits)	Benefits are denied to a service supplier who is a natural person of a non-member state or a juridical person owned or controlled by persons of a non-member state constituted under the laws of a member state, but not engaged in substantive business operations in the territory of member state(s)	Benefits are denied if service is supplied from or in the territory of a non-Party or by a natural person of a non-Party or juridical person owned or controlled by persons of a non-Party constituted under the laws of a Party but not engaged in substantive business operations in the territory of a Party.	
10. Government procurement	No provisions	Annex 4 of WTO (Government Procurement Agreement) applies, except for some provisions.	
11. Movement of natural persons	Not in Treaty	Disciplines on temporary entry of business people, investors, and providers of professional services.	Disciplines on temporary entry of business people, investors, and providers of professional services.

Table 5. (continued)

	ASEAN-AFAS	Japan-Singapore	NAFTA
12. Dispute settlement	A specific dispute settlement mechanism may be established for the purposes of this Framework Agreement, which shall form an integral part of this Framework Agreement	Provisions for settling investment disputes. No special provisions for dispute settlement in services.	Dispute settlement procedure is established.
13. Exceptions	Not in Agreement	Provisions are included for exceptions (Article 69)	Provisions are included for exceptions
14. Non-conforming measures	Listed as part of schedule	Listed as part of schedule	Requirement to list non-conforming measures
15. Special provisions	Financial services, basic telecommunications, maritime transport, movement of natural persons, and audio-visual	Financial services, telecommunications, investments, movements of natural persons	Financial services, telecommunications, transport, professional services
16. Future liberalization	Gradual liberalization through exchange of lists commitments.	Review of the Agreement in 2007 and every 5 years thereafter (Article 10). Establishment of a Supervisory Committee to consider and recommend further liberalization of trade in goods, services, and investments (Article 8, para. 2d).	Review of QRs every two years; Schedule future liberalization commitments

Source: Stephenson (1999) in addition to author's own data.

To allow the calculation of the sectoral coverage commitments, a value of '1' is given where the commitment in a given mode and sector says 'None', because this implies no restrictions on either market access or national treatment. A value of '0' is given in all instances where these countries list 'Unbound' for a sector/mode supply because this means no policies are bound and the country retains maximum policy flexibility. This scaling implies that the scheduling and binding have no value. Finally, a value of '0.5' in all instances where specific restrictions or limitations are listed for a sector/mode of supply, implying that the commitment has value, no matter how restrictive the policies that are maintained.¹⁰ The higher the number, the greater is the implied extent of openness cum binding.

If countries made commitments on sectors at an even disaggregated level than in the WTO classification list, it is counted along with the other sectors in that category. For example, if in the WTO list, accounting and auditing is listed as one category under professional services, and Singapore make commitments for auditing separately from accounting, the paper counts only one sector and use the more liberal commitment of the two for the scoring process. The assumption that the more liberal commitment applies to the whole subsector biases the sectoral coverage indicators upward. Conversely, if Singapore schedule commitments for an aggregated item (e.g., telecommunications instead of individual subsectors within telecommunications, then it is assumed that the commitment applies to all of the respective subsectors and, thus, is accordingly multiplied by the appropriate number of subsectors. Finally, where the commitment says "Unbound due to lack of technical feasibility," a value of '1' is allocated.

Measures of sectoral coverage

Tables 6–8 report the summary figures for Singapore, Japan, and the Philippines under the WTO, AFAS, and JSEPA. Singapore, like other countries, was very cautious in its GATS commitments. For example, it has a fairly liberal financial services regime, yet it has many "unbound" commitments under the WTO. In the JSEPA Singapore schedule, however, it is generally less cautious. Its total number of sector-mode commitments in JSEPA increased by 141 percent—from 232 in the WTO to 560. This represents some 97 percent of total maximum commitments (row 2), an even higher figure than its combined WTO-AFAS commitments share (only 61% of maximum). This means that Singapore has bound many measures in services in its bilateral agreement with Japan.

¹⁰ In some sense, the value comes from the transparency, which listing the limitations signify.

Table 6. Sectoral coverage of specific commitments, Singapore

	HIC in GATS (average)	WTO	AFAS [*]	JSEPA	WTO + AFAS ^{**}
No. of commitments	330.4	232	120	560	352
<i>Market Access</i>					
Count (sector-modes listed as a share of maximum) ^{1/}	53.3	40	21	97	61
Coverage (sector modes listed as a share of max, weighted by openness and binding scale factors)	40.6	27	15	61	43.9
Coverage/Count	76.1	72	73	63	72
No. of "No Restrictions"	188.9	118	77	357	195
"No Restrictions" as a share of total offer made	56.4	51	64	64	55
"No Restrictions" as a share of maximum		20	13	62	34
<i>National Treatment</i>					
Count (sector-modes listed as a share of maximum) ^{1/}	58.1	40	21	97	61
Coverage (sector modes listed as a share of max, weighted by openness and binding scale factors)	42.4	25	16	63	42.7
Coverage/Count	79.5	67	76	65	70
No. of "No Restrictions"	218.7	152	88	372	240
"No Restrictions" as a share of total offer made	65.1	66	73	66	68
"No Restrictions" as a share of maximum		26	15	64	41

Table 6. (continued)

<i>Memo Items</i>	HIC in GATS (average)	WTO	AFAS [*]	JSEPA	WTO + AFAS ^{**}
No. of NT 1's / No. of MA 1's	1.2	1.3	1.1	1.04	
No. of matched 1's (MA=NT=1)	173.4	115	64	345	179
Matched 1's / count	51.4	49.6	53	62	51
Matched 1's / max	28	19.8	11	59	31

Note: ^{1/} maximum is 145 sectors * 4 modes. The paper used 145 instead of 155 sectors as Hoekman (1995) to remove the ambiguous classification of "others" in some subgroups

* Addition to WTO commitments. Some committed sectors may be similar to WTO committed sectors

** may be overestimated because some sectors may be the same except that the modal commitments have become more liberal

Source: AFAS and JSEPA – author's own computation; WTO – from Hoekman (1995)

Table 7. Sectoral coverage of specific commitments, Japan

	HIC in GATS (avg)	WTO	JSEPA
No. of commitments	330.4	408	492
<i>Market Access</i>			
Count (sector-modes listed as a share of maximum 1/)	53.3	70	85
Coverage (sector modes listed as a share of max, weighted by openness and binding scale factors)	40.6	50	52
Coverage/count	76.1	72	61
No. of 'No Restrictions'	188.9	230	282
'No Restrictions' as a share of total offer made	56.4	56	57
'No Restrictions' as a share of maximum		40	49
<i>National Treatment</i>			
Count (sector-modes listed as a share of maximum 1/)	58.1	70	85
Coverage (sector modes listed as a share of max, weighted by openness and binding scale factors)	42.4	48	46
Coverage/count	79.5	68	54
No. of 'No Restrictions'	218.7	199	213
'No Restrictions' as a share of total offer made	65.1	49	43
'No Restrictions' as a share of maximum		34	37
<i>Memo Items</i>			
No. of NT 1's / No. of MA 1's	1.2	0.9	0.8
No. of matched 1's (MA=NT=1)	173.4	155	200
Matched 1's/count	51.4	38	41
Matched 1's / max	28	27	34

Note: 1/ maximum is 145 sectors * 4 modes. The paper used 145 instead of 155 sectors as Hoekman (1995) to remove the ambiguous classification of 'others' in some subgroups

Sources: AFAS and JSEPA are author's own computation; WTO are from Hoekman (1995)

Table 8. Sectoral coverage of specific commitments, Philippines

	Developing Country WTO Avg	WTO	AFAS *	WTO + AFAS **
No. of commitments	183.7	160	124	284
<i>Market Access</i>				
Count (sector-modes listed as a share of maximum 1/)	29.6	28	21	49
Coverage (sector modes listed as a share of max, weighted by openness and binding scale factors)	17.1	21	13	36
Coverage/count	57.6	76	61	73
No. of 'No Restrictions'	67.3	102	53	155
'No Restrictions' as a share of total offer made	36.6	64	43	55
'No Restrictions' as a share of maximum		18	9	27
<i>National Treatment</i>				
Count (sector-modes listed as a share of maximum 1/)	29.6	28	21	61
Coverage (sector modes listed as a share of max, weighted by openness and binding scale factors)	18.8	24	13	39
Coverage/count	63.3	87	61	64
No. of 'No Restrictions'	90.5	144	70	214
'No Restrictions' as a share of total offer made	49.3	90	56	75
'No Restrictions' as a share of maximum		25	12	37
<i>Memo Items</i>				
No. of NT 1's / No. of MA 1's	1.5	1.4	1.3	
No. of matched 1's (MA=NT=1)	64.3	91	45	136
Matched 1's/count	35	57	36	48
Matched 1's / max	10.4	16	8	23

*Note: 1/ maximum is 145 sectors * 4 modes. The paper used 145 instead of 155 sectors as Hoekman (1995) to remove the ambiguous classification of 'others' in some subgroups*

* Addition to WTO Commitments. Some committed sectors may be similar to WTO committed sectors

** May be overestimated because some sectors may be the same except that the modal commitments have become more liberal

Sources: AFAS and JSEPA are author's own computation; WTO are from Hoekman (1995)

Japan's increase in sector-mode commitments is less dramatic, but significant, nonetheless. It increased its sector-mode commitments by 20 percent from 408 in WTO to 492 in JSEPA, representing 85 percent of maximum possible commitments compared to only 70 percent in the WTO. For the Philippines, the number of commitments increased by 77 percent (from 160 in WTO to 284 in combined AFAS-WTO commitments), up from slightly below one-third to about half of possible maximum.

Coverage, defined as the sum of the scale factors allocated to each sector-mode (0 for unbound, 0.5 for bound restrictions, 1 for no restrictions), as a percentage of maximum, shows that the quality of opening has likewise improved from the WTO to the PTAs for all three countries. Even so, the coverage/count ratio shows that the commitments are still littered with many restrictions. In Japan, the improvement in coverage commitment is almost marginal. Coverage share of maximum possible commitments increased from 50 percent in the WTO to 52 percent in JSEPA for market access and dropped from 48 percent to 46 percent for national treatment. This is apparent from its national schedule that is full of either 'unbound' entrees or restrictions, even though more sectors have been listed. In Singapore's case, the proportion of '1' and '0.5' is much higher than Japan's, thus the 61 percent and 63 percent share of *coverage* to maximum for Market Access (MA) and National Treatment (NT), respectively.

In terms of the proportion of "no restrictions" to total offer made, Japan has barely improved in its market access commitments, and even dropped the ratio in national treatment commitments in the JSEPA. On the other hand, a marked improvement can be noted for market access in Singapore, while the proportion dropped in the case of the Philippines.

It can also be noted that Singapore and the Philippines are more liberal in their national treatment commitment, while Japan is more liberal in market access. This is shown in the ratio of "no restrictions" commitment in NT over "no restrictions" commitment in MA. Looking at the national schedules, almost all of Mode 4 commitments are "unbound" for all three countries, although the Philippines has indicated Mode 4 restrictions in some sectors with explicit reciprocity of labor access conditions in its AFAS package of commitments.

To summarize, overall commitments have increased in the PTAs compared to these countries' WTO commitments, even though both market access and national treatment disciplines remain littered with reservations or limitations. The movement of natural persons or Mode 4 commitments is still mostly unbound, even in the PTAs. Japan appears to be more generous with market access commitments than with national treatment, while it is the reverse for Singapore and the Philippines.

As mentioned, this type of measurement merely measures the extent of countries' willingness to bind their regulatory measures but does not imply actual liberalizing content. If at all, the extent of openness-cum-binding can be implied if the numbers are bigger. Moreover, this procedure suffers further limitations because the figures do not take into account the relative importance of different activities in the GDP (i.e., the size of the various service markets). The indicators of sectoral coverage do not incorporate information on the relative restrictiveness of measures that are maintained nor the relative importance of modes of supply on a sector-by-sector basis. For example, a foreign equity limit of 75 percent is valued the same as one that puts the cap at 30 percent. Similarly, a "no restriction" commitment for Mode 1 or cross-border delivery in retail banking is of little value since retail banking usually requires commercial presence (Hoekman 1995).

Options for the Philippines

Movement of natural persons and mutual recognition

Like many developing countries with surplus labor, much of the gains from services trade liberalization lay in more liberal Mode 4 commitments (movement of natural persons) by partner countries. A liberal Mode 4 commitment should enable domestic workers to offer temporary services abroad with relative ease than what is currently allowed. However, an analysis of services schedules of commitments in both WTO and regional agreements like the JSEPA hints of no major improvement in labor movement policies.

In the JSEPA and WTO, Japan left Mode 4 commitments in almost all services sectors largely unbound, which essentially means that it has taken no liberalization commitments as far as labor imports are concerned. This type of commitment schedule is unlikely to significantly vary in other bilateral agreements that Japan would sign, including the Japan-Philippines bilateral agreements. Yet, it is in Mode 4 commitments where significant complementarity between Japan and Philippines lies, because Japan has an aging population while the Philippines has surplus labor. The promise of a bilateral agreement for difficult issues like movement of natural persons lies in the fact that the Japanese market, nevertheless, is protected from having to extend any Mode 4 obligations to other countries.

Most barriers to movement of natural persons in Japan and in other countries include quotas or economic needs tests, requiring proof, for instance, that no local labor is able to take on the job.¹¹ In many countries, formalities

¹¹ At times, employers are required to take timely and significant steps to recruit and retain sufficient national workers in the specialty occupation. In addition, another requirement is that no worker should have been laid

to obtain a visa make red tape related to FDI seem trivial by comparison. Furthermore, entry can be impeded by (i) non-recognition of professional qualifications obtained abroad, (ii) burdensome licensing requirements, (iii) or by the imposition of discriminatory standards on foreign workers. Requirement of registration with, or membership in domestic professional organizations, such as the local bar for lawyers, can also constitute an obstacle for a person wishing to provide a service on a temporary basis (see also Table 1).

For the Japan-Philippines services trade agreement, the NAFTA would be a more useful starting point than the JSEPA. The JSEPA chapter on movement of natural persons talks mainly about entry facilitation of specific type of workers and makes no mention about the establishment of committee for mutual recognition as in NAFTA.¹² For instance, NAFTA contains an obligation to abolish nationality or permanent residency requirements for the recognition of diplomas and the granting of licenses for foreign providers of professional services. NAFTA also sets out the obligation to develop a generic blueprint aimed at defining procedures for assisting all professions to achieve mutual recognition of licenses and certifications. While both Mexico and the US have slackened in their full implementation of the mutual recognition provision, the fact that such an obligation is enshrined in the bilateral agreement is a major milestone for future liberalization in the movement of labor, perhaps when both political and economic scenarios are opportune for both countries.

Some preliminary progress under NAFTA, however, has already been achieved. For instance, Canadian and Mexican states have approved the agreement signed in 1995 to recognize the equivalency of professional qualifications for the temporary and permanent licensing of engineers. In the US, only Texas had adopted the agreement. A recognition agreement for legal consultants was also agreed by representatives of the legal profession from the US, Canada, and Mexico in 1995 but is yet to be adopted. Other professions that are working on elaborating recognition agreements under NAFTA include architects, accountants, nurses, land surveyors, and actuaries. Between Canada and the US, nongovernmental bodies on professional qualifications of architects and accountants signed two recognition agreements, which unfortunately, have not yet been extended to Mexico.

There are other NAFTA-like provisions that are attractive to adapt in the JPEPA. In the trade agreements of Mexico and Chile with other Latin American countries, there is an annex on professional services that establishes procedures

off for a certain period preceding and following the filing of any work permit or visa application for a foreign worker.

¹² Subsequent discussions on the NAFTA mutual recognition agreement draw a lot from Stephenson (2001).

for the recognition of studies, diplomas, licensing, and certification obtained by professional service providers. In NAFTA, the annex requires Parties to encourage the relevant bodies in their respective territories to

- (1) develop mutually acceptable standards and criteria for the licensing and certification of professional service providers,
- (2) provide recommendations on mutual recognition to the Parties, and
- (3) develop procedures for the temporary licensing of professional service providers from the other Party.

The guiding principle for establishing the standards is the equivalent of qualifications in the home and host countries using education, examination, and experience as criteria for evaluation. Moreover, the provisions of the Annex are to be revised every three years.

In practice, mutual recognition is very challenging because deep integration in this area entails the willingness of governments to recognize the regulatory authority and competence of other sovereign states, and necessitates a high degree of mutual trust. Even for the EU, which enjoys a relative homogeneity in educational and professional standards, mutual recognition remains a knotty issue to this day. What more for countries like Japan and the Philippines with starkly divergent levels of development and professional standards? The experience from NAFTA, however, is encouraging in that it is also an agreement between developed and developing countries, yet mutual recognition principles, at least, were laid down. It, thus, offers a model of a possible way forward.

Philippine sectors of interest

To determine which services sectors should be pushed for access in the Japanese market and which ones in the domestic market to be liberalized, a more in-depth and extensive analyses of each individual service sector is needed. Because of their scope, it is unrealistic to discuss all the major issues in depth, given the time constraint, but reference is made to substantial research in the Philippine context, if those exist. What this subsection presents is some kind of a situationer on the different service sectors in terms of their essential features for trade and negotiations. These include sector characteristic and definition, various trade and regulatory regimes in the Philippines or in other parts of the world that affect the sector, and existing liberalization commitments under the GATS, AFAS, or JSEPA.¹³

¹³ For more details, see the various background notes by the WTO Secretariat, from which this subsection was heavily drawn.

Telecommunications services

Telecommunications services is one of the most promising sectors that is a source of growth and efficiency for the global economy. In the WTO Classification List, it is broken down into 14 subsectors (2.C.a-n and "other" category [o]) (see Appendix 1 for the list of subsectors within telecommunications). For purposes of negotiations, *a.* through *g.* of the list, and a variety of "other" services like mobile communications, were generally considered basic telecommunications services. Subsectors *h.* through *n.* and any "other" services not supplied on a real-time basis or which transform the form or content of customer's information, were considered *value-added* telecommunications services. Increasingly, though, the distinction between basic and value-added telecommunication services has blurred with the adoption of new transmission technologies and the enhanced ability to integrate different technologies.

The relevant agreements for telecommunications services in the WTO are

- (1) the GATS;
- (2) the Annex on Telecommunications, which deals with specific points pertaining to trade in telecommunications services, such as access to public networks;
- (3) the Fourth Protocol, which provides the legal basis for the annexation of new basic telecommunications schedules to the GATS schedules; and
- (4) the Reference Paper, which contains pro-competitive regulatory principles and which was optional for WTO members.

Existing commitments

Current Philippine commitments in the WTO cover practically all subsectors of telecommunications services, but with "unbound" market access commitments for all modes of supply, except commercial presence (Mode 3). National treatment commitments are liberal, in contrast. Mode 3 limitations include (i) foreign equity cap at 40 percent; (ii) franchise to be granted by the Congress; (iii) requirement to obtain a Certificate of Public Convenience and Necessity from National Telecommunications Commission; and (iv) non-authorization of resale of private leased lines, call back, dial back, and other similar schemes. The commitment in AFAS is similar for the *basic* telecommunications services, except for Mode 1 where, instead of "unbound," the cross-border restriction was stated as "subject to commercial arrangement with licensed operators." No commitment on the telecommunications value-added services has yet been submitted. Under "national treatment," an additional restriction pertains to the number of foreign members of the Board (which should be proportionate to

equity share), and to the nationality of the executives and managers (must be Filipino citizens).

The Philippines has not fully subscribed to the Reference Paper with its specific regulatory principles. Instead, the Philippines has broadly stated commitments to the principles of competition. On interconnection or access to local loop carriers, the primary difference between the Philippine commitment and the Reference Paper is that the former applies its interconnection guidelines to all suppliers while the latter applies it specifically to the major supplier.¹⁴

Possible position

Areas for consideration for liberalization can focus on

- (1) the foreign equity cap of 40 percent in basic telecommunications services,
- (2) zero percent foreign equity in broadcasting entities, and
- (3) restrictions on cross-sector ownership in telecommunications and broadcasting.

Removing or increasing the maximum limit on foreign ownership can attract more foreign investments that are needed for the continued upgrading and build up of the basic telecommunications infrastructure. The stark reality of high investment demand to keep pace with rapid modernization of basic telecommunications infrastructure has spurred other countries like Malaysia and China to increase foreign equity limits to 61 percent and 49 percent, respectively.

Likewise, increasing the foreign ownership limit in broadcasting and removing the cross-ownership restrictions can usher in the restructuring of the telecommunications industry so that evolving networks can use a broad range of integrated services and technologies in a seamless, technology-neutral manner. This is merely recognition of the reality that rapid developments in technology have rendered archaic many of the domestic rules and restrictions affecting telecommunications.

This direction is all the more urgent as many other key services integrate into electronic networks. These key services include distribution services, advertising services, computer and related services, and financial services. Cheap and modern communications facilities are likewise an additional factor to attract a bigger portion of the burgeoning call center business from other parts of the world.

¹⁴ A "major supplier" is defined as a supplier that has the ability to materially affect the terms of participation in the relevant market for basic telecommunications, either because of control over essential facilities or because of a dominant position in the market. A more thorough discussion of the competition and regulatory issues in telecommunications services can be found in Serafica (2002).

Financial services

The Philippines have made significant commitments in financial services in the WTO, but it did not sign up in the Understanding on Commitments in Financial Services. Note that for financial services, four major agreements are relevant, namely the (i) GATS itself; (ii) annex on financial services, which adapts basic GATS provision to sector-specific characteristics of financial services and is binding to all WTO members; (iii) Fifth Protocol, which includes the new Schedules and MFN exemption; and (iv) Understanding on Commitments in Financial Services. The Understanding contains additional commitments that are referenced in the countries' scheduled commitments and have been signed mostly by OECD member countries.

The question in the upcoming negotiation is whether the Philippines is ready to sign up for the Understanding. This subsection, therefore, briefly explains the Understanding and its relation to GATS, the current Philippine commitments in WTO and AFAS, and determine if, indeed, given current regulatory provisions, the Philippines is ready to adopt the Understanding on Financial Services Agreement.

Understanding on Commitments in Financial Services

The obligations attached to the Understanding are the following: 1) Countries that sign the Understanding commit to a standstill obligation, that is, they have to list non-conforming measures that are actually applied, and not to a more restrictive measure than the status quo. 2) Existing monopoly rights in the financial services sector must be listed and the country must endeavor to eliminate them or reduce its scope. 3) The granting of MFN and national treatment with respect to the purchase or acquisition of financial services by public entities is obligatory (even though GATS excludes obligations in government procurement of services). In addition, financial service suppliers of other members established in the territory must be granted, under national treatment terms and conditions, access to payment and clearing systems operated by public entities, and to official funding and refinancing facilities available in the normal course of ordinary business. The Understanding, however, makes clear that a member's lender of last resort is under no obligation to act in respect of the financial service supplier of another member.

The Understanding also expands the commitments across the four modes of supply. In particular, a certain level of access through cross-border and consumption abroad modes of supply (i.e., Modes 1 and 2 commitments) has to be granted. Note that GATS by itself leaves all countries free to commit or not to Modes 1 and 2, yet under the Understanding, such access is mandatory.

As to commercial presence (Mode 3), a signatory to the Understanding must grant financial service suppliers of other members the right to establish or expand within its territory, including the acquisition of existing enterprises (e.g., takeovers). Significantly, access granted in financial services is extended on an MFN basis, regardless of whether a country has signed up to the Understanding or not. Furthermore, foreign financial service suppliers that are established in the territory of the host member are permitted to offer any new financial service in that territory provided they have already been supplied and approved either in their own home or in a third country. However, the Understanding allows for regulatory or prudential carve outs.

As to Mode 4 (temporary entry of personnel), while GATS does not mandate a minimum level of market access, the Understanding provides for a minimum commitment as to the temporary entry of personnel necessary for the establishment of a commercial presence and the conduct of activities in the territory of a host member. The Understanding also contains a "best efforts" obligation on certain types of nondiscriminatory measures that may have adverse effects on liberalization of financial services such as, for instance, nondiscriminatory limits on branching, or limits on types of financial services that a bank may offer, such as banking, insurance, or investment services.

Given these obligations imposed by the Understanding, is the Philippines ready to sign up for the Understanding? In the face of current regulatory and supervisory regime, the conditions do not yet seem to be right. For example, considering the local capacity to adequately supervise and regulate the activities of foreign cross-border financial service suppliers, it might be risky to take on unchecked commitments on cross-border supply of financial services (Mode 1), especially if they are "new," which domestic regulators may yet have inadequate grasp. The main consideration is actually whether the regulatory and supervisory structure is up to the job of regulating in a thoroughly liberalized financial environment. In the light of the 1997 Asian crisis, the country has, indeed, reasons to be circumspect.

On the other hand, the state of the domestic financial system cannot also be hostage to the pace of learning of the regulatory and supervisory authorities. If that were to happen, domestic financial services run the risk of being doomed to backwardness while the rest of the world would have grown in financial sophistication. In fact, one of the best way to improve the regulatory structure is to provide incentives for it to improve, that is, by allowing foreign financial institutions to operate in the domestic market, and in the process, put pressure on regulatory authorities to keep up and improve their knowledge of the field and adapt "best practices" in the different areas of regulation and supervision.

Philippine experience in financial liberalization

To resolve the issue of whether to liberalize the financial sector more or not, one source of guidance can be the past liberalization experience of the Philippines. The literature on foreign bank entry asserts that domestic banks are helped to be more competitive and efficient by foreign entry. Studies on domestic banking experience, however, show no significant impact of foreign bank entry on banks' spread (indicator of competition) and efficiency. On the other hand, these studies suffer major limitations because these relied on very short time period to assess the relatively recent entry of a few foreign banks. It is expected that the main impact of foreign entry is in its long-term dynamic effect on competition and efficiency.¹⁵

Besides, past liberalization efforts have not really gone far enough in providing domestic banks with a viable threat to competition. In the first place, the Central Banking Act maintains the objective of ensuring that 70 percent of financial assets remain with Filipino-owned banks. There have also been limits on the type of services and branching activities of foreign banks. Yet, despite these limitations, the presence of foreign competition have contributed to the introduction of new products and processes, especially technology-based enhancements such as phone banking, bills payment, point-of-sale transactions, and internet banking. The threat of foreign competition has also motivated the restructuring of the financial sector through mergers and consolidations. It is hard to imagine that all these took place without a strategic view to the impending increased competition from foreign banks.

Prospects for the Philippines

One strategy that the Philippines can adopt is to pre-commit to a further liberalization in the future. Brazil and Hungary did this in their WTO commitment schedules, so some precedents exist. The idea recognizes the reality that at the present regulatory and financial sector condition, the regulatory and supervisory structure is not ready to take on more liberalization but that at a determined future date, more significant opening should be expected. Meanwhile, certain incremental changes may be introduced in a paced manner in order not to backload all the financial liberalization to a later period.

¹⁵ Note, though, that the high bank spread is perhaps due to the greater focus of local banks on retail operations, which normally entail higher operating costs compared to banks oriented toward wholesale markets. Retail operations need more branches, equipment, and personnel to serve retail customers, which then translate into higher spread (Milo 2002).

A few of these incremental changes can be the adoption of a few provisions of the Understanding, for example, the standstill obligation. Committing to bind the non-conforming measures in market access and national treatment at the status quo contributes to greater transparency on conditions of market access in the domestic market and prevents regulatory rollbacks. After all, since the Philippines has already committed the same standstill obligations in its AFAS schedules to ASEAN countries, it would be merely extending the same to Japan. For example, updating the equity caps from 49 percent (in its WTO schedule) to the actual statutory limit of 60 percent, or the number of branches allowed from four to six, which is what the General Banking Act stipulates (Table 9). Other commitments in AFAS could be extended to Japan.

Table 9. Philippine financial services commitments in WTO and AFAS

WTO Commitments	ASEAN Framework Agreement on Services
<i>For all financial services sector</i>	
- Necessity test	- No necessity test
<i>Banking</i>	
- Cap on asset holding: 70% should be Filipino-owned.	- Cap on asset holding: 70% should be Filipino-owned.
- Allowable number of branches for foreign banks: 4	- Allowable number of branches for foreign banks: 6
- Majority of members of the Board should be Filipinos	- Proportion of foreign members of the Board is equivalent to foreign equity share.
- Cap on foreign equity in banks: 49%	- Cap on foreign equity in banks: 60%
- Cap on shareholding of foreign nonbank in locally incorporated bank must not exceed 20% for individual, and 30% for a corporation	- Cap on shareholding of foreign nonbank (whether individual or corporation) is 30%
<i>Investment houses</i>	
- Foreign equity cap is 49%; the majority of the Board members should be Filipinos; prior authorization requirement for quasi-banking functions	- No separate commitment for investment houses, hence, WTO commitments stand.
<i>Non-bank financial intermediary, e.g., insurance</i>	
- Foreign participation cap: 40%	- No separate commitment

Sources: WTO Philippine GATS Schedule

Philippine Schedule of Specific Commitments (for the second package of commitments) in the AFAS.

Furthermore, some of the discriminatory measures that are contained in present regulations may be considered for liberalization pre-commitment. An aid toward this step is a preliminary accounting of the regulatory measures (both discriminatory and nondiscriminatory) that are in effect in the Philippines (Appendix 4). A look at the table reveals a significant number of regulations that are not consistent with the Understanding and thus can be candidates for eventual removal. For instance, the 70 percent minimum limit on total asset holding reserved for Filipino-owned banks and the maximum limit of six branches to foreign banks violate Paragraph 5 of the Understanding. Policy-directed lending, too, though it is nondiscriminatory, is probably inconsistent with Paragraph 10b.¹⁶ On the other hand, there are many regulations that are clearly consistent with the prudential carve out provisions in the Annex and in the Understanding.

One suggestion is to weigh the cost and benefit of maintaining the discriminatory measures against foreign banks and their impact on competition and efficiency. If the regulation does not have any prudential or safeguard function, the country would perhaps be better off if those discriminatory measures are removed at the appropriate time, giving domestically owned banks sufficient time to adjust.

Japan's commitments

Japan's commitments in the financial services area, being a signatory to the Understanding, are sufficiently liberal. Would this imply that Philippine banks may easily establish commercial presence in Japan to service foreign remittances of Filipinos working in Japan? The answer is not straightforward and would, in fact, depend on how confident Japan is with the supervisory power of Philippine authorities over the activities of Philippine banks with commercial presence in Japan. This is not a violation of the MFN provision but is fully compatible with Paragraph 3 of the Annex on Financial Services, which specifies that a member *may* recognize the prudential measures of another country.¹⁷ The Philippines, therefore, should use the bilateral negotiations for Japan to accord recognition to Philippine prudential measures and supervisory capacity.¹⁸ This recognition, perhaps, would depend on how close our prudential measures are to "best practices" around the world.

¹⁶ "Each Member shall grant financial service suppliers of any other member the right to establish or expand within its territory, including through the acquisition of existing enterprises, a commercial presence." (para. 5, Understanding on Commitments in Financial Services).

¹⁷ "May" is not the same as "obligated" to recognize another country's prudential measures.

¹⁸ The complicating factor in according recognition to Philippine supervisory authorities is that, under Paragraph 3b of the Annex, Japan is obliged to allow third countries to show that their prudential measures are similar or better than the Philippines and thus they, too, should be accorded recognition. In this way, the bilateral arrangement benefit is not exclusive to the Philippines but may be extended to more countries.

Health services

Health-Related and Social Services is Category 8 in the WTO Services Sectoral Classification List (MTN.GNS/W/120), and has four main sections, namely, A) Hospital Services, B) Other Human Health Services, C) Social Services, and D) Others. The corresponding division in the United Nations Provisional Central Product Classification (CPC) is Division 93, which includes—besides those in the List—medical and dental services, veterinary services, and the services provided by nurses, midwives, and others. These latter services have been grouped under Professional Services (1.A. h-j) as per the WTO List.

Health services sector is normally a domestic economic giant, but it is traditionally a relatively minor contributor to trade because it has long been considered a non-tradable. The dominant trade-related concerns are the international migration of health professionals and movements of patients. Developing countries are interested in attracting foreign patients to domestic hospitals, or in sending health personnel to work temporarily abroad. For developed countries, their concern is on regulatory barriers that can inhibit subsectors in health services sector that can be delivered electronically. At the same time, concern about the burgeoning health costs should make developed countries take an interest in facilitating access to hospitals in developing countries where costs for both patients and insurers are significantly cheaper. For instance, the cost of coronary by-pass or liver transplant in India is only roughly one-tenth to one-fifth the cost in the US or Europe, thus implying potential significant savings for patients from developed economies.

Trade issue for negotiation

In the case of Japan-Philippine trade, the concern is again Mode 4 liberalization, i.e., a more liberalized environment or facilitated access for Philippine health professionals. Current Japanese commitments in both WTO and JSEPA, however, do not include commitments in professional medical/dental services, as well as those of nurses and midwives (1.A.h-j of the WTO Classification List) (Table 10). This is an issue that might need to be explored by the Philippine panel.

Besides Mode 4 commitment, the Philippines can also benefit from Mode 2 (consumption of hospital services abroad) commitment by Japan. Current Japanese commitments in both the WTO and JSEPA are quite liberal with regard hospital services (Table 10). It has no restrictions in Mode 2 (consumption abroad) with regard to hospital services (Category 8.A). This means that Japanese people can seek exotic type of treatment from developing countries where costs are low for treatment like cosmetic surgery, which are normally not covered by health insurers, anyway.

But for most medical needs, for Mode 2 liberalization in hospital services to be meaningful, what is required is that Japan also has an equally liberal commitment in health insurance, i.e., that health insurance should be portable. In many domestic health insurance policies, health coverage is not extended abroad, except in a few certified and licensed foreign facilities. For example, four large Mexican insurance companies have accredited a consortium of hospitals in Texas as preferred health providers eligible to receive patients. Hence, there should be no reason why similar arrangements could not be crafted between Philippine hospitals and Japanese insurers. For government insurance and medical care, coverage is even more limited to domestic licensed facilities without provisions for reimbursements for foreign medical expenses.¹⁹ Thus, despite liberal Mode 2 commitments, the lack of portability of government pension and medical care constrains some elderly persons from traveling or retiring abroad.

Yet, it is worth noting that according to a WTO report, if concerns about the quality of care received abroad are addressed through, for instance, certification or accreditation of medical facilities, the potential impact of permitting portability can be substantial for developing countries. Retired persons from OECD member countries who choose to live in countries like the Philippines can bring with them billions of dollars annually in personal consumption plus medical expenditures. In a symbiotic relationship, developed countries are, at the same time, enabled to cut their health care costs for their aging population.

As per GATS rules, *private* arrangements between developing countries' hospitals and developed countries' insurance companies are not covered by multilateral rules. However, the Philippines can request Japan to encourage and facilitate the accreditation process by, for instance, having transparent standards for hospital services on which the certification process could be based.

Philippine commitments

The Philippines has no commitment in health services either in the WTO or AFAS. For the bilateral negotiation with Japan, however, the Philippines should list this sector in its schedule and commit liberal Mode 3 (commercial presence) commitments to entice Japanese investors to invest in this sector. Considering that the hospital sector is not among those in the negative list of the foreign investment act, 100 percent equity by Japanese investors should be allowed. In addition, Mode 4 commitment, particularly for the hospital management staff and board of directors, would have to be equally open to match the 100 percent equity.

¹⁹ Interviews with Japanese retirees in the Philippines revealed that about 20 percent of hospitalization expenses can be reimbursed by government insurance in Japan.

Table 10. Japanese liberalization commitments in health services

Sector	Cross-Border Supply			Consumption Abroad			Commercial Presence		
	Full	Limited	Unbound	Full	Limited	Unbound	Full	Limited	Unbound
Commitments in the WTO									
8.A. Hospital services (CPC 9311)	x			x					x ¹
Commitments in JSEPA									
8.A. Hospital services (CPC 9311)	x			x					x ¹
8.B. Other human health services	x			x					x ¹
8.C. Social services	x			x					x ¹

¹ Unbound except that there is no limitation on the participation of foreign capital.

Notes: 1. The commitments are similar for market access and national treatment.

2. Japan made no commitment in Professional Services (i.e., medical and dental services, midwives and nurses, and other medical services) in both the WTO and JSEPA.

Source: WTO-GATS Commitments, www.wto.org.

Table 11 shows that, instead of increasing, bed capacity of Philippine hospitals had actually declined from 15.50 bed capacity per 10,000 population in 1985 to 10.20 in 2001, indicating a need to spur more hospital investments. In terms of the number of hospitals, average growth from 1993-2001 is negative 0.3 percent. Opening up hospital services sector to foreign investment, therefore, should help in uplifting hospital care and in upgrading health facilities.

Table 11. Philippine hospitals: Number and bed capacity

	Total Number of Hospitals	Total Bed Capacity	Bed Capacity per 10,000 population
1985	1,814	89,508	15.5
1990	1,733	87,133	14.0
1995	1,700	80,800	11.8
2000	1,712	81,016	10.6
2001	1,708	79,444	10.2

Sources: Department of Health and ADB's *Key Development Indicators*, 2001.

Energy services

The WTO Classification List does not have a distinct and separate major category for energy services. Instead, energy services are incorporated into various categories like transport services, particularly pipeline transport of fuels sub-classification (WTO List 11.G.a), or "Other business services" such as services incidental to energy distribution (WTO List 1.F.j),²⁰ as well as construction (Civil Engineering) category. Other forms of services related to energy include consulting (in various fields, including energy efficiency, conservation, and renewable energy), construction, maintenance of the network, and services related to distribution such as metering and billing.

Part of the difficulty in analyzing the energy sector, particularly the role of trade in energy services and before privatization and liberalization in many countries, is that traditionally, the industry adopted a unified approach and did not distinguish between the "goods" and the "services" aspects of energy trade. After privatization and the unbundling of previously vertically integrated energy sector into production, transmission, and distribution of energy, regulatory principles for goods have been typically applied on production of energy, while those for services apply to transmission and distribution of energy.

²⁰ The corresponding UN Centralized Product Classification (CPC) 887 explanatory note states that this category includes distribution and transmission activities.

In the WTO context, production of energy goods comes under GATT, while transmission, distribution, and related services come within the scope of GATS.

The transport of energy is distinct from the transport and distribution of goods like cars and other manufactured goods because of two reasons. First, energy, specially electricity and gas, are difficult to store unlike any other goods, including oil. Second, the transport and distribution network for energy are also distinct. These do not require highways, but distribution grids or pipelines (in the case of gas), and thus, in most cases, require quasi-natural monopolies. In contrast, seldom would a monopoly be necessary to transport and distribute manufactured products.

Historically, the energy sector in many countries was vertically integrated state monopolies. The process of privatization broke up public monopolies and unbundled vertically integrated utilities. The result, generally, is that production or generation of energy is competitive; so with energy distribution or the delivery of electricity to ultimate consumers through low-voltage mains. But transmission, which refers to the transport of electricity from generators to distribution companies and large industrial consumers through high-voltage mains, remained the activity of a natural monopoly.

GATS and GATT Rules for Energy

The distinctions in activities (production, transmission, and distribution) have profound implications for multilateral trade regulation. For instance, in foreign investment or commercial presence, while GATS provides legally binding rules applying to establishment of energy services suppliers, there is, for now at least, no similar comprehensive rule on investment for goods. The Trade-Related Investment Measures (TRIMs) Agreement in the WTO affects cross-border trade of energy goods rather than establishment. For example, it applies to trade-related investment measures such as those linking investors' right to use imported goods as inputs to their export performance. Thus, foreign investments in energy generation—which is under GATT have no similar legal cover as foreign investments in transmission and distribution of energy which fall under the scope of GATS. Table 12 summarizes these issues.

On competition rules, GATS also includes binding rules on monopolies and exclusive services suppliers²¹ and contains a legal framework to develop more regulatory disciplines touching upon important anti-trust issues (the Reference Paper for Telecommunications is an example). This is particularly important since transmission of energy is generally run by quasi-natural monopolies. The liberalizing effort of many countries can thereby be vitiated by weak regulations

²¹ GATS Article VIII.

Table 12. Application of trade rules to segments of energy sector

	Trade in Goods		Foreign Direct Investment	
	Barriers	WTO Rules	Barriers	WTO Rules
Production of energy (Goods)	- Tariff and nontariff barriers	- GATT and other WTO goods agreements, e.g., TRIMs	- Market access, national treatment, and other regulatory barriers	- None yet
	- Restrictive business practices (RBPs), vertical foreclosure		- RBPs, vertical foreclosure	- None yet
Transmission and distribution of energy (Services)	Cross-Border Trade		Establishment Trade	
	- Market access, national treatment, and other regulatory barriers	- GATS obligations and commitments	- Market access, national treatment, and other regulatory barriers	- GATS Obligations and commitments
	- RBP, vertical foreclosure	- Articles VIII, XVIII (reference paper) of the GATS	- RBP, vertical foreclosure	- Articles VIII, XVIII (Reference Paper)

Source: *WTO Background Note on Energy Services*

on, for example, access to transmission network, which is virtually controlled by a natural monopoly. In contrast, restrictive business practices (RBPs) of goods manufacturers are currently out of the scope of WTO agreements.

Deregulation experience

Overall, the benefits of unbundling and privatization in various countries have, generally, been positive. In many places, efficiency was enhanced, outages reduced, new investments generated, wholesale prices dropped, and government subsidies abolished.

In the Philippines, EO 215 broke the monopoly of the National Power Corporation (NPC) in power generation. It opened the generation of electricity to the private sector and paved the entry of independent power producers (IPPs). Further, the Power Industry Reform Act of 2000 (RA 9136) embodies two major reforms: the privatization of NPC and the unbundling of the energy activity components into generation, transmission, and distribution. At the moment, the current structure is that the NPC remains as the sole energy generator for geothermal and hydroelectric power, as well as the sole transmission utility. The energy distribution sector, however, is competitive with 146 (private and public) entities.

Trade commitments

The Philippines has not made trade commitments in energy-related services, neither in the WTO nor in AFAS. Japan, similarly, has not made commitments in services incidental to energy distribution (List 1.F.j).

As a public utility, foreign investment in the energy sector is subject to 40 percent limit in the Philippines. Considering that Japan can potentially be enticed to invest in this sector, and in view of the required resources to upgrade and develop new transmission lines, the foreign investment limit should be increased.

Other modes of supply, e.g., Modes 1 and 2, are not relevant in the Philippine case. Cross-border trade in energy services apply more to countries that are geographically close to each other like Malaysia and Singapore, or European countries that share the same borders. More liberal Mode 4 commitments may be worthwhile, particularly for the more technical and knowledge-intensive jobs, which the Philippines do not have. Other regulations, where they exist, pertaining to health and safety objectives, environmental protection, consumer protection, and universal service should be reviewed and prevented from becoming a disincentive to investment.

Environmental services

Environmental services is Category 6 of the WTO Classification List and includes sewage services, refuse disposal, sanitation and similar services, other environmental services. The OECD definition of environmental services is broader than that used in the WTO Classification. It includes services provided to measure, prevent, limit, minimize, or correct environmental damage to water, air, and soil; as well as problems related to waste, noise, and ecosystems. The classification encompasses services relating to

- (1) pollution management, including those related to the construction and installation of facilities for such purposes, and services related to the installation and utilization of
- (2) cleaner technologies; and
- (3) technologies and products that reduce environmental risk and minimize pollution and resource use.

Historically, many of these services, particularly sewage and refuse disposal, were provided by governments because they were considered public good or natural monopolies owing to the high levels of required investment. But the situation has changed. In more developed countries, private markets for environmental services have been created as a result of stringent government regulations designed to control pollution problems. Natural monopolies have, likewise, been delineated narrowly to introduce greater competition in services that are not inextricably linked to the monopoly. For instance, sewage treatment is competitive even as sewage collection remains a natural monopoly.

The global environment market was estimated to be USD 453 billion in 1996, of which the services component accounted for roughly 50 percent or USD 229 billion. Within services, solid waste management and water treatment services were the dominant activities (Table 13). Growth rates in this sector in the developed country markets have declined in recent years because the major industrial sectors have already achieved a high degree of compliance with existing legislations. However, faster growth is expected in Africa, Asia, and Latin America as the stringency of domestic environmental regulations increase and international environmental standards are beginning to be more strictly enforced.

Trade commitments

The Philippines does not have any commitments in environmental services. One important thing to note though is that Malaysia has started to privatize the sewage system of the entire country. If other countries, including the Philippines, start following Malaysia's example, this would have to mean Mode

Table 13. Global environmental market, in USD billion, 1996

	United States	Japan	Asia	Total USD	Total %
Equipment					
Water equipment and chemicals	16.0	5.6	2.7	38.9	8.6
Air pollution control	15.4	3.3	0.9	29.0	6.4
Instruments and information systems	1.8	1.0	0.2	5.2	1.1
Waste management equipment	10.7	8.6	1.3	32.4	7.2
Process/prevention technology	0.9	0.5	0.1	2.3	0.5
Services					
Solid waste management	32.7	29.6	3.4	102.2	22.6
Hazardous waste management	5.9	3.8	0.5	16.8	3.7
Consulting and engineering	14.2	1.1	0.8	26.8	5.9
Remediation and industrial services	8.3	1.1	0.4	15.0	3.3
Analytical services	1.2	0.5	0.1	3.2	0.7
Water treatment services	24.6	9.6	2.7	64.8	14.3
Resources					
Water utilities	27.0	12.2	4.5	73.0	16.2
Resource recovery	11.6	9.2	1.1	37.7	8.3
Environmental energy	1.4	1.0	0.4	4.9	
Total (USD)	171.8	87.1	18.9	452	
Total (%)	38.0	19.3	1.9	1.0	

Source: Environmental Business International, Inc. as cited in *WTO Background Report on Environmental Services*

3 commitments that are attractive to foreign investors. Again, the Philippine constraint is the 40 percent limit on foreign equity on public utilities. This foreign equity cap would have to be reviewed.²² Allowing foreign investment in this sector alleviates government deficiencies to provide essential infrastructure services because of budget constraint.²³

²² Alternatively, environmental services facilities can use the build-operate-transfer (BOT) scheme. The advantage of BOT is that it overcomes the foreign equity limits for foreign investment because once the facility becomes operational and the public authority has reimbursed the costs that the private firm has incurred, its role changes from being owner to manager, as the public authority continues to pay the private firm for operating the facility.

²³ What is not clear, however, is whether the environment sector will fall within the scope of GATS rules or should be covered by Government Procurement Agreement. Government procurement of services, based on GATS rules, do not fall within its scope. But if the government privatizes a public utility, as in the case of Malaysian sewage utility, then GATS rules would have to apply.

Table 14. Growth prospects and potential advantages in selected countries

Country	Growth prospects according to national opportunities			Potential advantage according to opportunities in international market
	High Growth	Moderate Growth	Low Growth	
Germany	High-technology products Recycling	Air pollution	Water treatment Waste management	Waste- water Waste treatment Land remediation Measurement and analysis
United States	Waste management Land remediation	Air pollution	Water and wastewater	Monitoring Remediation: nuclear, mining, agriculture, chemicals Biotechnologies Air pollution
Japan	Air pollution	Waste management	Water and wastewater	Air pollution: urban and industry
Australia	Mine remediation Consultancy services Water and waste water	Industrial remediation Clean production Air monitoring	Air control Solid waste management	Mine remediation Consultancy services

Source: OECD as cited in *WTO Background Note on Environmental Services*

It is worth noting too that Japanese firms are among the efficient environmental service providers particularly in air pollution and waste management. Germany, France, and Italy, on the other hand, have advantage in wastewater treatment (Table 14). Thus, even if the Philippines provides Japan with a preferential treatment in environmental services, there is less scope for trade diversion because Japanese providers are among the most efficient in the world.

Distribution services

The distribution services is category 4 in the WTO classification list and includes commission agents' services, wholesale and retailing services, franchising, and other sub-classification. In the Philippines, the wholesale and retail taken together account for more than a third of total value added in services and more than 15 percent of GDP (Table 15). It also accounts for a significant portion of employment as the sector is heavily labor-intensive. Hence, FDIs in this sector can significantly contribute to growth in employment.

Trade commitments and Philippine liberalization

The Philippines did not make any commitment in the distribution services sector in either AFAS or WTO. For future commitments in this sector, the government must keep in mind that developments in distribution services can be significantly enhanced with growth in telecommunications. Fairly liberal e-commerce laws or Mode 1 (cross-border mode of supply) commitments are going to be significant for the development of the distribution services sector.

Even without international commitments, the sector has been liberalized unilaterally. The Retail Trade Liberalization Act of 2000 (RA 8762) removed barriers to foreign investment for certain categories of minimum paid-up capitalization. In particular, for retail enterprises with paid up capital of at least USD 7.5 million (Category C), foreign equity is allowed up to 100 percent. For enterprises with paid up capital of USD 2.5 million to USD 7.5 million (Category B), 100 percent equity is likewise allowed but only after two years of the

Table 15. Share of Wholesale and Retail Trade in the Economy (%)
(based on GVA data in constant prices)

	1980	1985	1990–1995	1995–2000	2001
Share in total services sector	36.2	35.9	35.5	35.0	35.5
Share in GDP	13.0	14.5	15.2	15.6	16.3

Source: National Statistical Coordination Board.

Table 16. Retail Trade Liberalization Act of 2000 (RA 8762)

	Category A	Category B	Category C	Category D
Capitalization requirement	Less than USD 2.5 million	USD 2.5 million to USD 7.5 million	Greater than USD 7.5 million	High-end, luxury stores; USD 250 thousand per store
Foreign equity limit	0%	60% (2000-2002) 100% thereafter	100%	100%

Source: Author's compilation based on the Philippine Retail Trade Liberalization Act of 2000.

effectivity of the Act (i.e., 2003) (Table 16). Before that, foreign equity limit is 60 percent. Category D caters to enterprises specializing in high-end and luxury products with a paid up capital of USD 250,000 per store. Foreign equity limit in Category D is likewise 100 percent. RA 8762, however, reserved small retail trade with capitalization of less than USD 2.5 million for Filipino nationals.

While RA 8762 liberalized the entry of foreign investments, it maintained certain non-conforming measures that would have been listed under national treatment were this sector put in the Philippine GATS schedule. One is that for 10 years (i.e., up to 2010), foreign retailers falling under categories B and C are required to sell Philippine-made products with value equivalent to at least 30 percent of aggregate cost of stock inventories. For foreign retailers in Category D, the value of Philippine-made products should be at least 10 percent. Foreign retailers are also restricted not to carry out retailing activities outside their accredited stores, which limits the type of activities foreign investors can do. Moreover, the Philippines would have listed an MFN exemption because the retail Act allows for a limited reciprocity, allowing entry in Philippine retail sector only to nationals/enterprises from countries that grant similar access to Filipino retailers.

Trade barriers

In the global context, some regulations that impinge on the activities of the sector are implemented by local governments and municipalities, which wield the authority to license new stores and set the conditions of operation. Foreign distributors are, thus, confronted not only with cross-country differences in policy but also divergent regional and local attitudes. Since distribution services have a close relationship with trade in goods, the trade regime for goods, (e.g., technical barriers to trade), efficient custom clearance, certification, and product testing, also inevitably have an effect on the distribution sector. The experience of the European Union points to the fact that technical harmonization and the removal of barriers caused by differences in national product regulations and

elimination of border controls can greatly encourage the internationalization of distribution.

Other issues affecting distribution services are competition policy issues like vertical foreclosure, selective distribution, exclusive dealing, exclusive territories, and retail price maintenance. In the Philippine context, what seems to be a budding concern is the dominance of big mall operators capable of foreclosing access to retailers in the malls if they do not agree with some of their conditions such as, for instance, a requirement not to establish another retail outlet within certain distance from the mall. However, because foreign market access in distribution services had been allowed fairly recently, no significant competition problems appear to affect foreign distributors yet. This is not so in other countries as per the experience of US manufacturers in the Japanese market.²⁴ But it is important to take note that liberalization commitments in this sector can easily be nullified through lack of adequate implementation of competition rules.

Computer and related services

Computer services usually refer to computer-related consultancy services such as software development and systems integration. It is usually considered one of the three pillars of the computer industry, along with hardware and software. However, addressing computer services in isolation makes little sense because both hardware and software companies are significant suppliers of computer services and compete with independent services firms. For purposes of negotiations in the GATS, computer and related services have been classified as a subsector of business and professional services, designated 1B in the WTO Classification List.²⁵ It appears to have considerable overlap with regard to telecommunication services for activities such as database and data processing services that are increasingly performed or supplied online such that the distinction is blurred when telecommunication services, or computer services, or both are supplied. Similarly, it is not clear where to draw the line between software (good) and services. Presumably, packaged software is treated as a good, but do consultants hired by a firm to develop packaged software covered by GATS Mode 4 commitments? When packaged software is supplied online, is it still a good or a service?

²⁴ For example, the US government complained that US manufactured products had limited access to Japanese show rooms for finished vehicles as well as in repair markets for parts. Likewise, Kodak company filed a complaint with the US government alleging that Fuji and its network of domestic wholesalers and distributors sustained anti-competitive practices to limit the Japanese market access of Kodak films and print paper.

²⁵ It includes five subcategories: (i) consultancy services related to the installation of computer hardware, (ii) software implementation services, (iii) data processing services, (iv) database services, and (v) others.

Sales in computer services to foreign persons through affiliates are far more important than through direct sales via cross-border. For example, in 1995, US sales to foreign persons through foreign affiliates of foreign companies amounted to USD 23 billion compared to USD 4.7 billion direct sales from the US of computer and data processing as well as of database and other information services. Perhaps, as with most other services, proximity to the customer is important for computer services to diagnose adequately what the client needs. The implication is that commercial presence is an important mode of supply.

In the Philippines, commercial presence of foreign computer services firms may be motivated less by serving domestic clients' needs but by the attraction of cheap and fairly good computer professionals. Labor costs of software development is famous for being very high in developed economies compared to that in developing countries, where costs are roughly only a tenth. This explains the established presence of foreign firms in Eastern Europe and India.

Trade commitments

What are the current Philippine commitments in computer services sector? The Philippines has no WTO commitment in this sector, but has included it in the AFAS schedule. It has the usual 40 percent foreign equity limit, even though the sector itself does not belong to any of the negative lists for foreign investment, and thus, in principle, qualified for 100 percent foreign equity share. Modes 1 and 2 have full commitments but Mode 4 is unbound. Limitations on national treatment likewise include "unbound" Mode 3 commitment.

What are the flanking government measures that are necessary to develop the sector? One important area is in education and training of computer or IT professionals and in facilitating access to advanced computer equipment through low tariffs. The government can upgrade and impose technical standards as well as encourage more computer schools to offer and improve their IT courses to help fill up the dearth of computer professionals globally. But most importantly, the development of the computer services sector is closely tied up to the development of the local telecommunication services sector. Thus, low interconnection fees or internet access should indirectly benefit the computer services sector and allow them to offer their services cross-border competitively.

Education services

Educational services sector is Category 5 of WTO List, which includes five subsectors: primary, secondary, tertiary, adult education, and others. While

public sector expenditure is usually significant in the primary and secondary education services, private sector expenditure is more significant in the tertiary and adult education services.

Advances in technology have also benefited the sector. In particular, for tertiary and adult education services, distance learning has been a very dynamic area, thanks to the new ICTs such as cable and satellite transmissions, audio and video conferencing, PC software, CD-ROMs, and internet facilities. Distance education, education software, corporate training through ICT delivery are some examples of Mode 1 or cross-border mode of supply for educational services. Although distance education and the like have grown, the majority of international trade in education remains through students going abroad to study (Mode 2 or consumption abroad mode of supply).

In Asia, education services have been increasingly traded since the 1990s through commercial presence. Foreign educational institutions set up facilities abroad, either through partnerships with local universities or by establishing local branch campuses or subsidiaries. They capitalize on their institution's name and prestige in the home country to leap through local competition. Other types of institutional arrangement through which commercial presence takes place is through twinning arrangements. "Twinning" consists of domestic private colleges offering courses leading to degrees at overseas universities. Institutions with twinning arrangements adopt the program design, instructional methods, and examination standards of the foreign partner to validate the in-country courses. The arrangement is akin to franchising of individual educational courses.

Trade in education via Mode 4 (movement of natural persons) pertains to foreign professors, for example, lecturing in the country or academic researchers working abroad. The biggest importer of educational services through this mode of supply is the US where some 62,350 scholars have gone in 1996–1997.

Trade barriers

There is rarely any barrier on Mode 2 (consumption abroad) trade in education except the usual administrative burden of visa processing. For Mode 1, barriers can include foreign exchange controls and difficulties in validating degrees obtained abroad through distance learning. Barriers in commercial presence can be restrictions on financial assistance for students in non-certified or recognized institutions (a national treatment limitation), restrictions on granting degrees by private institutions, restrictions on the type of entity, and on acquisition of real estate. In addition, Mode 3 trade barriers include the usual limits on equity, nationality requirements of managers and executives of the school,

restrictions on recruiting foreign teachers, and high government subsidization of local institutions. Mode 4 barriers are the usual difficulties in visa processing, guaranteeing entry only to certain categories of persons, and others.

Summary and Conclusions

The paper summarizes many of the current discussions on international services trade, the enormous challenge in further services liberalization that lie ahead, and the rise of many regional trade agreements. Two different models of regional trade agreements in services: NAFTA-type and GATS-type approach are discussed. The paper discusses the difference between these two approaches and their implications on transparency, stability of commitments, and trade liberalization. In general, the negative list or NAFTA-type approach appears more favorable because it provides greater transparency, stability, and liberalization.

The paper also analyzes the commitments of Japan, Singapore, and the Philippines in the context of the WTO, AFAS, and JSEPA. It finds that, indeed, the PTAs exhibit higher "index of liberalization of services" than the multilateral agreement. In particular, the main findings are as follows:

- (1) Singapore has more sector-mode binding in the JSEPA than in AFAS.
- (2) All three countries are more liberal in their commitments in the PTAs than in the WTO.
- (3) The quality of opening (coverage index) has improved in the PTAs for all three countries.
- (4) Many restrictions still abound.
- (5) The Philippines and Singapore are more liberal in their national treatment commitments than in market access, while it is the reverse for Japan.
- (6) Almost all Mode 4 (movement of natural persons) commitments for all sectors are still "unbound."

Finally, it discusses the various services sectors that can be of interest to the Philippines in the upcoming negotiations with Japan. In most of these sectors, the most important modal commitment is the liberalization of commercial presence (Mode 3).

Appendices

Appendix 1. Services sectoral classification list

SECTORS AND SUBSECTORS		CORRESPONDING CPC
1.	BUSINESS SERVICES	Section B
A.	<i>Professional Services</i>	
a.	Legal Services	
b.	Accounting, auditing and bookkeeping services	862
c.	Taxation Services	863
d.	Architectural services	8671
e.	Engineering services	8672
f.	Integrated engineering services	8673
g.	Urban planning and landscape architectural services	8674
h.	Medical and dental services	9312
i.	Veterinary services	932
j.	Services provided by midwives, nurses, physiotherapists and paramedical personnel	93191
k.	Others	
B.	<i>Computer and Related Services</i>	
a.	Consultancy services related to the installation of computer hardware	841
b.	Software implementation services	842
c.	Data processing services	843
d.	Database services	844
e.	Others	
C.	<i>Research and Development Services</i>	
a.	R&D services on natural sciences	851
b.	R&D services on social sciences and humanities	852
c.	Interdisciplinary R&D services	853
D.	<i>Real Estate Services</i>	
a.	Involving own or leased property	821
b.	On a fee or contract basis	822
E.	<i>Rental/Leasing Services without Operators</i>	
a.	Relating to ships	83103
b.	Relating to aircraft	83104

Appendix 1. (continued)

SECTORS AND SUBSECTORS		CORRESPONDING CPC
c.	Relating to other transport equipment	83101+83102+
d.	Relating to other machinery and equipment	83106-83109
e.	Others	
F.	<i>Other Business Services</i>	
a.	Advertising services	871
b.	Market research and public opinion polling services	864
c.	Management consulting service	865
d.	Services related to management consulting	866
e.	Technical testing and analysis services	8676
f.	Services incidental to agriculture, hunting, and forestry	881
g.	Services incidental to fishing	882
h.	Services incidental to mining	883+5115
i.	Services incidental to manufacturing	884+885
j.	Services incidental to energy distribution	887
k.	Placement and supply services of personnel	872
l.	Investigation and security	873
m.	Related scientific and technical consulting services	8675
n.	Maintenance and repair of equipment (not including maritime vessels, aircraft, or other transport equipment)	633+8861-8866
o.	Building-cleaning services	874
p.	Photographic services	875
q.	Packaging services	876
r.	Printing, publishing	88442
s.	Convention services	87909*
t.	Others	
2.	COMMUNICATION SERVICES	
A.	<i>Postal services</i>	7511
B.	<i>Courier services</i>	7512
C.	<i>Telecommunication services</i>	
a.	Voice telephone services	7521
b.	Packet-switched data transmission services	7523**

Appendix 1. (continued)

SECTORS AND SUBSECTORS		CORRESPONDING CPC
c.	Circuit-switched data transmission services	7523**
d.	Telex services	7523**
e.	Telegraph services	7522
f.	Facsimile services	7521**+7529**
g.	Private leased circuit services	7522**+7523**
h.	Electronic mail	7523**
i.	Voice mail	7523**
j.	Online information and data base retrieval	7523**
k.	Electronic data interchange (EDI)	7523**
l.	Enhanced/value-added fax services, including store and forward, store and retrieve	7523**
m.	Code and protocol conversion	n.a.
n.	Online information and/or data processing (incl. transaction processing)	843**
o.	Others	
D.	<i>Audiovisual services</i>	
a.	Motion picture and video tape production and distribution services	9611
b.	Motion picture projection service	9612
c.	Radio and television services	9613
d.	Radio and television transmission services	7524
e.	Sound recording	n.a.
f.	Others	
E.	<i>Others</i>	
3.	CONSTRUCTION AND RELATED ENGINEERING SERVICES	
A.	<i>General construction work for buildings</i>	512
B.	<i>General construction work for civil engineering</i>	513
C.	<i>Installation and assembly work</i>	514+516
D.	<i>Building completion and finishing work</i>	517
E.	<i>Others</i>	
4.	DISTRIBUTION SERVICES	
A.	<i>Commission agents' services</i>	621
B.	<i>Wholesale trade services</i>	622
C.	<i>Retailing services</i>	631+632

Appendix 1. (continued)

SECTORS AND SUBSECTORS		CORRESPONDING CPC
D.	<i>Franchising</i>	8929
E.	<i>Others</i>	
5.	EDUCATIONAL SERVICES	
A.	<i>Primary education services</i>	921
B.	<i>Secondary education services</i>	922
C.	<i>Higher education services</i>	923
D.	<i>Adult education</i>	924
E.	<i>Other education services</i>	929
6.	ENVIRONMENTAL SERVICES	
A.	<i>Sewage services</i>	9401
B.	<i>Refuse disposal services</i>	9402
C.	<i>Sanitation and similar services</i>	9403
D.	<i>Others</i>	
7.	FINANCIAL SERVICES	
A.	<i>All insurance and insurance-related services</i>	812**
a.	Life, accident, and health insurance services	8121
b.	Non-life insurance services	8129
c.	Reinsurance and retrocession	81299*
d.	Services auxiliary to insurance (including broking and agency services)	8140
B.	<i>Banking and other financial services (excluding insurance)</i>	
a.	Acceptance of deposits and other repayable funds from the public	81115-81119
b.	Lending of all types, incl., inter alia, consumer credit, mortgage credit, factoring and financing of commercial transaction	8113
c.	Financial leasing	8112
d.	All payment and money transmission services	81339**
e.	Guarantees and commitments	81199**
f.	Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market or otherwise, the following:	
	- Money market instruments (cheques, bills, certificate of deposits, etc.)	81339**

Appendix 1. (continued)

SECTORS AND SUBSECTORS	CORRESPONDING CPC
- Foreign exchange	81333
- Derivative products incl., but not limited to futures and options	81339**
- Exchange rate and interest rate instruments, inclu. products such as swaps, forward rate agreements, etc.	81339**
- Transferable securities	81321*
- Other negotiable instruments and financial assets, including bullion	81339**
g. Participation in issues of all kinds of securities, incl. underwriting and placement as agent (whether publicly or privately) and provision of service related to such issues	8132
h. Money broking	81339**
i. Asset management, such as cash or portfolio management, all forms of collective investment management, pension fund management, custodial depository, and trust services	8119+** 81323*
j. Settlement and clearing services for financial assets, incl. securities, derivative products, and other negotiable instruments	81339** or 81319**
k. Advisory and other auxiliary financial services on all the activities listed in Article 1B of MTN.TNC/W/50, incl. credit reference and analysis, investment and portfolio research and advice, advice on acquisitions and on corporate restructuring and strategy	8131 or 8133
l. Provision and transfer of financial information, and financial data processing and related software by providers of other financial services	8131
C. <i>Others</i>	
8. HEALTH RELATED AND SOCIAL SERVICES (other than those listed under 1.A.h-j.)	
A. <i>Hospital services</i>	9311
B. <i>Other human health services</i>	9319 (other than 93191)
C. <i>Social services</i>	933
D. <i>Others</i>	

Appendix 1. (continued)

SECTORS AND SUBSECTORS		CORRESPONDING CPC
9.	TOURISM AND TRAVEL RELATED SERVICES	
A.	<i>Hotels and restaurants (incl. catering)</i>	641-643
B.	<i>Travel agencies and tour operators services</i>	7471
C.	<i>Tourist guides services</i>	7472
D.	<i>Others</i>	
10.	RECREATIONAL, CULTURAL AND SPORTING SERVICES (other than audiovisual services)	
A.	<i>Entertainment services (including theatre, live Bands, and circus services)</i>	9619
B.	<i>News agency services</i>	962
C.	<i>Libraries, archives, museums, and other cultural services</i>	963
D.	<i>Sporting and other recreational services</i>	964
E.	<i>Others</i>	
11.	TRANSPORT SERVICES	
A.	<i>Maritime transport services</i>	
a.	Passenger transportation	7211
b.	Freight transportation	7212
c.	Rental of vessels with crew	7213
d.	Maintenance and repair of vessels	8868**
e.	Pushing and towing services	7214
f.	Supporting services for maritime transport	745**
B.	<i>Internal waterways transport</i>	
a.	Passenger transportation	7221
b.	Freight transportation	7222
c.	Rental of vessels with crew	7223
d.	Maintenance and repair of vessels	8868**
e.	Pushing and towing services	7224
f.	Supporting services for internal waterway transport	745**
C.	<i>Air transport services</i>	
a.	Passenger transportation	731
b.	Freight transportation	732
c.	Rental of aircraft with crew	734
d.	Maintenance and repair of aircraft	8868**

Appendix 1. (continued)

SECTORS AND SUBSECTORS		CORRESPONDING CPC
e.	Supporting services for air transport	746
D.	<i>Space transport</i>	733
E.	<i>Rail transport services</i>	
a.	Passenger transportation	7111
b.	Freight transportation	7112
c.	Pushing and towing services	7113
d.	Maintenance and repair of rail transport equipment	8868**
e.	Supporting services for rail transport services	743
F.	<i>Road transport services</i>	
a.	Passenger transportation	7121+7122
b.	Freight transportation	7123
c.	Rental of commercial vehicles with operator	7124
d.	Maintenance and repair of road transport equipment	6112+8867
e.	Supporting services for road transport services	744
G.	<i>Pipeline transport</i>	
a.	Transportation of fuels	7131
b.	Transportation of other goods	7139
H.	<i>Services auxiliary to all modes of transport</i>	
a.	Cargo-handling services	741
b.	Storage and warehouse services	742
c.	Freight transport agency services	748
d.	Others	
I.	<i>Other transport services</i>	
12.	OTHER SERVICES NOT INCLUDED ELSEWHERE	95+97+98+99

* The (*) indicates that the service specified is a component of a more aggregated CPC item specified elsewhere in this classification list.

** The (**) indicates that the service specified constitutes only a part of the total range of activities covered by the CPC concordance (e.g., voice mail is only a component of CPC item 7523).

Appendix 2. Sample sector commitment

Sector or Subsector	Limitations on Market Access	Limitations on National Treatment	Additional Commitments	Notes
Life Insurance as follows: Ordinary Group Industrial	1) Risks located in the Philippines should be insured with companies authorized #4 to transact business in the Philippines	1) Unbound		#4 Authorized means the company has been issued a license or a certificate of authority by the Insurance Commission
	2) same as (1) above	2) Unbound		
	3) Market access limited to: a) acquisition of up to 40% of the voting stock of an existing domestic insurance company	3) None		
	4) None	4) None		

Source: Philippine Schedule of Commitments

Appendix 3. Philippines service sector commitments in AFAS

First Package

V. WTO Classification	VI. Sector or Subsector
	BUSINESS/ PROFESSIONAL
1.A.b	- Auditing services (financial auditing and accounting review)
	TOURISM
9	- Tourism accommodation facilities
9.A	- pension house
	- tourist inn
	- apartelle

Second Package

VII. WTO Classification	VIII. Sector or Subsector
	AIR TRANSPORT
11.C.e	- Computer reservation system
	BUSINESS/ PROFESSIONAL
1.A	- Architectural services
1.A.d	- Environmental (urban planning) services
1.A.g	- Landscape architectural services
1.A.g	- Interior design services
1.A.e	- Engineering services (civil, electrical, geodetic, mechanical, sanitary, electronics, and communications engineering)
1.A.b	- Auditing services (financial auditing and accounting review)
3.A – E	CONSTRUCTION SERVICES
7	FINANCIAL SERVICES
7.B	- Commercial banking
7.B.a	- Acceptance of deposits and other repayable funds from the public
7.B.b	- Lending of all types, including consumer credit, mortgage credit, and financing of commercial transaction
7.B.c	- All payment and money transmission services, including credit, charge and debit cards, travelers cheques, and bankers draft
7.B.d	- Guarantees and commitments

Appendix 3. (continued)

7.B.e`	- Trading for own account or for account of customers, whether on an exchange, in an over-the-counter market, or otherwise the following: money market instruments (bank's own promissory notes, repurchase agreements, and certificates of assignment/participation with recourse); foreign exchange; derivative products including but not limited to futures options; exchange rate and interest rate instruments, including products such as swaps, forward rate agreements; and other allowable negotiable instruments and financial assets;
7.B.f	- Participation in issues of all kinds of securities including underwriting and placement as agent (whether publicly or privately) and provision of services related to such issues.
7.B.g	- Assets management, such as cash or portfolio management, all forms of collective investment management, custodial, depository and trust services
11.A	MARITIME TRANSPORT
11.A.a and b	- International transport except: a) cabotage transport, and b) government own cargoes
2.C	TELECOMMUNICATIONS
2.C.	- Paging services
9	- Tourism accommodation facilities
	- pension house
	- tourist inn
	- apartelle
<hr/> Third Package <hr/>	
	AIR TRANSPORT
	Same as second plus
11.C.e	Selling and marketing of air transport
	BUSINESS/PROFESSIONAL SERVICES
	Same as second plus
1.B.a	- Consultancy services related to the installation of computer hardware
1.B.b	- Software implementation services
1.B.d	- Database services
	CONSTRUCTION
	Same plus

Appendix 3. (continued)

3.E	- Renting services related to equipment for construction or demolition of building or civil engineering works, with operator
2.C	TELECOMMUNICATIONS SERVICES
2.C.a	- Voice telephone services
2.C.e	- Telegraph services
2.C.d	- Telex services
2.C.b	- Packet switched data transmission services
2.C.c	- Circuit-switched data transmission services
2.C.f	- Facsimile services
2.C.a.	- Cellular mobile telephone services
	TOURISM
	Same as second plus
9.A	- Hotel and resort
9.A	- Meal serving services with full restaurant services
9.A	- Beverage serving services without entertainment
9.A	- Specialty restaurants

Appendix 4. Regulations and restrictions in banking and insurance

Discriminatory Restrictions		Non-Discriminatory	Legal Basis	IX. Notes
Banking		Three-year moratorium on the establishment of new banks	RA 8791 (2000)	Covered by Annex, prudential carve out
		Monetary Board approval for domestic bank branches licenses		Covered by Annex
	Foreign banks are limited to a maximum of six new branches		RA 7721 (1994)	Violates Para. 5 of Understanding
	100% foreign bank ownership limited to 7- year window of opportunity		RA 8791	
		Consolidated banking supervision, fit and proper rule for bank directors and officers, independent directors, risk-based capital requirement, safeguards against connected lending, family groups and related interests, interlocking directorships, disclosure requirements, etc.		Covered by Annex

Appendix 4. (continued)

Discriminatory Restrictions		Non-Discriminatory	Legal Basis	IX. Notes
Banking	Foreign banks can enter: (1) by acquiring, purchasing or owning up to 60% of the voting stock of an existing bank;	Underwriting may be performed only by commercial banks with expanded commercial banking authority.	RA 7721	Covered by Annex
	(2) by investing up to 60% of the voting stock of a new banking subsidiary incorporated under Philippine laws; or (3) by establishing branches with full banking authority. The last mode of entry is operative for only five years from the date of effectivity of the Act and limited to only 10 banks.			
Discriminatory Restrictions		Non-Discriminatory	Legal Basis	X. Notes
Banking	Non-Filipino citizen employed as officer or assigned to do technical functions shall have two Filipino understudies	Individuals and non-bank corporations may own up to 40% of the voting stock of a domestic bank.	RA 7721, RA 8791	Mode 4 restrictions in Philippine WTO schedule Violates Para. 5 of Understanding
	Control of at least 70% of bank resources or assets be held by domestic banks with majority owned by Filipinos.			

Appendix 4. (continued)

	Discriminatory Restrictions	Non-Discriminatory	Legal Basis	X. Notes
Insurance		Limits on loans, credit accommodations and guarantees; restrictions on portfolio assets	RA 8791	Covered by Annex
		Restrictions on capital adequacy, reserve requirements		Covered by Annex
		Policy directed lending		Violates Para. 10b of Understanding
	Foreign equity cap: 100%; paid-up capital requirement higher for new entrants.		RA 8179 (1996)	
	Security deposits with insurance commission is also higher for foreign-owned insurance companies (P300 M for insurance; P500 M for reinsurance, vs. only 25% of minimum paid up capital for domestic companies)	Restrictions on portfolio assets; limits on investments in stocks, bonds, real estate investments, investments in single enterprise, and in foreign currency.		Prudential carve out
				Violates GATS national treatment

Source: Author's own interpretation of regulations from text in Milo (2002)

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7 Developing the Japanese Market for Philippine Tourism and Retirement Services: Prospects and Impediments

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Background

The Philippines and Japan have considered forming an economic partnership that will remove barriers to trade and investments in a number of economic sectors including tourism. Ranked as the second largest tourism market (next to the US), Japan has contributed roughly USD 270 million in direct revenues to the Philippine tourism industry. In spite of these economic gains, the Department of Tourism (DOT) recognizes that the Philippines still has a lot of catching up to do with other Asian destinations as far as attracting the Japanese market is concerned. The Philippines has so far captured only 1.8 percent of the 20 million Japanese travelers in the Asia-Pacific region. The race has further intensified as the rapidly aging population of Japan has begun to exert pressures on destinations to develop and promote products catering to this growing market segment. Competition is becoming intense as regional destinations like Thailand, Singapore, and Malaysia are aggressively positioning themselves in niche markets like medical tourism, long- stay and retirement programs. Thailand, for instance, is pushing for the opening up of Japan's aviation and tourism sectors. Under the proposed provisions of the bilateral free trade agreement, Thailand has sought for Japan's technical support in liberalized areas such as agriculture, fisheries, and forestry; and for Japan's recognition of the standards of Thai medical care services, including health spas and elderly care centers.¹ Japan has considered

¹ From the looks of it, Thailand is intent on tapping the business potential of Japan's retirement industry. Indeed, according to the Japanese Thai Venture Co., a Japanese consulting firm, Thailand is already attracting the interest of small and medium Japanese enterprises to invest in the Thai hospitality sector, including the establishment of care centers for retired and elderly Japanese.

exporting its elderly market to the Philippines in an effort to ease the burden of long-term care, which will hopefully ease the unemployment problems in the Philippines.

This research study shall assess the prospects and impediments to developing the Japanese tourism market. More specifically, it shall identify the factors that will enable the Philippines to tap the Japanese retiree market and develop services that will cater to these retirees, including retirement destinations. It shall seek to identify the barriers to fully exploiting this market for those services.

Objectives of the Study

The study aims to look into the prospects of increasing foreign exchange earnings, investments, and employment through the development of the tourism industry with the Japanese market as a special focus. Specifically, the objectives are as follows:

- (1) To assess the prospects and impediments to developing the Japanese tourism market, particularly focused on the Japanese retirees,
- (2) To assess the implications of Japan's aging market on the Philippine tourism and retirement services, and
- (3) To identify areas of cooperation in tourism between Japan and the Philippines.

Removing Barriers to Trade in Tourism Services: Toward Developing the Retirement Industry

What factors influence the choice of a retirement destination? Wiseman (1980) suggests that the decision to migrate—whether on a temporary or permanent basis—actually begins with an evaluation of satisfaction with current living arrangements. As such, this evaluation is influenced by triggering mechanisms, evaluation factors, and the type of move. Wiseman (1980) argues that triggering mechanisms include both personal changes and external factors that can be positive (pull) or negative (push). It is in this area that tourism may serve as a pull factor, by providing information on the existence of amenities and support facilities in other destinations. A retiree's previous experience as a tourist on a short-term basis or as a seasonal migrant can influence that decision (Stallman and Espinoza and 1996). The search for destination places is influenced by vacation experiences where they may have developed strong social attachments (Wiseman and Roseman 1979), or established network such as childhood home or (Stallman and Jones 1995). It thus becomes imperative that tourism serves as a major entry point in attracting retirees for seasonal or even permanent migration.

According to the APEC Tourism Working Group (1997) several impediments exist that limited the growth of tourism to and within the APEC region. One of these impediments included constraints that limit the freedom of individuals to travel and therefore affecting their decisions to travel to countries in the region. It also included those factors that limit the operation, promotion, development, or establishment of tourism-related businesses within the APEC region such as infrastructure capacity, regulatory environment, the financial system, labor market, marketing and promotion network, and technology.

Economic theory does not justify the exclusion of tourism and allied industries such as air transport in services liberalization. Based on the principle of comparative advantage, nations can trade and specialize in activities where they enjoy the least opportunity costs relative to other goods or services. To maximize the gains from trade, countries have the option to negotiate a packaged deal rather than a single good or service such as air transport or travel agency operations. When airline services are liberalized, for example, it is possible that the airline industries of some countries will lose. Thus, liberalization will be viewed to have a net negative effect on the economy. However, when the airline industry is grouped with other industries in trade negotiations, the losses in one industry (airline services) may be outweighed by gains in other industries (agriculture or garments manufacturing or information technology [IT]-enabled services). Linking trade in aviation services with other goods and services is important to form successful free trade blocs.

Japan as a Tourism Market

Under the bilateral agreement, the Philippines can push for the removal of impediments to tourism growth (air access in particular) and for closer cooperation in areas such as marketing and promotions and access to information for product development (i.e., medical tourism, long-stay and retirement programs).

Japan is a country with a total population of 126 million and with a GDP of USD 4.2 trillion, seven times that of China and twice that of all the rest of Asia put together. The per capita income is USD 33,333. It has a relatively large number of households earning above USD 50,000 per annum (Table 1).

For most countries, Japan continues to be a huge market for their tourism suppliers. Outbound travel to Asia-Pacific destinations alone has averaged 20 million per year since 1999. According to the Japan Association of Travel Agents (JATA), the Japanese market loves to travel and winter bonuses are usually spent on leisure and travel. Average spending per trip by an average Japanese traveler is estimated at USD 1,750. In its communication to the WTO during

Table 1. Number of households earning USD 50,000 per annum or more in selected Asian countries (in '000)

	2000	2005	2010
India	1,109	1,540	2,275
China	1	3	25
Malaysia	76	96	145
Philippines	37	51	69
Singapore	241	394	559
South Korea	492	802	1,281
Taiwan	1,170	1,285	1,624
Thailand	42	63	116
Japan	28,388	23,468	25,701
Total (Asia excluding Japan)	4,807	6,280	8,592
Total (Asia including Japan)	33,195	29,748	34,293

Source: Asian Demographics (http://www.mti.gov.sg/ResearchRoom/Documents/app.mti.gov.sg/data/pages/507/doc/10%20ERC_Services_Healthcare.pdf, page 2)

the Symposium on Tourism Services (February 2001), the JATA recognized critical factors for the development and promotion of a tourist destination to the Japanese travel market. These are (a) strong presence through tourism promotion officers, (b) improvement in tourism infrastructures, (c) easy access (more airline seats, lower group airfares), and (d) availability of competent local Japanese interpreters, and visa waiver program (an added incentive). The JATA noted further that the Japanese are particularly concerned about personal safety and therefore are very sensitive to the crime rate, security, and hygiene of host destinations.

The Philippines as a destination for the Japanese

Japan is ranked as the second largest tourism market of the Philippines. As of this writing, it accounts for 17 percent of the total arrivals to the country. Around 85 percent of all Japanese tourists originate from Tokyo, another 5 percent from Osaka, and another 5 percent from Nagoya. They come here mostly for leisure (62%), business (19%), and to visit friends and relatives (10%). The average age of Japanese tourists is 41, mostly male (79%), and are repeat visitors (55%). Only 0.60 percent of total visitors are retired or pensioners. Average daily expenditure is USD 159 with 39 percent allocated for entertainment and recreation, 20 percent for food and beverage, and 18 percent for shopping. Most frequently visited places are Tagaytay in Cavite, Cebu, and Batangas.

However, the Philippines has not been as competitive as the other Southeast Asian countries in attracting the Japanese market. Arrivals to Thailand (which is seven hours away from Japan), for instance, are almost four times than what the Philippines has captured from the 20 million Japanese outbound travel to Asia-Pacific (Table 2).

Peace and order issues

Compared with Thailand, the Philippines has a relatively poor image in terms of safety and security. However, even without those travel advisories in the past, the Philippines still was not as popular as other ASEAN destinations like Bali, Phuket, and Penang (Figure 1).

As noted earlier, the Japanese are particularly concerned about personal safety. Hence, they are very sensitive to the crime rate, security, and hygiene of host destinations. The government has been issuing "travel advisories" in five levels, updating information on security concerns of each country. The higher the level, the more serious the security concerns. If the travel advisory becomes Level 2 or higher in a country, travel companies are virtually not allowed to plan or operate any leisure trips there.

During the height of the Abu Sayyaf kidnappings in 2000, the Japanese government issued a Level 2 travel advisory, which led to the cancellation of tours and reduction in air bookings. The Philippine Airlines (PAL) had to reduce its flights from Tokyo to Cebu from four times a week to just twice due to poor load factors. The Federation of Tourism Industries of the Philippines mounted a series of campaigns and lobbying to convince the Japanese government to remove its travel advisories.

Apart from marketing and promotions, and peace and order, infrastructure is another area that needs improvement. McKinsey (2002) further notes that infrastructure in Cebu, for instance, is not as developed as in Phuket's.

Air access

Over the years, the Japanese market has largely been developed with the support of direct flights provided by PAL and the Japan Airlines (JAL) although JAL has concentrated its operations in Manila. Fifth freedom² carriers like Northwest Airlines, Egypt Air, and Thai Airways added to the capacity but on a limited basis. PAL's direct services between Tokyo and Cebu have helped make the latter the most popular destination for the Japanese outside of Luzon.

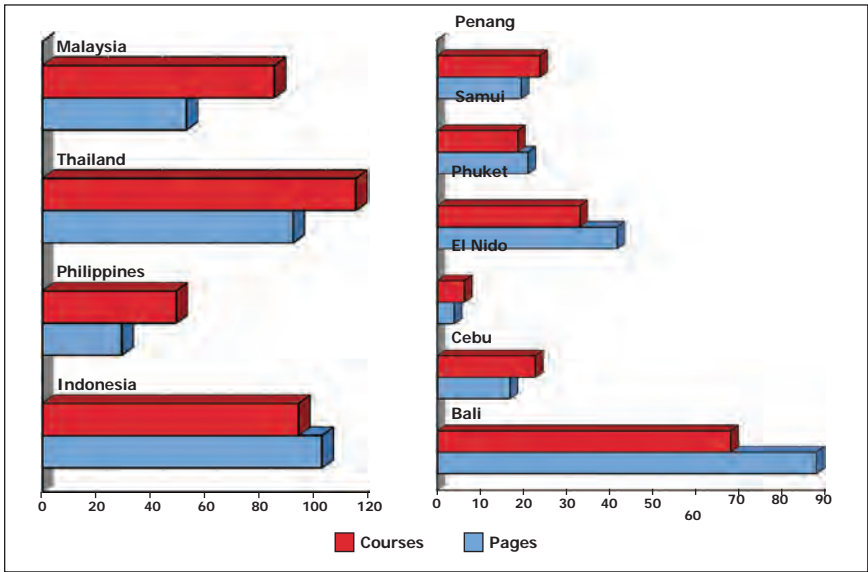
² In commercial aviation, "freedom" refers to the type of international services permitted between two or more countries. The fifth freedom is the right to fly between two foreign countries during flights while the flight originates or ends in one's own country. For example, Manila to Tokyo to Cairo by Egypt Air.

Table 2. Visitor arrivals from Japan to Asia-Pacific destinations

	1997	1998	1999	2000	2001	2002
Philippines	376,714	361,631	387,513	390,517	343,840	341,867
Singapore	1,094,040	843,683	860,661	929,895	755,683	723,350
Thailand	972,056	982,116	1,059,872	1,202,164	1,177,599	1,233,239
Indonesia	706,942	469,409	606,102	643,794	611,314	617,427
Malaysia	308,902	252,178	286,940	455,981	397,639	354,563
Total arrivals from Japan to Asia Pacific	20,327,232	18,490,060	19,266,893	20,950,725	19,186,294	19,570,020

Source: Pacific Asia Travel Association

Figure 1. No. of brochure pages and courses of top 10 Japanese travel agencies devoted to ASEAN beach destinations



Source: Seminar on Upgrading the Service Standards of Travel Trade Supporting Industries (1999) held in Bangkok, on May 30, 1999.

Air access between Japan and the Philippines can still be improved to make it more competitive with the level of Thailand. The number of flights from Tokyo to Bangkok, for instance, is 2.9 times that of the Philippines' level of services (Table 3). Data reveal further that Thai Airways mounts 29 flights per week (out of the total 87) from Tokyo to Bangkok. The Japanese carriers such as JAL, JALways, and Nippon Airways provide another 28 flights. The rest (about 30 flights) is mounted by fifth freedom carriers, such as United Airlines, Northwest, Air India, Egypt Air, and Bangladesh Airlines.

Fares are likewise more expensive between Tokyo and Cebu (USD 590) than Tokyo and Phuket (USD 300). The bilateral air service agreement between the Philippines and Japan restricts weekly capacity to 45 frequencies (for each country's carriers) for combination and dedicated carriers. Prior to October 2002, there were 43 weekly entitlements. At that time, the Philippines utilized 21 frequencies using A330 – a wide-body long-range and 335-seater aircraft manufactured by Airbus – with average load factors of 80 percent. Japan,

Table 3. Air access between Japan and the Philippines (direct flights only)

From	Philippines		Thailand	
	Manila	Cebu	Bangkok	Phuket
Tokyo	30	6	87	11
Osaka	12		52	
Nagoya	10		8	
Fukuoka	6		4	
Okinawa	4		0	
Total	62	6	151	11

Source: Official Airline Guide (2003)

on the other hand, utilized 40.5 frequencies (10 of which were used by All Nippon Cargo).³

Removing restrictions in air traffic rights between the two countries can lead to more competition particularly in routes currently monopolized by PAL (Osaka-Cebu, Fukuoka-Manila, and Okinawa-Manila). This will give flexibility to other Philippine carriers like Cebu Pacific to explore and develop the market without being constrained by capacity and aircraft utilization or lack of competition policy in the allocation of additional traffic rights. Furthermore, this will likely help address one of the concerns of the JATA, which is easy access (more airline seats, lower group airfares). It is recognized, however, that slot restrictions already exist in the Narita airport.

To provide flexibility to both Philippine and Japanese carriers and to assist travel operators in developing the tourism markets, it is recommended that the Philippines push for an opening up of the air traffic routes, that is, a bilateral open skies agreement. This will also facilitate the development of secondary gateways and entry of secondary carriers.

An assessment of Japan's silver market: Opportunities and threats

Japan's population is rapidly aging. In 2002, there were more than 20 million Japanese who were 60 years old and above. The number of senior citizens belonging to this bracket increases not only because of the number of individuals reaching that age level, but also because they tend to live longer. As of 1999, the average life span of a Japanese individual was 77.10 years for males and 84 years for females—the highest life expectancy rate in the world.

³ Under the agreement, utilization of entitlements are computed based on the following conversion factors: B744 (x2), B747 (x2), DC10 (1.5), B767 (x1.5), and MD11 (x2).

Table 4. Age distribution structure

Selected Asian Country	1990				2000			
	Population (in million)	0-14 years	15-64 years	65+ years	Population (in million)	0-14 years	15-64 years	65+ years
China	1,135.2	27.7	66.7	5.6	1,262.5	24.8	65.0	10.1
Hong Kong, China	5.7	21.5	70.0	8.5	6.8	16.3	69.3	14.3
Indonesia	179.4	35.7	60.4	3.9	210.5	30.8	61.6	7.6
Japan (1996)	n.a.	n.a.	n.a.	n.a.	129.87	10.0	77.0	13.0
South Korea	42.9	25.9	69.1	5.0	47.3	20.8	68.2	11.0
Malaysia	17.8	36.5	59.8	3.7	23.3	34.1	59.3	6.6
Philippines	62.0	40.4	56.1	3.5	78.4	37.5	56.9	5.5
Singapore	3.1	21.5	72.9	5.6	4.0	21.9	67.6	10.6
Taipei, China	20.2	27.3	66.6	6.1	22.1	21.4	70.1	8.6
Thailand	55.8	32.0	63.7	4.3	62.4	26.7	65.2	8.1

n.a. = not applicable

Source: Asian Development Bank, 2001. *Key Indicators 2001*, 29 August.

Note: For 1996, the population of Japan is 125.8. An assumption of an average population of 0.08 percent was made until 2000.

With this rate in which the demographic structure is changing in Japan, by the year 2025, the number of people aged 60 and over will be highest in Japan, Italy, and Germany.⁴ It is projected that out of the 124.1million population of Japan in 2020, 27.8 percent will be 65 years and older and that the growth rate in the age brackets of 0-39 will be negative.

The aging market provides opportunities for the export of our labor services—caregivers and medical practitioners—or for the export of tourism services via medical tourism, long-stay and retirement programs. The Philippines can tap the retiree markets for the tourism industry. To start with, it is important to segment the retiree market depending on their needs. The retiree market can be segmented into the following categories:

Retiring individuals. This category refers to individuals aged 50–55 years old and are about to retire. They in the process of winding down their active professional life and are contemplating what retirement plans they wish to pursue.

Retired individuals. This category refers to those generally within the range of 56–75 years of age. Some opt to maintain a schedule of social activities while others are relatively idle.

Retired elderly. This category refers to those at least 76 years and older. They are the least active and would have less capacity for independent existence.

To assess the implications of these market niches, it is important to identify the trends in Japan in these areas.

Overseas multi-habitation

Many elderly people in Japan are showing an interest to continue working even after retirement. In fact, the post-retirement period is considered an opportunity to enjoy a “second life.”⁵ In contrast to the traditional idea of a retiree as someone who lives in a quiet and inactive environment, a typical Japanese in his second life is still on the move. Old age is no longer seen as a quiet life but another stage in life when people make use of their increased free time and enjoy life fully. Sports have been adapted to suit the needs of older people. The second life is evidently a chance to engage themselves in a new range of activities such as sports, arts-related hobbies, and volunteer work, which are even more exciting if pursued abroad. This is where the concept of overseas multi-habitation (retirees’ pursuit of an alternative way life abroad) comes in. Table 5 presents the different categories of overseas multi-habitation – a loose classification according to Ono (2002) to refer to

⁴ See the article “Wooing the Elderly,” *Industry Monitor*, April 2002

⁵ Ibid.

Table 5. Lifestyles of Japanese seniors (Categories of overseas multi-habitation)

Long stayers	Retirees who live in Japan during their “second life,” but travel abroad on extended vacations
Migrant retirees	Retirees who live in Japan during spring and summer and just like birds – they often travel to tropical countries during autumn and winter
Immigrants	Those who opt to immigrate to or be a permanent resident of another country, and return to Japan periodically

Source: Hiroyoshi Ono (2002).

migrants who become enchanted with living in their new country and later opt to become immigrants. However, some retirees approaching their final years opt to return to their homeland for emotional reasons.

Statistics show that there are more than 800,000 Japanese on long stay abroad (Table 6). The number of long-stayers has increased from 326,225 in 1971 to 839,435 in 2001. Around 20 percent are in Asia, mostly in China, Singapore, and Thailand. Statistics show that as of October 2001, there are 10,137 Japanese officially residing in the Philippines making it the eighth most popular destination in Asia next to China, Singapore, Thailand, Korea, Taiwan, Malaysia, and Indonesia.

How do the elderly choose their retirement destination? Apparently, their decision is contingent on such factors as assets and pension revenue, marital status and relationship with spouse and children, as well as visa rules and regulations in the country where they wish to go or to stay permanently.

Assets and pension revenue. The family assets of those in the highest income group are valued at roughly USD 1 million. About 80 percent are in the form of residential land, 12 percent in financial assets, and the rest in houses and durable goods. The family assets of those working as corporate administrators or managers are valued at USD 0.9 million. The average monthly income of households with parents aged 65 or older is valued at USD 3,218 while those with parents under age 65 have USD 5,116. Accumulated savings per capita is USD 79,500.

Today there is a trend among the Japanese to depend on public pensions as the main source of income during elderly life. While the pension is at an average of USD 1,800 per month⁶ (Table 7) and considered to be one of the

⁶ The Tourism Authority of Thailand (TAT) is targeting different segments of the retirement group. One of these is the group of pensioners who receive more than USD 1,750 per month from industrial firms. The TAT is also positioning Thailand as a destination for their preferred customers in the 50-65 age group, the combined retiring and retired individuals.

Table 6. Japanese living abroad, by country, 1975-2000

Country	1975	1980	1985	1990	1995	1998	1999	2000	No. of Permanent Expatriates
Total	396,617	445,372	480,739	a)620,174	a)728,268	a)795,852	a)811,712	a)837,744	293,310
<i>Asia</i>	42,948	62,689	68,274	86,886	141,739	165,168	168,434	179,107	7,892
Iran	2,111	799	547	394	500	513	435	441	221
Iraq	492	2,143	1,560				4	6	1
India	793	838	1,054	1,190	1,442	2,050	2,035	1,959	106
Indonesia	4,255	6,026	6,524	7,031	10,583	11,766	12,254	11,366	759
Korea, Rep. of	2,725	3,040	2,567	5,826	10,206	15,217	16,446	17,613	808
Kuwait	449	711	1,857		161	211	161	157	43
Saudi Arabia	549	3,919	2,300	423	1,011	1,121	846	780	33
Singapore	4,694	8,140	8,077	12,701	24,003	24,186	23,063	23,174	961
Thailand	5,952	6,424	7,852	14,289	21,745	21,400	21,154	22,731	593
China 1)	5,037	6,199	8,415	8,269	16,592	43,997	46,090	53,357	537
Taiwan	3,394	5,022	5,088	7,729	10,687	13,227	14,041	14,554	531
Philippines	3,101	3,958	2,578	4,025	4,175	8,728	9,227	10,137	1,456
Hong Kong	3,964	7,795	8,974	13,980	21,766				
Malaysia	2,023	3,201	4,836	6,116	10,366	11,545	11,625	11,653	648
Other 2)	3,409	4,474	6,045	4,913	8,502	11,207	11,053	11,179	1,195
<i>America, North</i>	123,221	139,367	170,547	263,863	296,594	331,245	339,067	354,262	137,807
United States of America	109,645	121,180	146,104	236,401	263,577	293,606	297,968	312,936	113,233

Table 6. (continued)

Country	1975	1980	1985	1990	1995	1998	1999	2000	No. of Permanent Expatriates
Canada	8,759	12,280	16,995	21,846	25,493	30,681	34,066	34,446	22,002
Dominican Republic	562	555	610	622	620	603	614	669	445
Mexico	2,462	3,157	2,774	3,286	4,632	4,109	4,158	3,803	1,670
Other	1,793	2,195	4,064	1,708	2,272	2,246	2,261	2,408	457
<i>America, South</i>	184,592	178,336	154,503	130,565	116,859	103,796	99,496	96,909	90,958
Argentina	15,327	15,887	15,660	12,663	11,709	11,846	11,804	11,629	10,857
Colombia	716	833	973	963	1,353	1,370	1,392	1,360	962
Paraguay	4,964	5,187	5,120	4,388	4,119	3,860	3,915	3,835	3,500
Brazil	146,488	141,580	120,276	105,060	90,890	79,560	75,318	73,492	71,033
Peru	11,774	8,460	7,083	2,458	3,370	1,886	1,810	1,385	1,003
Venezuela	960	1,545	967	819	871	773	695	602	335
Bolivia	3,327	3,709	2,911	2,593	2,646	2,538	2,645	2,676	2,358
<i>Other</i>	1,036	1,135	1,513	1,621	1,901	1,963	1,917	1,930	910
<i>Europe, the NIS Group</i>	36,768	50,632	70,215	111,933	131,469	144,080	146,774	145,342	31,358
United Kingdom	5,559	10,943	19,889	44,351	51,668	55,224	53,114	51,896	9,310
Italy	2,337	3,013	3,442	4,849	6,174	7,359	7,997	8,297	2,383
Austria	768	1,187	1,173	1,568	1,605	1,792	1,826	1,825	583
Netherlands	1,469	2,059	2,500	4,334	5,931	5,919	6,481	6,821	785
Greece	643	951	1,028	907	724	624	620	628	436

Table 6. (continued)

Country	1975	1980	1985	1990	1995	1998	1999	2000	No. of Permanent Expatriates
Switzerland	1,326	1,946	2,864	4,456	4,980	5,595	5,694	5,992	3,289
Sweden	776	943	1,174	1,510	1,901	2,003	2,142	2,193	1,495
Spain	2,074	2,184	2,000	4,195	4,219	4,532	4,683	5,167	1,925
Denmark	498	580	597	870	886	947	960	1,060	652
Germany 3)	12,060	13,991	16,073	20,913	23,843	23,270	25,021	26,402	4,392
France	4,646	6,842	12,156	15,026	18,543	24,658	25,574	21,785	4,771
Belgium	1,719	2,433	4,014	4,551	5,039	4,688	4,936	5,323	
Russia 4)	978	976	831	957	1,471	1,562	1,484	1,612	40
Other	1,915	2,584	2,474	3,446	4,485	5,907	6,242	6,341	1,297
<i>Africa</i>	4,848	8,161	7,662	5,491	7,866	6,386	5,992	5,879	427
Algeria	737	2,199	1,238	344	53	66	72	101	10
Egypt	367	1,039	1,395	925	772	1,046	912	900	166
Kenya	444	560	713	828	875	740	735	708	
South Africa	644	611	801	530	3,136	1,540	1,210	1,238	132
<i>Other</i>	2,656	3,752	3,515	2,864	3,030	2,994	3,063	2,932	119
<i>Oceania</i>	4,240	6,187	9,538	21,398	33,701	45,137	51,909	56,205	24,868
Australia	3,393	5,007	7,466	15,154	23,929	33,188	38,427	41,309	18,501
New Zealand	442	659	1,068	2,006	4,337	6,412	7,780	9,090	3,953
Other	405	521	1,004	4,238	5,435	5,537	5,702	5,806	2,414

1) Excluding Taiwan. Beginning 1999, including Hong Kong, as it was returned to the People's Republic of China.

2) Through 1985, including Antarctica.

3) Through 1990, Germany (Fed. Rep.) only.

4) Through 1990, data for U.S.S.R.

a) Including Antarctica.

Source: Consular and Migration Affairs Department, Minister's Secretariat, Ministry of Foreign Affairs.

Table 6a. Japanese living abroad, by country: percent share, 1975–2000 (in %)

Country	1975	1980	1985	1990	1995	1998	1999	2000	No. of Permanent Expatriates
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
<i>Asia</i>	10.80%	14.10%	14.20%	14.00%	19.50%	20.80%	20.80%	21.40%	2.70%
Iran	0.50%	0.20%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Iraq	0.10%	0.50%	0.30%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
India	0.20%	0.20%	0.20%	0.20%	0.20%	0.30%	0.30%	0.20%	0.00%
Indonesia	1.10%	1.40%	1.40%	1.10%	1.50%	1.50%	1.50%	1.40%	0.30%
Korea, Rep. of	0.70%	0.70%	0.50%	0.90%	1.40%	1.90%	2.00%	2.10%	0.30%
Kuwait	0.10%	0.20%	0.40%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Saudi Arabia	0.10%	0.90%	0.50%	0.10%	0.10%	0.10%	0.10%	0.10%	0.00%
Singapore	1.20%	1.80%	1.70%	2.00%	3.30%	3.00%	2.80%	2.80%	0.30%
Thailand	1.50%	1.40%	1.60%	2.30%	3.00%	2.70%	2.60%	2.70%	0.20%
China 1)	1.30%	1.40%	1.80%	1.30%	2.30%	5.50%	5.70%	6.40%	0.20%
Taiwan	0.90%	1.10%	1.10%	1.20%	1.50%	1.70%	1.70%	1.70%	0.20%
Philippines	0.80%	0.90%	0.50%	0.60%	0.60%	1.10%	1.10%	1.20%	0.50%
Hong Kong	1.00%	1.80%	1.90%	2.30%	3.00%	0.00%	0.00%	0.00%	0.00%
Malaysia	0.50%	0.70%	1.00%	1.00%	1.40%	1.50%	1.40%	1.40%	0.20%
<i>Other 2)</i>	0.90%	1.00%	1.30%	0.80%	1.20%	1.40%	1.40%	1.30%	0.40%
<i>America, North</i>	31.10%	31.30%	35.50%	42.50%	40.70%	41.60%	41.80%	42.30%	47.00%
United States of America	27.60%	27.20%	30.40%	38.10%	36.20%	36.90%	36.70%	37.40%	38.60%

Table 6a. (continued)

Country	1975	1980	1985	1990	1995	1998	1999	2000	No. of Permanent Expatriates
Canada	2.20%	2.80%	3.50%	3.50%	3.50%	3.90%	4.20%	4.10%	7.50%
Dominican Republic	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.20%
Mexico	0.60%	0.70%	0.60%	0.50%	0.60%	0.50%	0.50%	0.50%	0.60%
Other	0.50%	0.50%	0.80%	0.30%	0.30%	0.30%	0.30%	0.30%	0.20%
<i>America, South</i>	46.50%	40.00%	32.10%	21.10%	16.00%	13.00%	12.30%	11.60%	31.00%
Argentina	3.90%	3.60%	3.30%	2.00%	1.60%	1.50%	1.50%	1.40%	3.70%
Colombia	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.30%
Paraguay	1.30%	1.20%	1.10%	0.70%	0.60%	0.50%	0.50%	0.50%	1.20%
Brazil	36.90%	31.80%	25.00%	16.90%	12.50%	10.00%	9.30%	8.80%	24.20%
Peru	3.00%	1.90%	1.50%	0.40%	0.50%	0.20%	0.20%	0.20%	0.30%
Venezuela	0.20%	0.30%	0.20%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Bolivia	0.80%	0.80%	0.60%	0.40%	0.40%	0.30%	0.30%	0.30%	0.80%
Other	0.30%	0.30%	0.30%	0.30%	0.30%	0.20%	0.20%	0.20%	0.30%
<i>Europe, the NIS Group</i>	9.30%	11.40%	14.60%	18.00%	18.10%	18.10%	18.10%	17.30%	10.70%
United Kingdom	1.40%	2.50%	4.10%	7.20%	7.10%	6.90%	6.50%	6.20%	3.20%
Italy	0.60%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.00%	0.80%
Austria	0.20%	0.30%	0.20%	0.30%	0.20%	0.20%	0.20%	0.20%	0.20%
Netherlands	0.40%	0.50%	0.50%	0.70%	0.80%	0.70%	0.80%	0.80%	0.30%
Greece	0.20%	0.20%	0.20%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%

Table 6a. (continued)

Country	1975	1980	1985	1990	1995	1998	1999	2000	No. of Permanent Expatriates
Switzerland	0.30%	0.40%	0.60%	0.70%	0.70%	0.70%	0.70%	0.70%	1.10%
Sweden	0.20%	0.20%	0.20%	0.20%	0.30%	0.30%	0.30%	0.30%	0.50%
Spain	0.50%	0.50%	0.40%	0.70%	0.60%	0.60%	0.60%	0.60%	0.70%
Denmark	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.20%
Germany 3)	3.00%	3.10%	3.30%	3.40%	3.30%	2.90%	3.10%	3.20%	1.50%
France	1.20%	1.50%	2.50%	2.40%	2.50%	3.10%	3.20%	2.60%	1.60%
Belgium	0.40%	0.50%	0.80%	0.70%	0.70%	0.60%	0.60%	0.60%	0.00%
Russia 4)	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.20%	0.00%
Other	0.50%	0.60%	0.50%	0.60%	0.60%	0.70%	0.80%	0.80%	0.40%
<i>Africa</i>	1.20%	1.80%	1.60%	0.90%	1.10%	0.80%	0.70%	0.70%	0.10%
Algeria	0.20%	0.50%	0.30%	0.10%	0.00%	0.00%	0.00%	0.00%	0.00%
Egypt	0.10%	0.20%	0.30%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%
Kenya	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.00%
South Africa	0.20%	0.10%	0.20%	0.10%	0.40%	0.20%	0.10%	0.10%	0.00%
Other	0.70%	0.80%	0.70%	0.50%	0.40%	0.40%	0.40%	0.30%	0.00%
<i>Oceania</i>	1.10%	1.40%	2.00%	3.50%	4.60%	5.70%	6.40%	6.70%	8.50%
Australia	0.90%	1.10%	1.60%	2.40%	3.30%	4.20%	4.70%	4.90%	6.30%
New Zealand	0.10%	0.10%	0.20%	0.30%	0.60%	0.80%	1.00%	1.10%	1.30%
Other	0.10%	0.10%	0.20%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%

1) Excluding Taiwan. Beginning 1999, including Hong Kong, as it was returned to the People's Republic of China.

2) Through 1985, including Antarctica.

3) Through 1990, Germany (Fed. Rep.) only.

4) Through 1990, data for U.S.S.R.

a) Including Antarctica.

Source: Consular and Migration Affairs Department, Minister's Secretariat, Ministry of Foreign Affairs.

highest in the world, Japan is implementing some reforms to deal with its dwindling funds and the possible bankruptcy of the national pension system by 2010 (as predicted by the International Monetary Fund). For one thing, the retirement age has been raised to 65 years old. The imposition of a mandatory insurance scheme covering the whole population (similar to Germany's) has been considered. Even Japan's private sector pension system is facing severe strain because of too few corporate workers, too many retirees, and many outdated rules that were crafted in the context of economic conditions 30 years ago.

Relationship with spouse and children. People who are retiring at age 60 actually face an average of 20–30 years of post-retirement life independent from one's children.⁷ Although the ratio of living together is extremely high in Japan compared to other countries, the enthusiasm is waning—the ratio of living together has declined from 68 percent in 1975 to 55 percent in the 1990s. At present, 4 out of 5 old people are still looked after in a family setting, but Japanese women who bear much of the responsibility of caring for the older generation are becoming restive.

Personal and social factors affecting the choice of destination. These include personal preferences (familiarity with the foreign country), peace and order situation in the country, cost of living, distance from Japan (presumably affecting cost of visits by the retirees to their families and vice versa), English-speaking population, and beauty of the natural environment.

According to the study conducted by the TAT for the long-stay program, Japanese respondents indicated several major considerations in choosing a retirement destination (Table 8).

The growing silver market has been shaping the kinds of products and services being developed and offered in major destinations of Japanese tourists. In Hawaii, for instance, the percentage of Japanese travelers 60 and older increased from 8.3 percent to 12.7 percent from 2000 to 2002. Older Japanese travelers are more interested in walking, hiking, cultural activities, and nature. As revealed by the survey of the JATA on the overseas travel of the "over 60" generation, 66.5 percent prefer future trips that would allow them to have a pleasant time and enjoy the natural scenery. Another 58.8 percent would like to tour places of historical and architectural significance. People between the ages of 55 and 64 had the highest likelihood of going on ecological tours because they are interested in nature and are strong enough to bear the physical strain involved in such tours.

⁷ Hiroyoshi Ono (2002).

Table 7. International comparison of old-age pensions

		Pension per month
Japan	Average for all recipients	JPY 172,200
United States	Average for all recipients	USD 765 (single) USD 1,148 (couple)
Germany	Average for workers' pension and employees' pension	JPY 88,600 (EUR 1,270)
	Workers' pension	JPY 73,600 (EUR 1,055)
	Employees' pension	JPY 104,000 (EUR 1,491)
United Kingdom	Basic pension	GBP 286 (single)
		GBP 457 (couple)

Source: Ministry of Health and Welfare, Government of Japan

Table 8. What will make them stay

Factors affecting Japanese retirees' choice of retirement location	Responses (%)
Safety	40.2
Natural beauty	12.9
Promptness	7.9
Conducive environment	7.6
Friendliness of local population to the Japanese	7.4
Others (not specified)	24.0
Questions often asked by Japanese retirees when considering Thailand as a retirement location	
Safety and security	40
Medical services and availability	14
Language barriers	14
Costs and expenses	11
Local attitude	10
Others	11

Source: Tourism Authority of Thailand (TAT)

Cost of medical care and long-term care services

Another reason why a growing number of Japanese retirees have considered seeking medical attention abroad is the high cost of medical care in Japan. If they are going to depend on their pension and insurance benefits alone for

Table 9. Comparison of average medical care expenditures in selected countries and the presence of private insurance

Country/Year	% Share of Population with Private Health Insurance	Average Medical Care Expenditure (in USD)
United States (1996)	71	4,090
Japan (1997)	65	2,453
Singapore (1996)	2	473
Taipei, China (1997)	2	2,642
Australia (1996)	45	1,818
South Korea (1996)	94	410
New Zealand (1996)	50	1,350
Hong Kong (1996)	65	3,062
East Asia and the Pacific (1994)	2	38

Source: The World Bank. 1997. *Innovations in Health Care Financing*, pp. 104-109, various articles.

their day-to-day living, they will consider maximizing the value of their money in hospitals and medical facilities abroad.

Older people are more prone to sickness and thus require regular medical check-up or special medical attention. The cost of living and medical care in Japan is one of the highest in the world. This could put a lot of pressure on the limited pension of an average Japanese retiree. For instance, an average Japanese in 1997 spends at least USD 2,400 annually in medical care (Table 9). This reflects almost the average medical spending in developed economies. With 20 million retirees having their regular medical check-ups or treatment, that adds up to USD 48 billion. The amount is even expected to go up.

The daily cost of hospitalization in Japan in 1997 is around USD 720. Elderly people in Japan tend to stay longer at 4.1 days—much longer than the national average of 2.0 days. Since Japan has one of the highest proportions of its population covered by private health insurance, the growing number and cost of medical care of its senior citizens would ultimately place a lot of strain on the pension and insurance systems of the country.

Given the longer life span of the Japanese, the demand for long-term care will continue to increase as cultural changes have been observed among Japanese families. Up until the 1980s, Japan's national policies reflected the basic belief that children should take care of their aged parents (Ihara 1997). Although the ratio of living together is extremely high in Japan compared

Table 10. Cost of long-term care in Japan: public and private silver businesses

Type of Services	Description	Cost of Service
Home care for the elderly who find themselves alone	Company keeps an eye on the situation at home and reports to the senior citizen's family who can feel at ease as they move elsewhere in Japan or even overseas at work.	JPY 2,200 (USD 18 at JPY 120 to the US dollar) per hour for these calls
Emergency transportation	Taxi companies have established a cooperative emergency alert support network operating in around 40 areas in Japan	JPY 4,800 (USD 40) monthly rental fee for an emergency alert device
Home helper services	Involves nursing care and help with household chores	JPY 5,000 (USD 42 when provided by municipal employees but less than half from private equivalents)
Bathing services	Privately run	JPY 14,000 (USD 117 per month)
	Nursing home	JPY 2,400 (USD 270 per month)
A one-month stay in a nursing home	Municipally operated	JPY 366,000 (USD 3,000)
	Privately run	JPY 267,000 (USD 2,200)

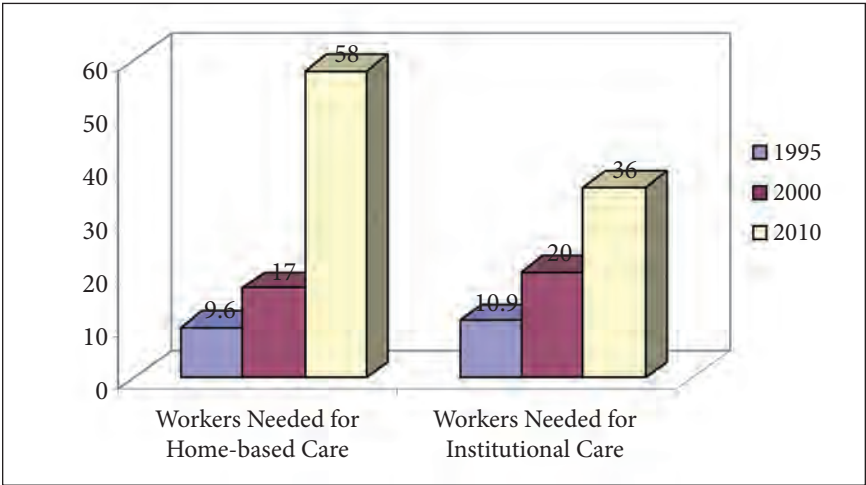
Source: Japan Association for Administration of Local Government

to other countries, the enthusiasm is waning: the ratio of living together has declined from 68 percent in 1975 to 55 percent in the 1990s. Although 4 out of 5 old people are still looked after by the family, Japanese women who bear much of the responsibility are becoming restive.

The supply of long-term care by the family can be expensive from both the individual and society's standpoint (Seike and Yamada, 1998). This is because the productivity in providing care services is lower for family members than it is for professional care workers. The opportunity cost for many family members is that they have to give up work from which they can earn wages. This opportunity cost is great for family care workers who have accumulated their own professional skills. Apart from lost income, their skills can be rusty thereby putting them at the margins of their professions. Volunteer workers tend to be less reliable and dependable than professional workers.

The Ministry of Health and Welfare estimates over 2 million of the number of elderly needing nursing care and this is expected to increase to 4 million in

Figure 2. Projection of necessary number of care workers (in thousands)



Source: Ministry of Health and Welfare; Seike (1998)

2010 and as high as 5.2 million in 2025. The Ministry plans to separate nursing services from existing medical care and institute a social insurance plan to cover the former.

Care workers have been in great demand in Japan especially in after the turn of the millennium. Since 1990 the number of care workers has increased from about 40,000 to about 120,000 in 1996 and the increase has been about 10,000–20,000 new workers each year.

Japan still does not allow the entry of medical practitioners and caregivers from other countries into their society. Furthermore, it would be relatively more difficult to uproot the Japanese particularly the retired elderly. Thus, destinations like Thailand have considered attracting the growing “wintering market” or seasonal migrants although others have developed retirement communities.

Regional Competition

The reality is that Japan’s aging market will be the largest tourism market that Asian destinations like the Philippines will have to cater to in the future. Recognizing these trends, countries like Singapore, Thailand, Malaysia, and even the Philippines are aggressively positioning themselves to become the travel destinations of this aging market, and eventually become the retirement choice. The most aggressive of all these destinations is Thailand.

Singapore

In the past, Singapore was the only country in the region known for its state-of-the-art hospitals. Based on figures from the Ministry of Health, patients come mostly from Malaysia and Indonesia (70%-85%). An estimated 150,000 foreign patients sought treatment in Singapore in 2000 and spent about SGD 345 million a year in health care expenditure. Regional competition has intensified with the aggressive marketing of Thailand as a destination for medical tourism. Singapore is working to boost its image as a destination that has set standards for quality health care. It plans to lead over its regional competitors in terms of medical expertise rather than just price. It also aims to establish one-stop centers in key regional markets to make it more convenient for patients to come to Singapore.

Thailand

Thailand has been cited as a model for tourism marketing and promotions after it successfully launched the "Visit Thailand Year" in 1997. The program helped attract nine million arrivals that year and created awareness of Thailand's products. However, the average length of stay and per capita spending declined thus preventing Thailand from generating higher revenues from the huge volume of visitors. As a result of the Amazing Thailand campaign (and devaluation of the Thai baht), destinations have been promoted as cheap and packages have been strict thereby preventing tourists from enjoying other attractions and from staying longer (World Tourism Organization 2001). To achieve economic sustainability, Thailand has to attract more longer-staying and higher-spending tourists to increase the yield. The retirees are one of these markets.

In 1998, the government developed the long-stay program under the TAT. It regards the long-stay and health care project as a high potential industry and several official departments have been working actively on this project, as follows:⁸

- Department of Export Promotion, Ministry of Commerce
- Ministry of Public Health
- Ministry of Public Foreign Affairs
- Immigration Bureau
- Tourism Authority of Thailand
- Private Hospital Association
- Thai Hotel Association
- Thai Airways International

⁸ <http://www.tourismthailand.org>

The Private Hospital Association with over 185 member hospitals has been supporting this project. For the past two years, participating long-stay providers such as hotels, condominiums, and service apartments in the city and resorts in the suburb region began to convert their premises to be ready for this new project. The standards of services have been taken into consideration by the long-stay and health care committee.

Thailand is promoting Bangkok as a hub for medical tourism, challenging the position of Singapore, which has become a costly destination. Services in Bangkok can be as low as 50–70 percent of that charged in Singapore.

Medical tours are readily available and heavily promoted in the website of the TAT. The holiday packages include a two-week trip to Thailand, including airfare, hotel, and a complete medical check-up in Bangkok before heading to the beaches in the South. Tour operators offer wide array of packages that couple medical procedures like liposuction with a stint on the beach or boat trip. The government is likewise promoting its top hospitals as the latest national attractions, with the TAT leading the marketing efforts. The TAT has organized a health travel mart that brings around 150 tour operators from Asia and Europe plus journalists to see the best of Thailand's hospitals. The international patient volume of Bumrungrad Hospital increased by 57 percent between 1999 and 2001 and revenue contribution reached 37 percent.

Malaysia

Health tourism has been identified as a major sector earmarked by the government under the 8th Malaysia Plan. In 1998, the government introduced this niche in response to the Asian economic crises. All health care-cum-tourism activities are categorized under health tourism. Any health care program that covers medical care, wellness, and fitness are included under health tourism. It also aims for the enhancement of the mind, body, and spirit of the individual, families, and groups. The Plan has identified 44 hospitals out of the 224 private hospitals as part of the program. Some medical centers have expressed interest to participate while another 13 have already embarked on various promotional activities. Malaysia was also promoted as "My Second Home." The Social Visit Pass can be granted to any person who fulfills certain criteria to stay in Malaysia as long as possible on a social visit pass for initially a period of five years and is renewable. The government has likewise created a National Committee for the Promotion of Health Tourism in 1998. This aims to promote smart partnerships between government, health care providers, travel organizations, and medical insurance groups and to identify suitable countries for promoting medical and health tourism to Malaysia. Japan is the second largest tourism market of Malaysia and it was a major target for the health tourism programs. Table 11 shows some of these medical tourism packages.

Table 11. Malaysia's wellness paradigm (health screening packages)

Type of Package	Cost (RM)	Details of Package
Basic health screening	450	<ul style="list-style-type: none"> • Consultation by medical officer • Full medical examination • Chest x-ray • Electrocardiogram (ECG) • Eye test • Comprehensive blood profile* • Lung function test • Medical report and counseling
Wellness woman package	1,150	<ul style="list-style-type: none"> • Specialist consultation by O&G consultant • Full physical examination • Chest x-ray • Electrocardiogram (ECG) • Eye test • Urine FEME • Comprehensive blood profile • Lung function test • Stress test <p>PLUS</p> <ul style="list-style-type: none"> • Breast examination • Pap smear • Mammogram • Medical report and counseling
Wellness man package		<ul style="list-style-type: none"> • Specialist consultation by O&G consultant • Full physical examination • Chest x-ray • Electrocardiogram (ECG) • Eye test • Urine FEME • Comprehensive blood profile • Lung function test • Stress test <p>PLUS</p> <ul style="list-style-type: none"> • Blood test for PSA • Ultrasound for prostate, liver, gall bladder, and kidney • Medical report and counseling

*Hematological profile, infectious diseases (Hepatitis B & VDRL), kidney function. full lipid profile, metabolic disorders (including diabetes, thyroid, and gout disorder), and liver function.
(O&G - Obstetric & Gynecologic; FEME - Full Examination, Microscopic Examination; PSA - Prostate Specific Antigen Test;

The website of the Association of Private Hospitals of Malaysia promotes Malaysia as the preferred health and medical destination because of

- its English-speaking medical staff;
- its harmonious plural society practicing a variety of religion;
- affordable hospitalization costs;
- highly trained medical specialists most with recognized practices from the United Kingdom (UK), Australia, and the United States (US);
- accessibility to major international airports (22 airports nationwide); and
- comprehensive network of hospitals and clinics.

Philippines

Only the Philippines has a dedicated government agency—the Philippine Retirement Authority (PRA)—to develop and promote the Philippines as a retirement haven. In other countries like Thailand and Malaysia, retirement programs are undertaken by tourism authorities. Created under Executive Order (E.O.) 1037 by President Marcos in 1985, the PRA was under the Office of the President and its main purpose was to adopt an integrated approach to the development of retirement communities. In 1989, the Leisure Development Center of the Ministry of Trade and Industry in Japan undertook a USD 2-million survey of Japanese nationals living in the Philippines on the Extended Leisure Stay Abroad (ELSA) program of the Japanese government.⁹ The ELSA is a government program that encouraged private companies to send out their employees who are about to retire in 3–5 years at company expense to countries with ELSA tie-up for 3–6 months' vacation. In 2001, President Arroyo placed the PRA under the supervision and control of the Board of Investments by virtue of E.O. No. 26. to enhance the efforts to attract additional investments.

In 2002, the PRA was renamed as Philippine Leisure and Retirement Authority (PLRA) 2003 to reflect its thrust of encouraging foreign nationals to try the Philippines as a leisure destination and eventually as a retirement haven. The Philippines revived the relationship with the Long Stay Coordinating Committee in Japan by signing a Memorandum of Agreement (MOA) that involves partnership and cooperation in marketing and facilitation for the entry of Japanese nationals. To address the lack of retirement villages and facilities in the country, the PLRA has embarked on negotiations with existing leisure

⁹ The ELSA replaced the Silver Columbia Plan, a scheme based on research that calls for the old Japanese people to be sent out of Japan to spend their aging years in other countries, particularly Spain, which was then the leading retirement destination. However, the Japanese elderly did not like the lack of care and haughtiness for the elderly of the Spanish caretakers. This eventually led the Japanese to return voluntarily to Japan (Ono 2002).

communities where such retirement facilities can be established. It has also signed various MOAs with the DOT to undertake a marketing campaign, and the Bureau of Immigration to implement “look and see” programs of varying durations.¹⁰ The PLRA likewise signed agreements with the DOT and the Bureau of Immigration to allow foreigners registered as participant in the program of the PLRA to stay for at least 31 days in the accredited accommodation facilities. The Bureau of Immigration’s Special Resident Retiree’s Visa has been merged with the Board of Investment’s Special Investor’s Resident Visa to produce the IR2 Visa (Investor and Retiree Resident Visa). This visa awards holders with a permanent non-immigrant status with multiple entry privileges, as well as exemption from exit and entry clearances and exemption from custom duties and taxes on imported personal effects such as appliances and furniture.

Implications on the Development of the Philippine Retirement Industry

The Philippines can tap into the Japanese retirees market. It has the manpower, the culture, the resources and the cost structure to make life for the Japanese retiree less stressful and more active.

Manpower resources

The Philippines has both the available manpower and culture to support retirees. The educational system churns about 300,000–400,000 graduates every year and 7 percent or 21,000–28,000 come from medical-related degrees. The abundance of medical service providers in the country is supported by the endless stream of nurses, physical therapists, and caregivers from the Philippines going to other countries like the US, Canada, and the UK. With retirees going to the Philippines, these people need not go to these countries and leave their families behind just to earn the levels of income they would get catering to other nationalities. They can provide the same service and perhaps receive the same income levels serving these nationalities here in the Philippines.

The elderly require special care giving that a typical Filipino finds natural to provide. The cheerful and hospitable disposition of the Filipinos makes the nation a natural haven for care giving and other services. The elderly can also avail of high levels yet affordable quality of medical care. There are many competent doctors who practice specialty medical in the Philippines. In fact,

¹⁰ The “look and see” programs aim to attract foreigners (who do not have the money to invest) as retirees. The program provides different options: a tour package of one week, a short visit of one month, or an extended stay for one year. This aims to give visitors a taste of Philippine lifestyle without pressuring them to invest immediately.

a number of them have received training or first practiced their professions in the US, Canada, the UK, and others.

Overcoming cultural barriers especially in the medical and health sectors

The interviews conducted with some Japanese retirees have shown that these two major challenges must be overcome to be considered a successful retirement facility. The first is closing the gap between the cultures. The second is providing a personalized care for each retiree in the facility.

Caring for the retiree, especially for the elderly, entails close cultural interaction between the caregiver and the retiree. With two different cultures closely brought together in a place where one becomes highly dependent on the other is bound to create friction. Most of the weaknesses of care giving in the Philippines are cultural in nature. This can be primarily traced to the lack of effective communication because of the Filipino caregiver's lack of understanding of the Japanese language. Another area of difficulty is certain actions and behaviors of both the cared-for and the caregiver that lead to misunderstanding and oftentimes, tension between the two parties.

The training curriculum for caregivers must also incorporate programs that aim to close these cultural gaps. In addition to the medical training for the care of the elderly, training courses should also incorporate basic languages, culture practices and norms, and even on values. Professional training courses must also be given to service providers of ancillary services like facility design, food preparation, culinary arts, tourist guides, and even commercial attaches abroad.

Caring for retirees, particularly the elderly, is intensely service-oriented and goes beyond medical care. This care must involve other meaningful activities that will keep retirees busy. As a result, a retirement facility does not only become a venue for providing medical attention, but also a place where self-esteem and self-worth are restored.

Since the services provided already target foreign nationals, it is important that high standards of care giving must be made. These standards must apply for medical care, facilities, and even amenities for recreation and extra-curricular activities.

Price discrimination against foreign nationals must be avoided. The interviews seem to indicate the arbitrariness of some hospitals and doctors in pricing their services to foreign nationals, especially to retirees and the elderly. Perhaps, the cost of the medical care provided to retirees should be standardized as far as possible or to set ceilings based on local rates. The

National Insurance Industry of Japan and the retirement facilities must also accredit these hospitals including the manner in which they set the rates of their medical services.

Taking advantage of existing real estate opportunities

Retirement homes are traditionally associated with clusters, nursing homes, and villages. These places are especially designed to serve the elderly and to provide specialty care for them.

However, the retirement homes market is not only focused on the elderly that belong to the 65 and above age bracket. Retirement homes can also target those who are close to retirement or have opted for early retirement. This segment caters to working professionals and executives between 45 and 65 years old including their family members. They are often referred to as "retirables."

Among the sectors in the economy that will greatly benefit from retirement villages is the real estate market. In the Philippines, there are a number of idle land and unsold but highly developed properties that can be transformed into retirement villages or subdivisions. For instance, over half a million lots and 110,000 house and lots were added into the housing market in the last 11 years. These housing projects are concentrated in Region IV, National Capital Region, and Region III.

However, the majority of these housing projects' inventory had not moved because of the current glut and intense competition in the market. For instance, based on a survey of housing projects in Region IV or the Southern Tagalog Region, it is estimated that over 30 percent of the house and lot packages remain unsold.¹¹ And yet, new housing units are expected to be put up every year, estimated to be at least 1,000 house and lot open market units throughout the country.

Idle housing subdivisions may not be the only beneficiary of a robust retirement industry. Vertical housing structures or residential condominiums can also be sold to the "retirables" who are more active and require minimal nursing care or medical attention except for some regular diagnostic tests.

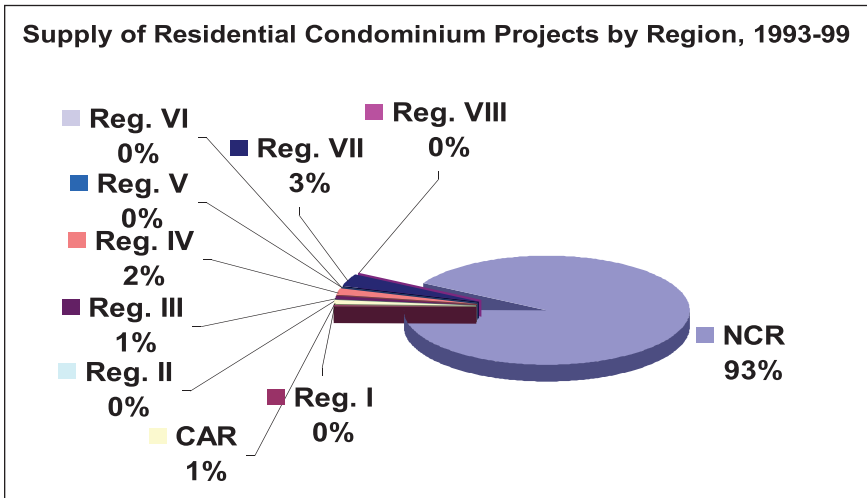
In the Philippines, residential condominiums cluster in and around the Metro Manila and Cebu. From 1993 to 1999, the NCR accounts for 93 percent of the total residential condominium inventory in the country followed by 3 percent in Region VII. Both areas already account for over nine-tenths of

¹¹ This was culled from a May 2003 SBE Consulting Group Survey of 11 subdivision housing units in the Cavite, Laguna, and Batangas areas. These areas belong to Region IV, which accounts for 63 percent and 44 percent of the country's house and lot developments in the open markets, and low-cost housing markets, respectively.

Table 12. Percentage share of additional housing per region classified according to type of development (H&L and lots), 1992-2002

REGION	Open Market				Low Cost			
	H&L Total	% Share to Total	Lots Total	% Share to Total	H&L Total	% Share to Total	Lots Total	% Share to Total
NCR	24,252	22	67,182	13	35,449	8	38,045	18
I	715	1	6,578	1	2,688	1	1,953	1
II	674	1	2,008	0	11,540	2	2,459	1
III	4,864	4	81,516	16	104,556	22	34,042	16
IV	70,254	63	290,991	56	204,421	44	62,028	29
V	423	0	7,282	1	3,881	1	21,108	10
VI	983	1	23,463	5	14,663	3	26,379	12
VII	2,884	3	11,474	2	4,936	1	5,095	2
VIII	1,141	1	2,568	0	4,403	1	2,780	1
IX	107	0	3,073	1	4,035	1	4,680	2
X	1,449	1	12,101	2	14,772	3	4,221	2
XI	4,084	4	7,315	1	48,253	10	10,952	5
XII	120	0	1,447	0	12,528	3	1,314	1
Total	111,950	100	516,998	100	466,125	100	215,056	100

Source: Housing and Land Use Regulatory Board (HLURB)

Figure 3. Regional distribution of condominium projects, 1993–1999

the total market. The residential condominium also suffers from a supply glut and intense market competition. As of 2003, there are close to 600,000 condominium units in Metro Manila alone with a fourth of that remaining unsold or unoccupied.¹² The survey data came only from units classified as sold units. The estimate of unsold units could even be higher if those repossessed by financial institutions would also be classified as unsold and therefore idle inventory. At present, there is no estimate of the total number of housing units, both subdivision and condominium units, repossessed by banks.

Standards of the facilities in residential subdivisions and condominiums and their amenities can be conformed to the standards set by the PLRA.

The rates and sizes of dwelling units in the Philippines are lower and more spacious than Japan. The continuous weakening of the peso against major currencies can even make real estate properties in the Philippines more affordable to a Japanese retiree or visitor.

However, both Japan and the Philippines prohibit foreign ownership of land. In the Philippines, foreigners can possess properties either as rights to use or occupy it or own it as a condominium unit provided that the total number of units owned by foreigners in a condominium building does not exceed 30 percent.

¹² SBE Consulting Group Survey done in May 2003.

Table 13. Comparative real estate housing size and rates in the Philippines and Japan

Comparative Housing Statistics	Japan*		Philippines*	
	Size (in sq. m)	Price (USD/sq. m)	Size (in sq. m)	Price (USD/sq. m)
New condominium sale	50-70	3,900-4,100	40-300	730-1,820
New detached unit sale	80-92	3,000-3,300	140-500	545-900
Daily apartment rental **	40-100	54-211	50-150	40-113

* Rates in Central Tokyo and Makati were used as basis for the highest priced or for luxury units. Kōnsai and Cavite property markets were used for the lower-priced detached units. Exchange rates assumptions used are JPY 08.9 = USD 1.0 and PHP 55 = USD 1.0 for Japan and Philippines, respectively.

** Based on the lowest and highest monthly rates of full serviced apartments in Central Tokyo and Makati

Sources of data:

For Japan: www.stepon.co.jp/ir/or/ar2003/5e.pdf www.yoke.city.yokohama.jp/theyoke/no.82/f1.2.82.html

For the Philippines: SBE Consulting Group Survey of Housing in Metro Manila and Cavite, May 2003.

Another option is to provide accommodations under long-term or perpetual lease arrangements. In this case, the arrangement is similar to an apartment user whose payments would depend on the length of stay, the location, the amenities, and other services provided to the resident.

A host of sectors in the Philippines will benefit if the retirement industry flourishes. Besides real estate, industries closely linked with the retirement industry will likewise benefit like health care, pharmaceuticals, care giving, medical services, educational institutions, retail spending, and tourism among others. For Japan, having their retirees living in the Philippines can ease the pressure on its pension and social security system while according them the necessary care and attention they need. While the cost could be lower or even the same in Japan's point of view when it spends for its retirees, the expenditure in peso terms would actually be very lucrative to Philippine industries because of the large disparity in the cost of living between the two countries.

In spite of these advantages the Philippines has to offer, Japan's potentials remain fully untapped for the Philippine retirement industry.

Strengthening the regulatory framework

A series of roundtable discussions with private sector representatives from real estate, health care, and tourism sectors were conducted for this study. They highlighted the need to coordinate efforts of private sector members, to

begin with. In the medical tourism market, for instance, there are no existing packages that could compete with packages being offered by Thailand and Malaysia. For one, the tourism industry is still fragmented at this point. The coordination of efforts by travel agencies and medical facilities is not yet extensive and marketing efforts are not aggressive at this point. However, it was pointed out that a national plan that will direct the efforts of tourism and its allied industries do exist. This is in stark contrast with the efforts of Malaysia where the national government spearheaded the creation of a health care sector committee that will specifically address the development of the medical tourism and long stay niches of the country.

There is likewise a need to increase awareness about these market niches among the local government units and local communities that are positioning their areas as destinations for tourism and investments. Social acceptability issues can be addressed through dialogues with the communities.

Summary and Conclusion

The study aimed to assess the prospects and impediments to developing the Japanese tourism market, particularly the retirees as target market, as well as the implications of Japan's aging market on the Philippine tourism and retirement services, and to identify areas of cooperation in tourism between Japan and the Philippines.

A developed economy of 126-million, Japan's economy is large with GDP of seven times that size of China and twice that of all the rest of Asia put together. Per capita income is USD 33,333. It has a relatively large number of households earning above USD 50,000 per annum. However, the Philippines has not been as competitive as the other Southeast Asian countries in attracting the Japanese market. Arrivals to Thailand (which is seven hours away from Japan), for instance, are almost four times than what the Philippines has captured from the 20 million Japanese outbound travel to Asia Pacific. The impediments identified are in the areas of air access, peace and order issues, as well as marketing and promotions. These are impediments that affect the ability of tour operators, such as the JATA, in developing and promoting destinations. In its communication to the WTO in February 2001, the JATA recognized the following as critical factors: strong presence through tourism promotion officers, improvement in tourism infrastructures, easy access (more airline seats, lower group airfares) and availability of competent local Japanese interpreters, and visa waiver program (an added incentive). The JATA noted further that the Japanese are particularly concerned about personal safety and therefore are very sensitive to the crime rate, security, and hygiene of host destinations. It is, therefore, proposed that the Philippine government seek for

an opening up of the air traffic routes between Japan and the Philippines on a bilateral basis, removing restrictions between third and fourth freedom traffic, and opening up all gateways as a starting point.

It should be noted, however, that the Japanese tourism market is already aging. In 2002, there are more than 20 million Japanese aged 60 years and above. The number of senior citizens belonging to this bracket increases not only because of the number of individuals reaching that age level, but also because they tend to live longer. The aging market provides opportunities for the export of our labor services—caregivers and medical practitioners—or for the export of tourism services via medical tourism, long-stay and retirement programs. These market niches allow the country to still generate foreign exchange earnings and generate employment opportunities despite the restrictions imposed by the health care sector of Japan. However, the Philippine businesses, as well as communities and local government units, need access to information and technical assistance so that the right products for the aging market can be developed.

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8 Philippine-Japan Economic Linkages: A Case Study of Cebu

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Victorina H. Zosa¹

Introduction

Cebu is a good case study for determining the impacts of a Japan-Philippine economic cooperation at a regional scale, for the following reasons. *First*, Cebu is an export-led economy. It is home to seven economic zones, which provide local employment and generate foreign exchange earnings. Japan is a major export destination of Cebu Economic Zone (CEZ) products. *Second*, Japanese direct investments (JDIs) have become increasingly important over the years. The majority of CEZ locators are Japanese. *Third*, Japanese tourists account for a substantial portion of foreign tourist arrivals in Cebu. *Fourth*, Cebu is a recipient of a substantial amount of Japanese ODA to the Philippines. *Fifth*, several associations of Filipino professional-grantees studied and trained in Japan. There is also the Japanese Association Cebu, Inc. with a membership of over 1,000 Japanese nationals. *Sixth* and last, there is the Cebu Investment Promotion Center, which is active in attracting JDIs into Cebu. Hence, the experience of Cebu could provide insights into a meaningful cooperation framework between Japan and the Philippines.

This study seeks to

- (1) describe the existing structure of Cebu-Japan economic arrangements,
- (2) discuss the economic competitiveness of Cebu from the perspective of local and Japanese businessmen,
- (3) quantify the benefits and costs of Japanese presence in the economy of Cebu,
- (4) identify gains and losses that may arise from a bilateral trading arrangement, and

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- (5) propose a cooperation framework that would promote stronger economic linkages between Cebu and Japan.

Regional Situationer

Cebu accounts for about 60 percent of the regional population, based on 2000 census. Metro Cebu, in fact, is the largest urban concentration in the country. The population is the third fastest-growing region in the country, next to Southern Tagalog and Central Luzon. Population density in the region is also one of the highest in the country, ranking third at 381 persons per square kilometer, next to NCR and Central Luzon.

Cebu's natural advantage is its strategic geographical location, which is further enhanced by the presence of important infrastructures, such as international port and airport, road networks connecting Mactan Island (site of the Mactan Export Processing Zone) to mainland Cebu, and 44 domestic ports. Cebu is base of over 80 percent of the interisland shipping capacity in the Philippines. Cebu is thus readily accessible via air and sea routes. Communications infrastructure in the region is also fairly reliable.

Service providers, such as major local and international banks, learning institutions, health facilities, hotels and restaurants, construction, transport, utilities, and storage among others operate in the region.

Central Visayas ranks fourth in contributions to the gross regional domestic product (GRDP), following NCR, Southern Tagalog, and Central Luzon. In terms of economic sector, Central Visayas ranks second in services GVA and fourth in industrial GVA. The industrial service sector accounts for 62 percent in the non-agricultural employment. The manpower requirement of the service and industrial establishments is supplied by higher educational and technical/vocational institutions located in the region.

The main constraints confronting the region are the looming power shortage in Cebu, the saltwater intrusion into Cebu's water table, and the uneven distribution of development gains across the provinces in the region. During peak hours, the demand for power reaches 375 megawatts (MW), with a deficit of 49 MW from current supply. Meanwhile, the Water Resources Center of the University of San Carlos reported that the present capacity of Cebu's coastal aquifer is 150,000 cubic meters daily, while the actual pumping is double or 300,000 cubic meters per day. This unregulated practice resulted in seawater intrusion since 1975. If unmitigated, it is estimated that 50 percent of the coastal aquifer will be permanently lost in 2025.

The performance of Central Visayas in agriculture is rather dismal, as it ranked 11th in agricultural gross value added and 10th in agricultural productivity in 2002. The region's basic education indicators are also unspectacular. Although

the elementary cohort survival rate and the National Elementary Achievement Test (NEAT) average are slightly higher than the national average (2000), the functional literacy rate of its population, the National Secondary Achievement Test (NSAT) average, and secondary cohort survival rates (2000) are lower than the national average. This can be partly explained by the inadequate provision of basic education resources in the region, which could not catch up with its rapid population growth of 2.79 percent.

Rapid and unplanned urbanization and industrialization have led to (a) the high incidence of poverty and (b) the high-income inequality in the region. Although its per capita poverty threshold in 2000 was the third lowest in the country at PHP 11,061, its poverty incidence was 43.7 percent, much higher than the national poverty incidence of 39.4 percent. Inequality was relatively higher, with a Gini ratio of 0.4696, slightly higher than the 0.4507 national average. This indicates the failure to distribute the gains from economic development across the provinces in the region.

Cebu-Japan Economic Relationship

Central Visayas exports accounted for only 9 percent of total Philippine exports in 2002 (Table 1). The top five exporters included Pentax Cebu Phils. Corp., Cebu Mitsumi Inc., Lexmark International (Phil) Inc., and Muramoto Audio Visual Philippines. For the same period, the top 10 export products in descending order are electronics, furniture, electrical equipment, other industrial goods, garments/wearables, marine products, steel/metal products, traditional products, GTH, and processed foods. Within this period, Japan was the top destination for Central Visayas exports.

Table 2 reflects the volume of foreign trade in Cebu (exports and imports) vis-à-vis the national totals, using the 2000 Foreign Trade Statistics of the Philippines. With the exception of electronics, the ranking for the top 10 exports and imports for Cebu and the entire Philippines were not congruent. For instance, the following top Cebu exports were not included among the country's top exports: other industrial goods, electrical equipment, marine products, and mineral products. In the same manner, the following Cebu imports were not excluded from the Philippines top 10 imports: forest products, resource-based products, mineral products, chemicals, consumer manufactures, and wood products, not elsewhere specified (NES).

Japanese investments play a key role in regional development. In 2003, 907 different investments were scattered in the various economic zones (EZs) throughout the country; 46 percent of them were owned by Japanese investors. Cebu ranked second to Manila, in terms of the most preferred location of

Table 1. Share of Central Visayas exports to Philippine merchandise exports, 2002 (FOB value in USD '0000)

Major Product	Central Visayas Exports		Total Philippine Exports ²		Central Visayas Export Share (%)
	Value	%	Value	%	
All Products	3,108,127	100	35,208,159	100	8.83
<i>Consumer Manufactures</i>	632,758	20.36	3,662,105	10.40	17.28
Garments & Footwear	84,260	2.71	2,353,385	6.68	3.58
Housewares	6,853	0.22	189,755	0.54	3.61
Furniture & Wood Products	241,558	7.77	402,554	1.14	60.01
Giftware & Accessories	282,412	9.09	418,981	1.19	67.40
Other Consumer Products	17,674	0.57	297,430	0.84	5.94
<i>Food & Food Preparations</i>	143,332	4.61	1,396,362	3.97	10.26
Processed Foods	20,050	0.65	588,214	1.67	3.41
Fresh Foods	986	0.03	396,017	1.12	0.25
Marine Products	122,296	3.93	412,131	1.17	29.67
<i>Resource-Based Products</i>	56,283	1.81	1,719,896	4.88	3.27
Coconut Products	2,790	0.09	357,113	1.01	0.78
Mineral Products	8,203	0.26	279,506	0.79	2.93
Forest Products, Tobacco, Marble	3,184	0.10	69,031	0.20	4.61
Seaweeds, Carageenan, Cut Flowers	19,917	0.64	75,194	0.21	26.49
Textile Yarns, Twine, Cordages	21,911	0.70	220,080	0.63	9.96
Non-Metallic Mineral			22,486	0.06	

Table 1. (continued)

Major Product	Central Visayas Exports		Total Philippine Exports ²		Central Visayas Export Share (%)
	Value	%	Value	%	
Petroleum Products	N.D.	N.D.	379,102	1.08	
Other Resource-Based Products	277	0.01	317,383	0.90	0.09
<i>Industrial Manufactures</i>	1,479,109	47.59	26,713,309	75.87	5.54
Electronics	1,424,472	45.83	24,321,896	69.08	5.86
Machineries/Transport Equipment	42,094	1.35	1,511,372	4.29	2.79
Metal Manufactures	3		51,501	0.15	
Construction Materials	1,504	0.05	122,855	0.35	1.22
Chemicals	11,039	0.36	322,068	0.91	3.43
Other Industrial Manufactures	3		383,617	1.09	
<i>Special Transactions</i>	310,435	9.99	1,716,487	4.88	18.09

Table 2. Top 10 exports and imports, Philippines and Cebu, 2000

Philippines					Cebu		
Rank	Exports	Value (USD M)	%	Rank	Exports	Value (USD M)	%
1	Electronics	22,880.14	60.09	1	Electronics	946.24	33.65
2	Garments	2,562.62	6.73	2	Other Industrial Goods	360.22	12.81
3	Woodcraft & Furniture	592.84	1.56	3	Electrical Equipment	234.24	8.33
4	Ignition Wiring Sets	576.28	1.51	4	Furniture	219.62	7.81
5	Coconut Oil	463.94	1.22	5	Garments	157.47	5.60
6	Petroleum Products	436.35	1.15	6	Steel/Metal Products	100.95	3.59
7	Metal Components	431.52	1.13	7	Marine Products	71.71	2.55
8	Other Manufactured Products	369.56	0.97	8	Gifts, Toys & Housewares	46.4	1.65
9	Bananas (Fresh)	291.65	0.77	9	Vehicles, Machinery	34.59	1.23
10	Cathodes (Refined Copper)	233.79	0.61	10	Mineral Products	28.12	1.00
Total of Top Ten		28,838.69	75.74	Total of Top Ten		2,199.56	78.22

Table 2. (continued)

Philippines					Cebu		
Rank	Imports	Value (USD M)	%	Rank	Imports	Value (USD M)	%
1	Electronics	6,804.61	21.68	1	Machinery/Transport Equipment	388.85	30.81
2	Mineral Fuels & Lubricants	3,876.61	12.35	2	Electronics	100.43	7.96
3	Telecommunication Equipment	2,931.35	9.34	3	Industrial Manufactures	95.14	7.54
4	Industrial Machinery	1,909.98	6.09	4	Forest Products	91.14	7.22
5	Office and EDP Machines	1,536.19	4.89	5	Resource-based Products	63.19	5.01
6	Electrical Machinery	1,444.19	4.60	6	Metal Manufactures	56.53	4.48
7	Transport Equipment	1,149.73	3.66	7	Mineral Products	54.84	4.35
8	Textiles	1,114.20	3.55	8	Chemicals	51.5	4.08
9	Iron and Steel	886.07	2.82	9	Consumer Manufactures	23.11	1.83
10	Plastics	694.77	2.21	10	Wood Products, NES	14.81	1.17
Total of Top Ten		22,347.70	71.19	Total of Top Ten		939.54	74.45

Sources: 2000 Foreign Trade Statistics of the Philippines (NSO) and DTI Region VII

investors. Thus, it is home to 160 establishments or 18 percent of total EZ firms in the country. Of the 160 Cebu EZ firms, 60 percent were controlled by Japanese corporations (Table 3). As to the type of industrial activity, Japanese firms preferred the following industries:

- motor vehicles and other transport equipment (82%);
- computer equipment (73%);
- machinery and equipment (67%);
- medical, precision, and optical instruments including watches (65%);
- metal products (59%);
- chemical and other products (57%);
- electrical machinery (45%);
- recycling (41%); and
- semiconductor and electronics (38%), among others.

Around 78 percent of these firms enjoyed 99–100 percent Japanese equity participation.

JDis in the Philippines centered on economic activities that required cheap unskilled or semi-skilled (assembly-type) labor. This is in contrast with JDis in Singapore, South Korea or Taiwan, which required more technically demanding production processes. In any case, research and development was mainly carried out in Japan. Tecson (2003) pointed out that this practice of distributing different value-adding activities to different countries is a response to the efficiency considerations in order to take advantage of differences in relative factor endowments. This practice of Japanese firms in locating various production phases in different countries is designed to exploit the comparative advantage of the host countries. The main consideration for the spatial segmentation of the production chain is the efficiency gain in exploiting the comparative advantage of host countries.

Contribution of Cebu Ecozones to the Regional Economy

There are seven economic zones in Cebu, the oldest of which is the Mactan Export Processing Zone established in 1979. Table 4 highlights the 59 percent contribution of Cebu Ecozone firms to total regional exports over the period 1991–2002. In 1991, the ecozone firms accounted for 34 percent of regional exports, peaking at 68 percent in 2000. Ecozone firms are relatively import-intensive, contributing 66 percent of the total imports passing through Cebu ports and airports over the period 1991–2002. In 1991, ecozone firms accounted for 42 percent of regional imports, rising steadily and reaching 79 percent of total imports in 2002. The imported products obtained from Manila ports are not included in this data.

Table 3. Distribution of Japanese firms in PEZA, by selected characteristics, 2003

Selected Characteristics	Total		Japanese	
	No.	%	No.	%
Region	907	100	417	46
Southern Tagalog	597	65.8	294	49
Central Visayas/Cebu	160	17.6	96	60
NCR	68	7.5	12	18
Central Luzon	66	7.3	12	18
CAR/Benguet	13	1.4	1	8
Eastern Visayas/Leyte	1	0.1	1	100
North Mindanao/Misamis Oriental	1	0.1	1	100
Central Mindanao/South Cotabato	1	0.1	1	100
Industry	907	100.0	417	46
Motor Vehicles & Other Transport Equipment	72	7.9	59	82
Office, Accounting & Computing Equipment	66	7.3	48	73
Machinery & Equipment	55	6.1	37	67
Medical, Precision & Optical Instruments, Watches	34	3.7	22	65
Basic Metals & Metal Products	85	9.4	50	59
Chemical, Rubber, Plastic & Non-Metallic Products	79	8.7	45	57
Electrical Machinery	58	6.4	26	45
Furnitures, Recycling & Other Manufactures	54	6.0	22	41
Semi-conductor and Electronics	123	13.6	47	38
Food, Tobacco, Leather, Wood, Paper, Printed & Petroleum Products	53	5.8	15	28
Computer & Related Business Activities	76	8.4	20	26
Textiles & Wearing Apparel	152	16.8	26	17
Owners' Share	907	100	417	100
50% and Below	84	9.3	34	8.2
51% - 99%	138	15.2	58	13.9
99.01% - 99.99%	256	28.2	131	31.4
100%	421	46.4	194	46.5
No information	8	0.9		
Filipino Owners Share	907	100	417	100
0%	372	41.0	212	50.8
50% and Below	369	40.7	185	44.4
51% - 99%	74	8.2	18	4.3
99.01% - 99.99%	4	0.4	2	0.5
100%	88	9.7		

Source: www.peza.gov.ph

Table 4. Central Visayas and Cebu Ecozone foreign trade indicators, 1991–2002 (in USD Million)

Year	Central Visayas			Cebu Economic Zone			Cebu Economic Zone Share	
	Exports (USD M)	Imports (USD M)	Trade Balance	Exports (USD M)	Imports (USD M)	Trade Balance	Exports (%)	Imports (%)
1991	749.00	424.00	325.00	251.00	179.00	72.00	33.51	42.22
1992	806.00	440.00	366.00	306.00	213.00	93.00	37.97	48.41
1993	1,006.00	545.00	461.00	466.00	287.00	179.00	46.32	52.66
1994	1,291.00	1,248.00	43.00	663.00	415.00	248.00	51.36	33.25
1995	1,454.00	1,203.00	251.00	896.00	781.00	115.00	61.62	64.92
1996	1,694.00	1,013.00	681.00	1,103.00	604.00	499.00	65.11	59.62
1997	1,941.00	872.00	1,069.00	1,102.00	627.00	475.00	56.77	71.90
1998	2,200.00	909.00	1,291.00	1,349.00	634.00	715.00	61.32	69.75
1999	2,407.57	986.10	1,421.47	1,626.37	697.78	928.59	67.55	70.76
2000	2,812.00	1,265.96	1,546.04	1,919.00	992.00	927.00	68.24	78.36
2001	2,988.00	1,694.00	1,294.00	1,755.72	1,333.11	422.61	58.76	78.70
2002	3,108.13	1,522.44	1,585.69	1,775.77	1,208.33	567.44	57.13	79.37
Total	22,456.70	12,122.50	10,334.20	13,212.86	7,971.22	5,241.64	58.84	65.76
Ave.	1,871.39	1,010.21	861.18	1,101.07	664.27	436.80		

Source: DTI Region VII <http://dti.gov.ph>

Table 5 reflects the contribution of CEZ to regional employment and investments. Regional investments are classified into regional FDIs (including both Board of Investments (BOI)- and CEZ-registered firms) and total investments. Total regional investments include regional FDI and new investments made by the DTI-registered and *Securities and Exchange Commission* (SEC)-registered firms. The employment generation potential of CEZ is quite limited, estimated at 3 percent of regional employment. The contribution of CEZ to regional FDI ranges from a low of 2 percent to a high of 67 percent. From 1999 onward, there was an increasing trend for regional FDI to locate in the CEZ. This indicates that foreign investors preferred this arrangement to avail themselves of incentives granted by the PEZA vis-à-vis BOI incentives.

Table 6 puts into perspective the contribution of Cebu EZ firms to PEZA. In 1994, Cebu EZ firms contributed 11 percent of PEZA employment, 16 percent of PEZA investments, and 24 percent of PEZA exports. However, CEZ's share dwindled over the years, and in 2001, it merely contributed 7 percent of PEZA employment, 2 percent of PEZA investments, and 9 percent of PEZA exports. This decline in the relative share of CEZ is due to the increasing attractiveness of PEZA firms located in Southern Tagalog.

Around 60 percent of CEZ firms in the Top 7,000 corporations are Japanese-owned. These Japanese firms contributed 57 percent of gross sales, accounted for 48 percent of profits generated in the CEZ, comprised 57 percent of the total assets of CEZ locators, incurred 69 percent of the total liabilities of CEZ locators, and contributed 50 percent of owner's equity.

It has been widely observed that Japanese firms tend to subcontract their production processes to other Japanese firms. Thus, there is a tendency for the agglomeration of Japanese firms. This practice is consistent with their Just-in-Time Delivery in the procurement of their raw materials. In the manufacture of electronic or computer products, other Japanese firms supply the needed raw materials, such as electronic valves, insulated wires and cables, plastic products, electrical transformers, fabricated metal products, fabricated wire products, and the like.

Tourism

Cebu is a tourism gateway in the Philippines. Tourists are drawn by its mix of metropolitan and rural ambience. The presence of hotels, convention centers, cosmopolitan restaurants, and shopping complexes make Cebu an ideal combination for corporate and tourism activities. A number of beach resorts, ranging from five-star to inexpensive category, dot the island. Cebu offers a feast to nature lovers, cool highlands, golf resorts, scuba diving sites, and a wonderful view of the night lights. Cebu is rich in cultural heritage as shown

Table 5. Share of CEZ in regional employment and investments, 1990–2000

Year	Employment		Investments (in PhP Million)			Cebu EZ Share in Regional		
	Cebu EZ	Region VII	Cebu EZ	Regional FDI	Region VII	Employment (%)	FDI (%)	Investments
1990	11,678	1,734,000	246,580	4,089,398	8,871,000	0.67	6.03	2.78
1991	13,317	1,753,000	620,090	7,536,823	12,136,000	0.76	8.23	5.11
1992	16,310	1,832,000	340,230	960,388	6,699,000	0.89	35.43	5.08
1993	19,710	1,880,000	582,250	10,150,385	19,627,000	1.05	5.74	2.97
1994	25,665	1,928,000	1,539,130	53,682,981	68,136,000	1.33	2.87	2.26
1995	29,243	1,945,000	498,000	7,902,432	21,198,000	1.50	6.30	2.35
1996	32,811	1,961,000	679,408	7,556,278	24,226,000	1.67	8.99	2.80
1997	36,047	2,056,000	500,000	20,801,754	38,760,000	1.75	2.40	1.29
1998	35,920	2,038,000	600,961	12,105,379	28,434,000	1.76	4.96	2.11
1999	43,433	2,073,000	157,880	449,978	15,101,000	2.10	35.09	1.05
2000	50,065	2,049,000	2,691,000	4,245,426	15,411,000	2.44	63.39	17.46
2001	48,114	2,115,000	1,621,000	2,404,372	17,828,000	2.27	67.42	9.09
2002	43,354	2,180,000	1,621,00	1,820,014	12,122,000	1.99	89.07	13.37
Total	405,667	25,544,000	11,698	133,706	288,549	1.59	8.75	4.05
Ave	31,205	1,964,923	899,810	10,285,047	22,196,077			

Note: Regional FDI includes investments in CEZ and BOI-registered firms. Regional investments include investments in Regional FDI, capitalization of DTI-registered and SEC-registered firms.

Sources: DTI Region VII, various *Philippine Statistical Yearbooks* and Labor Force Survey (Regional Employment)

Table 6. Share of CEZs in PEZA employment, exports, and investments, 1994–2002

Year	Employment			Investments (in Php M)			Exports (in USD M)			Cebu EZ Share in PEZA		
	Cebu EZ	PEZA		Cebu EZ	PEZA		Cebu EZ	PEZA		Employment (%)	Investments (%)	Exports (%)
1990	11,678			246,580			185.63					
1991	13,317			620,090			251.17					
1992	16,310			340,230			305.87					
1993	19,710			582,250			465.51					
1994	25,665	229,650		1,539,130	9,600		663.48	2,739		11.18	16.03	24.22
1995	29,243	304,557		498,000	52,500		898.95	4,284		9.60	0.95	20.98
1996	32,811	380,625		679,408	65,300		1,103.00	6,500		8.62	1.04	16.97
1997	36,047	562,085		500,000	159,700		1,102.32	10,626		6.41	0.31	10.37
1998	35,920	609,044		600,961	96,900		1,349.01	13,270		5.90	0.62	10.17
1999	43,433	617,690		157,880	155,700		1,626.37	15,807		7.03	0.10	10.29
2000	50,065	696,035		2,691,000	156,700		1,919.00	20,025		7.19	1.72	9.58
2001	48,114	708,657		1,621,000	80,800		1,755.72	19,498		6.79	2.01	9.00
2002	43,354	820,960		1,621,000	38,700		1,775.77	22,723		5.28	4.19	7.81
Total	405,667	4,929,303		11,698	815,900		13,402	115,472		8.23	1.43	11.61
Ave.	31,205	547,700		839,711	90,656		1,030.91	12,830		5.70	0.93	8.03
Investments/Employment Ratio				P 349,816	P 163,036							
Investments /Export Ratio				PHP/USD 10.59	PHP/USD 7.96							
Export/Employment Ratio				USD 2,541	USD 22,343							

Note: No data available for Cebu EZ Share in PEZA from 1990-1993.

Sources: PEZA website and DTI Region VII

in its old churches, museums, forts, and monuments. A substantial portion of Japanese tourists prefer Cebu as their tourism destination (Table 7).

More recently, Cebu has become a jump-off point for eco-tourism in the Visayas and Mindanao. Its accessibility via both sea and air transport makes it easy for both the domestic and foreign tourists to spend a day or two in Cebu island, and vacation away in the neighboring islands of Bohol, Negros Oriental, Siquijor, Camiguin, and Surigao.

Table 7. Foreign tourist arrivals in the Philippines and Cebu, 1982–2002

Year	Philippines			Cebu		
	Total	Japan	%	Total	Japan	%
1982	890,807	157,399	17.67	63,067	21,237	33.67
1983	860,550	177,166	20.59	69,034	30,433	44.08
1984	816,721	156,944	19.22	96,689	50,079	51.79
1985	773,074	153,511	19.86	92,043	47,004	51.07
1986	781,517	134,261	17.18	88,958	34,410	38.68
1987	794,700	126,127	15.87	99,379	31,061	31.26
1988	1,043,114	181,741	17.42	110,185	37,518	34.05
1989	1,189,719	215,634	18.12	130,194	47,868	36.77
1990	1,024,520	201,982	19.71	111,475	44,886	40.27
1991	951,365	197,540	20.76	109,830	43,348	39.47
1992	1,152,952	221,578	19.22	131,859	47,779	36.23
1993	1,372,097	243,412	17.74	164,138	52,921	32.24
1994	1,573,821	93,673	5.95	188,903	65,359	34.60
1995	1,760,163	107,151	6.09	227,329	88,918	39.11
1996	2,049,367	350,242	17.09	248,311	99,588	40.11
1997	2,222,523	376,714	16.95	277,614	106,122	38.23
1998	2,149,357	361,631	16.83	242,894	83,448	34.36
1999	2,170,514	387,513	17.85	289,098	118,361	40.94
2000	1,992,169	390,517	19.60	296,187	127,751	43.13
2001	1,796,893	343,840	19.14	273,876	106,769	38.98
2002	1,932,677	374,441	19.37	286,783	87,168	30.40
Total	29,298,620	4,953,017	16.91	3,597,846	1,372,028	38.13

Sources: National Statistics Office, 2001 and Department of Tourism Region 7, 2002

Movement of Natural Persons

In 2001, over two-thirds (67%) of the overseas contract workers (OCWs) from Central Visayas were males and over half (51%) belonged to age group 25–35 years. About a fourth (24%) of the OCWs worked in Saudi Arabia, while 15 percent worked in Japan. Over half (53%) are trade and promotion operators. OCWs working in Japan contribute 15 percent of total remittances in Central Visayas. In 2001, there were about 94,000 Filipinos working in Japan, with 7,000 coming from Central Visayas. The Cebuano OCWs contributed P252.52 million in remittances in 2001.

Table 9 concentrates on Filipino OCWs in Japan. Nationwide, 29 percent of Filipino OCWs in Japan are hired as technicians and associate professionals, while another 28 percent work as plant and machine operators and assemblers. Some 11 percent are service workers and shop workers. In Central Visayas, approximately 4,000 Filipino OCWs or 57 percent found jobs as plant and machine operators and assemblers. Perhaps, their experiences in Japanese firms based in the Philippines have boosted their chances for Japanese overseas employment.

Japan has long been active in the human resource development of the Filipino workers through scholarship and technical training programs. For more than 50 years, an annual average of 100 Philippine scholars studied in Japan under six different scholarship categories. Japan also contributed to the training of the Filipino labor force through the Association of Overseas Technical Scholarships (AOTS). Supported by the Japanese METI, AOTS recognizes that manpower development of developing countries is the most effective form of technical cooperation. A substantial number of AOTS scholars are workers of Japanese firms based in Cebu or workers of Cebu firms that do business with Japanese firms.

Japan's strategy of technology transfer to developing countries is to provide the developing countries' workforce with technical training. Table 10 shows the distribution of AOTS trainees. From 1959 to 2001, about 100,000 AOTS trainees from over 160 countries and regions availed themselves of training in Japan. The top recipients of AOTS scholarships are China, Indonesia, Thailand, Malaysia, South Korea, and the Philippines. In a way, this is indicative of the investment preference of Japanese firms. The training programs are geared toward industrial structure improvement, SMEs, IT, engineers, and improved productivity, among others.

Cebu workforce has been a recipient of training opportunities in Japan. Table 10 breaks down the human resource development extended by the Japanese government to Filipino professionals. Out of 4,939 AOTS scholars, 391 (8%) are from Cebu. Specifically, 248 (63%) of the Cebuano participants

Table 8. Selected information on overseas contract workers, October 2001

Variables	Central Visayas		Philippines		Central Visayas Share (%)
	No.	%	No.	%	
Number of OCWs (1,000)	46	100.00	1,029	100	4.47
Male	31	67.39	528	51.31	5.87
Female	15	32.61	501	48.69	2.99
<i>Age Distribution</i>	45	100	1,030	100	4.37
15 – 24	5	11.11	127	12.33	3.94
25 – 34	23	51.11	417	40.49	5.52
35 – 44	14	31.11	284	27.57	4.93
45 & Over	3	6.67	202	19.61	1.49
<i>Place of Work</i>	46	100	1,029	100	4.47
Saudi Arabia	11	23.91	266	25.85	4.14
Hongkong	2	4.35	123	11.95	1.63
Japan	7	15.22	94	9.14	7.45
Taiwan	4	8.70	87	8.45	4.60
Singapore	2	4.35	58	5.64	3.45
Others	20	43.48	401	38.97	4.99
<i>Occupation</i>	45	100	1,030	100	4.37
Managers / Professionals	2	4.44	118	11.46	1.69
Technicians, Associate Professionals & Clerks	5	11.11	103	10.00	4.85
Service Workers	5	11.11	116	11.26	4.31
Trade & Promotion Operators	24	53.33	336	32.62	7.14
Laborers & Unskilled Workers	9	20.00	346	33.59	2.60
Others (Special Occupations & Farmers)		0.00	11	1.07	0.00
Remittance of OCWs (in P1,000)	1,683,680	100.00	38,514,872	100.00	4.37
Saudi Arabia	557,796	33.13	9,477,131	24.61	5.89
Hongkong	55,922	3.32	3,305,933	8.58	1.69
Japan	252,515	15.00	3,704,804	9.62	6.82
Taiwan	70,570	4.19	2,454,522	6.37	2.88
Singapore	79,091	4.70	1,842,209	4.78	4.29
Others	667,786	39.66	17,730,273	46.03	3.77

Source: 2001 Survey on Overseas Filipino Workers

Table 9. Distribution of OCWs in Japan, by occupation, 2001

	Philippines		Central Visayas	
	No.	%	No.	%
Executives & Managers				
Professionals	9	9.57		
Technicians & Associate Professionals	27	28.72	1	14.29
Clerks				
Service Workers & Shop Market Sales Workers	10	10.64	1	14.29
Farmers, Forestry Workers & Fisherman				
Trades & Related Workers	6	6.38		
Plant & Machine Operators & Assemblers	26	27.66	4	57.14
Laborers & Unskilled Workers	10	10.64	1	14.29
Special Occupations				
Not specified	6	6.38		
Total	94	100.00	7	100.00

Source: 2001 Survey on Overseas Filipinos

Table 10. Number of recipients of Japanese scholarships and trainings, 2003

Organization	Philippines	Cebu	Cebu EZ Firms	Cebu Share (%)	Cebu EZ Firms' Share (%)
Association for Overseas Technical Scholarship, 1959 – 2000	4,939	391	248	7.92	63.43
Philippine Association of Japanese Ministry of Education (PHILAJAMES)	207	18	6	8.70	33.33
AsiaN Productivity Organization, 1993 – 2003	1,230	70	n.d.	5.69	N.D.
Total	6,376	479	254	7.51	53.03

Sources: Cebu AOTS, Phil. Association of Japanese Ministry of Education, Development Academy of the Philippines

N.D. – Data available only at the national level.

are employed by Cebu Ecozone firms. The Japanese Ministry of Education likewise grants scholarships for doctoral and steral programs. Of the reported 207 grantees of the Philippine Association of Japan Ministry of Education (PHILAJAMES), 18 (9%) hail from Cebu, of which a third (33%) work for Cebu ecozone firms. The Asian Productivity Organization (APO), administered in the Philippines by the Development Academy of the Philippines (DAP), likewise gave training opportunities to Filipino professionals. From 1993 to 2003, a total of 1,230 professionals attended these seminars, and 70 (6%) came from Cebu-based firms.

Information Technology

Cebu has long desired to be the IT hub of the Philippines, and eventually, of South East Asia. Japanese IT firms in Cebu include the manufacture of electronic products, computer products, software programming, and computer-aided design applications. More recently, there was an increase in the demand for e-services to locate in Cebu, specifically call centers. Presently, there are 12 firms expressing their desire to locate in Cebu, with three call centers already operational: Sykes, WesternWats, and People Support.

One of the possible reasons why the IT industry has been growing in Cebu is because of its ability to service IT manpower requirements. Of the total higher education enrollment of 131,664 in school year (SY) 2003-2004, there were 22,651 (17%) who were enrolled in IT courses, next only to business and accountancy. In 2003, there were a total of 22,920 higher education graduates. Of these, 3,045 (13%) pursued an IT degree. With 41 higher education institutions engaged in IT education, Cebu hosts the only PEZA-registered IT park outside Luzon, the five-hectare Asia Town Cyberpark. Likewise, there are internationally accredited Software Learning Centers in Cebu, such as the CISCO Networking Academy, Microsoft Certified Training Centers, and the Oracle Programming Academy. The Cebu Educational Foundation for Information Technology (CEDF-IT) was established in 2001 to improve the quality of Cebu's IT workforce.

Sociocultural and Political Factors

Cebu has been a major recipient of Japanese ODA over the years. For instance, the JICA funded the Long-Term Development Plan of Cebu Province in the 1990s. The Japanese government has also funded Cebu's major infrastructures such as the rehabilitation of the international airport and seaport, the two bridges connecting Mactan to Cebu mainland, and Cebu's reclamation project. In 2003, 42 percent or a total of P8.83 billion of Japanese ODA went to Cebu.

Japanese manufacturing firms generally outsource their jobs to other Japanese firms. Japanese firms send their Filipino workers, such as the

engineers, supervisors, and operators to Japan for training. According to the key informants, Japanese investors prefer Cebu because of its favorable peace and order condition, industrial peace, a trainable workforce, the workers' fluency in English, less bureaucratic procedures in doing business, more local government unit (LGU) support to foreign investors, and tourist attractions in Cebu. Some economic zones have their own power provider, the East Asia Utilities Corporation.

Japanese firms are transparent in their financial transaction and comply with environmental rules and regulations. Mitsumi, for instance, has a multipartite monitoring team composed of the Department of Environment and Natural Resources (DENR), PEZA, and LGUs, which monitors the extent of pollution brought about by its economic activity of washing the chips and discharging wastewater. Among the main beneficiaries of foreign locators are the SMEs in Cebu. The foreign locators facilitate technology transfer to SMEs. An important contribution of Japanese presence in Cebu is the exposure to the Japanese work ethic. The Japanese worker requires less supervision, and they can solve operational problems without referring them to their supervisors. However, once an SME is tapped by a Japanese firm as its subcontractor, the SME can no longer directly export to Japan.

The Japanese Association of Cebu has about 1,000 members: 65 percent of whom are Japanese technicians working in the CEZ, 20 percent are independent businessmen, and 15 percent are retired Japanese. To assist non-English-speaking Japanese tourists, there is a need for Japanese-speaking personnel at the Bureau of Immigration. While the CEZ administrators take care of the visa requirements of Japanese nationals employed at CEZ, there is a need to provide Japanese immigrants with visa assistance.

Both governments should encourage the exchange of students between Cebu and Japan to explore the different cultures. A feedback mechanism should be set up in Cebu so that the Filipino professionals and workers who benefited from study and training grants in Japan can effect a technology transfer in their respective work environments. It has also been observed that Japanese companies are able to reduce the delivery time of their work output from 180 days to 45 days. These lessons in work productivity could benefit the local labor force. Over the past years, it has been a practice in CEZ to showcase the best practices in labor productivity. Perhaps, the different business, employees, academic, government, and nongovernment organizations (NGOs) can benefit from the success stories. More importantly, in order to forge a meaningful economic relationship between Cebu and Japan, there must be an understanding of the richness of their respective cultures.

Economic Competitiveness of Cebu

To determine the factors that contribute to the attractiveness of Cebu, two surveys were conducted under the Philippine City Competitiveness Ranking Project 2003 and the 2002 JETRO Survey on Investment-Related Costs of Selected 26 Asian Cities.

Table 11 ranks seven broad location factors, including its 49 selected indicators. The broad location factors, ranked in order of importance, are as follows:

- (i) quality of human resources,
- (ii) dynamism of local economy,
- (iii) linkages and accessibility,
- (iv) infrastructure,
- (v) cost of doing business,
- (vi) quality of life, and
- (vii) responsiveness of LGU to business.

The human resources, required by business and industry, are readily supplied by Cebu's educational institutions, being the educational center in Southern Philippines. The role of schools is evident through the on-the-job training (OJT) provided to their students (8th), upgrading of their school curricula (14th), and the numerous training programs jointly organized by both the schools and industry (21st). Aside from schools, the quality of Cebu's labor force is likewise an asset. The worker's productivity is enhanced through the firm's investment in training and skills development (1st), quality circles (3rd), fair labor practice (9th), eagerness of the local workers to develop skills (11th), job satisfaction (12th), additional benefits (15th), availability of IT programs in the city (17th), and the existence of a healthy relationship between labor and management (26th). However, firms are not perceived as effective in managing their human resources (48th).

Local businessmen acknowledge the dynamism of tourism in spurring regional growth (6th). Other factors attributed to a dynamic local economy are access to business financing (19th), a conducive regulatory environment (24th), and the perception of a more favorable business climate within the next six months (28th).

The accessibility of Metro Cebu is measured in terms of

- proximity to international entry and exit points (4th),
- reasonable time from raw material source to the factory (16th),
- benefits of collaborating with other firms in the industry (23rd),
- availability of business support services (27th),
- proximity to sources of raw materials and other productive inputs (32nd), and
- good services provided by national agencies (34th).

Table 11. Ranking of location factors by Metro Cebu businessman, 2003

Rank	Broad Category	Rank	Indicators
1	Quality of Human Resources	1	Investing in training and skills development is important.
		3	Workers' suggestions about ways to improve business operations are encouraged.
		7	Availability of skilled labor needed by the company.
		8	Allows on-the-job trainees from schools.
		9	Poor labor practices such as discrimination and harassment are discouraged.
		11	Workers from the local pool are eager to develop skills.
		12	Job satisfaction of my workers and productivity is existent.
		14	Curricula and academic programs in local HEIs equip graduate with basic skills needed by local industries
		15	Good performance by workers can be attained through additional benefits.
		17	Availability of IT programs in the city
		21	Existence of training programs jointly organized by schools and industry partners.
		26	Relations between management and labor are constructive.
		48	Effective management of my firm's human resources is a key priority.
2	Dynamism of Local Economy	6	Tourism as an industry is a very vibrant sector
		19	Access to financing for private businesses is available.
		24	The city's regulatory environment is conducive to business.
		28	In the next six months, revenues of local businesses are expected increase considerably.

Table 11. (continued)

Rank	Broad Category	Rank	Indicators
3	Linkages and Accessibility	32	Proximity to location of raw materials and other productive inputs
		16	Reasonable time in transporting raw materials from domestic sources in the city
		4	Proximity to international entry and exit points (airports, seaports & other transshipment points)
		27	Available business support services, such as advice on product or process development, marketing, and business strategy making.
		23	The benefits of collaborating with other firms in the industry is existent.
		34	The level of services provided by national agencies (e.g. DENR, BFAR, BFAD) is good.
4	Infrastructure	37	Management of road network and traffic
		49	During peak hours, roads are clear.
		18	Reliable electric power
		22	Reliable water services
		10	Ease of connection to telephone lines from other service providers
		2	Adequate cellular phone signals
		5	Adequate ISPs
5	Cost of Doing Business	44	Adequate facilities for managing garbage
		20	Profitability of doing business in this city is high.
		45	Non-existence of informal fees
6	Quality of Life	40	Clean roads and public open spaces
		46	Clean open bodies of water
		41	Clean air quality in the city
		13	Adequate rest and recreational facilities (cinemas, bookstores, malls, etc.)
		25	Security environment is conducive for business.

Table 11. (continued)

Rank	Broad Category	Rank	Indicators
7	Responsiveness of LGU to Business	36	Simple and efficient process in securing business permit.
		39	Local government units are dynamically involved in developing human resources.
		47	Local government programs are effective in assisting displaced workers.
		43	Honesty and transparency of LGUs in its dealings
		30	The city's administration of justice is fair.
		29	Policies and regulations in the city is reflective to business needs.
		42	LGU holds regular forums to elicit opinions of its constituents
		38	Very effective Clean and Green Program
		31	Reasonable business taxes imposed by LGU.
		33	Well-implemented master development plan.
		35	Reasonable and flexible land-use regulations such as zoning

Source: <http://www/jetro.go.jp>

The strategic role of Cebu's international airport and port is highlighted in this set of location factors. Likewise, the role of agglomeration economies is imputed in this measure of accessibility and linkages.

Infrastructure received diverse ratings from high to low. Belonging to the plus factors are adequate cellular phone signals (2nd), adequate ISPs (5th), and ease of connection to telephone lines from other service providers (10th). Businessmen are starting to become wary of the reliability of both electric power (18th), and water services (22nd). On the other hand, businessmen have expressed concern over the congested traffic during peak hours (49th), the garbage problem (44th), and road and traffic management (37th).

The cost of doing business is quite high due to the existence of informal fees (45th) and the limited profit potential (20th). The latter could reflect the phenomenon of business overcrowding, and could serve as a signal for businesses to disperse outside of Metro Cebu.

Among the quality of life indicators, only adequate rest and recreational facilities and security environment fared well (13th). The remaining indicators, such as clean open bodies of water (46th), clean air quality (41st), and clean roads and public open spaces 40th did not fare as well. Metro Cebu now

manifests a deterioration of environmental quality, as a result of increased economic activity and uncoordinated societal response to the environmental problems.

The lowest rating went to the responsiveness of LGU to business concerns. LGUs are rated low on the following aspects:

- effective programs in assisting displaced workers (47th),
- honesty and transparency in its dealings (43rd),
- holding of regular forums to solicit their constituents' opinions (42nd),
- dynamic involvement in developing human resources (39th),
- very effective Clean and Green program (38th),
- simple and efficient process in securing business permit (36th),
- reasonable and flexible land-use regulations (35th),
- well-implemented master development plan (33rd),
- reasonable business taxes (31st), and
- fair administration of justice (30th).

The low rating to LGUs could also indicate that economic activities in Metro Cebu are largely private-driven, with the LGUs taking the back seat in steering the economic actors to the road of economic development.

Table 12 enumerates the advantages of Cebu, in terms of belonging to the top five most competitive Asian cities. Cebu is most competitive in the monthly wage of mid-level managers and department chiefs, paying an equivalent of USD 122–USD 243. Cebu imposes the lowest value-added tax (10%) and the lowest tax on royalties remitted to Japan (10%).

Cebu is the second most competitive city in terms of

- bonus payments (next to Shenzhen),
- monthly office rent at USD 3.75–USD 7.02 (next to Hanoi),
- monthly housing rent for foreigners at USD 468–USD 665 (next to Shenzhen), and
- tax on dividends remitted to Japan at 10 percent (next to Beijing, Shanghai, Dalian, Shenyang, Chongqing, and Shenzhen).

Cebu is the third most competitive city in terms of monthly gas rate for business use at USD 0.52/kg (next to Yangon and Colombo).

Cebu is the fourth most competitive city in terms of

- social security burden ratio to employers at 6.21 percent (next to Yangon, Bangkok, and Hongkong);
- international call charge to Japan at USD 1.2 per three minutes (next to Hongkong, Taipei, and Singapore);

Table 12. Competitiveness of Cebu, in terms of top 5 ranking in investment-related costs JETRO survey of 26 Asian cities, 2002

Investment Costs	Rank	Value	Higher Ranked Cities (Country)
WAGES			
Mid-level managers (monthly; section and department chief level)	1	USD 122–USD 243	
Bonus payments (fixed bonus+ variable bonus months)	2	Basic wage x 1 month	Shenzhen (China)
Social Security burden Ratio (A. Employer)	4	6.21% (SSS: 5.21%, EC: 1%)	Yangon (Myanmar), Bangkok (Thailand) and Hong Kong (China)
Social Security burden Ration (B. Employee)	5	3.33% (SSS)	Karachi (Pakistan), Yangon (Myanmar), Batam (Indonesia), Jakarta (Indonesia) and Taipei (Taiwan)
LAND COSTS and OFFICE SPACE			
Office rent (monthly) (per sq m)	2	USD 3.75–USD 7.02	Hanoi (Vietnam)
Housing rent for foreigners (monthly)	2	USD 468–USD 655	Shenzhen (China)
Industrial estate rents (monthly) (per sq m)	5	USD 0.34–USD 0.36	Seoul (Korea), Colombo (Sri Lanka), Ho Chi Minh City (Vietnam) and Dalian (China)
TELECOMMUNICATION COSTS			
International call charge (for 3 min. to Japan)	4	USD 1.2	Hong Kong (China), Taipei (Taiwan), and Singapore (Singapore)
PUBLIC UTILITIES COST			
Value-added tax (standard tax rate)	1	10%	
Tax on royalties remitted to Japan (highest tax rate)	1	10%	

Table 12. (continued)

Investment Costs	Rank	Value	Higher Ranked Cities (Country)
Tax on dividends remitted to Japan (highest tax rate)	2	10%	Beijing (China), Shanghai (China), Dalian (China), Shenyang (China), Chongqing (China) and Shenzhen (China)
Gas rate for business use (monthly basic charge)	3	USD 0.52/kg	Yangon (Myanmar) and Colombo (Sri Lanka)
Regular gasoline price (1 liter)	4	USD 0.32–USD 0.36	Yangon (Myanmar), Batam (Indonesia), Jakarta (Indonesia), Kuala Lumpur (Malaysia), Manila (Philippines), Hanoi (Vietnam), and Ho Chi Minh City (Vietnam)
Value-added tax rate (highest tax rate)	4	10%	Singapore (Singapore), Okinawa (Japan), Yokohama (Japan), and Bangkok (Thailand)
Large passenger car purchase price (sedan over 2500cc)	5	USD 29,307	Batam (Indonesia), Yokohama (Japan), Okinawa (Japan) and Manila (Philippines)
Personal income tax rate (highest tax rate)	5	32%	Hong Kong (China), Yangon (Myanmar), Dhaka (Bangladesh), Singapore (Singapore), and Kuala Lumpur (Malaysia)

Source: <http://www/jetro.go.jp>

- regular gasoline price at USD 0.32 to USD 0.36 per liter (next to Yangon, Batam, Jakarta, Kuala Lumpur, Manila, Hanoi, and Ho Chi Minh); and
- value-added tax rate at 19 percent (next to Singapore, Okinawa, Yokohama and Bangkok).

Cebu is considered the fifth most competitive city in terms of

- social security burden ratio to employees at 3.33 percent (next to Karachi, Yangon, Batam, Jakarta and Taipei),
- monthly industrial estate rents at USD 0.34–USD 0.36 per square meter (next to Seoul, Colombo, Ho Chi Minh, and Dalian),
- larger passenger car purchase price of USD 29,307 (next to Batam, Yokohama, Okinawa, and Manila), and
- personal income tax rate at 32 percent (next to Hongkong, Yangon, Dhaka, Singapore, and Kuala Lumpur).

Cebu is relatively not competitive with respect to telecommunications, water rate, gas rate, and container transport. On monthly basic telephone charges, Cebu and Manila are the least competitive cities. Cebu is also not so competitive in terms of monthly basic mobile phone charges (19th), broadband internet connection fee (16th), and internet connection fee (12th). Beijing reports the lowest internet connection fee, while Seoul charges the lowest broadband internet connection fee. Ho Chi Minh and Hanoi enjoy the lowest monthly basic telephone fee, while Colombo charges the minimum monthly basic mobile phone fee.

Cebu ranks 14th in business water rates and 16th in business gas rate. Cebu is (20th) in container transport. New Delhi charges the lowest water rate for business use, while Hongkong charges the lowest gas rate for business use. Mumbai (India) charges the lowest fee for container transport.

The Philippines, and Cebu, as a destination of Japanese investments is hampered by many factors. Foremost is the relatively high wages of both unskilled and skilled labor. Dhaka has the lowest wage rates. Bangkok has guaranteed a stable wage rate environment, by minimizing wage rate increases from 1999 to 2001. Despite the liberalization of the telecommunications, utilities, and the shipping industries in the country, our rates are still globally uncompetitive. The time is now opportune to look into the efficiency of these industries.

Elements of the Cooperation Framework between Cebu and Japan

This section looks into the benefits and constraints spurred by the economic relationship between Cebu and Japan. Based on the analysis, a cooperation

framework, which could address the Philippines' reform objectives, is suggested.

Estimates of Japanese economic presence in cebu: an exercise

Japanese economic presence in Cebu is felt in the following areas: (a) foreign direct investments, (b) foreign trade, (c) training and exchange of skilled workers, (d) Japanese ODA, and (e) estimated local purchases of CEZ.

Investments of CEZ firms were reported to be PHP 1.62 billion in 2002. Using a 1996 estimate, it was noted that 88.54 percent of the CEZ workforce were factory workers, some 10.88 percent were managers and staff, while 0.58 percent were foreign nationals. Estimates of salary contribution, withheld income taxes and mandatory employment contribution comprise societal benefit from employment generation. They also pay mandatory contributions, consistent with Philippine labor laws and policies. The total benefits from FDI are estimated at PHP 9.32 billion in 2002.

However, as CEZ locators are generally exempt from corporate income tax, it has been estimated that foregone income taxes amounted to around PHP 2.30 billion. The net benefit of CEZ FDIs was estimated at PHP 7.02 billion in 2002. The estimated benefits totaled PHP 9.34 billion, of which PHP 1.62 billion could be attributed to total FDIs. Some PHP 7.69 billion represented salaries and mandatory contributions or the employment generation potential of CEZ firms. On the other hand, the opportunity cost of foregone income taxes was estimated at PHP 2.30 billion.

Another perceived benefit of FDIs is foreign exchange earnings. In 2002, CEZ exports were valued at PHP 91.63 billion, while CEZ imports were reported at PHP 62.35 billion. While it seemed that that CEZ enjoyed a balance of trade surplus equivalent to PHP 29.28 billion, these reported data merely refer to the exports and imports, which were processed in Cebu ports. A substantial portion of imported raw materials still passed through the Manila ports. Considering the import adjustment factor that represented the average Philippines-Japan export-import ratio in 2002, losses from CEZ firms operations were estimated to be around PHP 33.52 billion, arising from high import content in these operations.

To arrive at an estimate of the contribution of Japanese firms, 60 percent allocation factor was used. It was noted that 96 out of 160 locators in CEZ were Japanese firms. Thus, in terms of FDI and foreign trade, the net contribution loss of Japanese firms is estimated at PHP 17.944 billion, mainly due to the foreign exchange loss.

Nonetheless, the net contribution loss was partly offset by the following:

- (a) contribution of Japanese tourists, which generate a tourist income of PHP 4.76 billion,
- (b) remittances of Central Visayas OCWs working in Japan amounting to PHP 224.66 million,
- (c) estimated cost-of-living expenses of Japanese nationals residing in Cebu running at PHP 576 million,
- (d) estimated Cebu allocation of Japanese ODA amounting to PHP 6.07 billion, and
- (e) share of Japanese firms in CEZ local purchases estimated at PHP 4.92 billion.

On the whole, Japanese economic presence is still favorable to the Cebuano economy, with an estimated net contribution of PHP 653 million in 2002.

Possible gains and losses in a bilateral arrangement

Bilateral relationship between Cebu and Japan has long been in place. Since 1959, 391 Cebuano workers benefited from AOTS, 18 Cebuano scholars enjoyed Japanese Ministry of Education study grants, and 70 Filipino trainees attended APO seminars. As a result, the local universities have a pool of Japanese-trained PhDs in iology, marine sciences, robotics, and engineering. AOTS scholars have returned to their workplaces, while some of them moved on to other companies, bringing with them the technical skills they acquired from their Japanese experience. Moreover, APO scholars have attempted to improve the productivity of their respective workplaces, with some of them spearheading local productivity workshops.

The strategy of bringing in Japanese nationals first as tourists and then as potential investors could account for the relatively higher share of Japanese firms in the CEZ. A substantial number of tourism facilities in Cebu largely cater to Japanese tourists.

Japan's interest in Cebu is not limited to tourism, foreign investments, and technology transfer. Even the Japanese government contributed to the development of Cebu by providing both the Long-Term Cebu Development Plan and the infrastructures needed to transform Cebu into a region with low agricultural productivity to an export region with industrial-service orientation. The share of CEZ exports to GRDP has substantially increased from 6.37 percent in 1990 to 32.06 percent in 2002. This validates the export orientation of Central Visayas. In addition, the estimated receipts from foreign tourists are

substantially more than the GRDP. As an open economy, Cebu's growth hinges on the external developments of its trading partners. Its economy is likewise cushioned against the uncertainties generated by national politics.

In 1988, Central Visayas was the fourth poorest region, with a poverty incidence of 46.7 percent of the total families and 52.1 percent of the regional population. In 2000, Central Visayas slid down to the ninth poorest region, reporting a slight alleviation of its poverty situation. The proportion of poor families dropped by 7.9 percent from 46.7 percent in 1988 to 38.8 percent in 2000. Likewise, there was an 8.4 percent reduction of poverty incidence of the regional population from 52.1 percent in 1988 to 43.7 percent in 2000. Offhand, it seems that the CEZ was able to alleviate the poverty situation in Central Visayas. Cebu is home to 59 percent of total families in Central Visayas. Cebu contributes 65 percent of total family income and claims 66 percent of total family expenditures. Although Cebu accounts for 40 percent of total cities and municipalities in the region, Cebu generates 65 percent of total LGU income and expenditures.

Central Visayas has the third highest Gini ratio in 2000, next to Eastern Visayas and Northern Mindanao. However, among the four provinces in Central Visayas, Cebu has the lowest Gini ratio. More interesting is that among the three urbanized cities in Cebu, Lapulapu, the site of three economic zones, has the lowest Gini ratio. This indicates that the export economy of Cebu has contributed to a more equitable income distribution within the province. Japanese nationals have also commented on the favorable peace and order conditions in Cebu as an important location factor. It is worth noting that a favorable peace and order condition is associated with an equitable income distribution.

Summary and Conclusion

The Cebu-Japan cooperation is boosted by the economic competitiveness of Cebu. Cebu's competitiveness manifests itself through its quality human resources, its dynamic export sector and tourism industry, its proximity to international entry and exit points, its infrastructures, its cost of doing business, its quality of life, and the responsiveness of LGU to business needs. In a survey of 26 Asian cities, Cebu figured as one of the most competitive, particularly with regard to the monthly wage of mid-level managers and supervisors and in terms of affordability of housing facilities for foreigners. On the other hand, Cebu, as a destination of Japanese investments, is hampered by the relatively high wages of both unskilled and skilled labor; an unstable wage rate environment; and moderately high costs of telecommunication, water, gas, and container transport. Cebu has adopted a strategy to promote investments

in the region. As a proof, the share of CEZ exports to GRDP has grown from 6.37 percent in 1990 to 32.06 percent in 2002.

The growth of export industries in Cebu has likewise increased the demand for higher education. The quality of Cebu's labor force is enhanced through the firm's investment in training and skills development, quality circles, the worker's desire for self-improvement, availability of IT programs in the city, and industrial peace. In addition, Japanese scholarships and training programs are available to the graduates and workers of Cebu to facilitate technology transfer. A substantial number of the Cebuano workforce has been exposed to the Japanese work ethic. In turn, Japanese engineers based in Cebu have interacted with local labor.

An unintended consequence of a trained human resource is labor mobility. Thus, it is common for workers to seek employment in other firms within the zone, or for Filipino workers in Japanese firms to job-hunt in American or European firms. On the other hand, there are also cases when Japanese engineers, with expired work contracts, would seek employment in other Japanese firms within the economic zone.

CEZ is an example of the agglomeration of Japanese firms. Large Japanese firms would subcontract their input or service requirements to other Japanese firms, usually of the SME category. It is not unusual for Japanese firms to buy, even their office supplies, from a Japanese company. In the literature, Krugman (1991) argues that firms agglomerate due to increasing returns. It is widely held that firms agglomerate due to the presence of increasing returns to scale. Further, geographic concentration of similar activities results in technical externalities, such as the development of specialized suppliers, workers investing in industry specific skills, and knowledge spilling between firms. These technical externalities reduce the firms' cost, improve their product quality, or both.

Crucial in the development of the economic zones is the role of Japanese ODA. By providing funds for the support infrastructure in industrial development, such as the renovation of the Mactan International Airport and Cebu International Port, the construction of the Mactan-Cebu Bridge, and the upgrading of the Leyte Geothermal Project to supply the needed electricity, the Japanese government has made Cebu an attractive location for Japanese investors, workers, and tourists.

In terms of human development, Cebu's export-led growth was able to reduce poverty incidence by approximately 8 percent from 1988 to 2000. There was also a more stable income distribution for Cebu, especially in its key cities. Lapulapu City, the site of the Mactan Export Processing Zone, has the lowest Gini ratio. While more income opportunities became available in Metro Cebu, the other provinces in Central Visayas suffered from a

relatively high-income inequity, especially Bohol and Negros Oriental. There is a need for Cebu's economic growth to spillover to its neighboring provinces. The ecotourism potential of Bohol, Siquijor, and Negros Oriental has attracted a lot of foreign and domestic tourists. However, there is a need to complement tourism development with industrial development, as in the case of Cebu.

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PJEPA: Strengthening the Foundation for Regional Cooperation and Economic Integration

This two-volume publication of the Philippine Institute for Development Studies (PIDS) and the Philippine APEC Study Center Network (PASCN) is composed of 17 studies that assess the potential impact of the Philippines-Japan Economic Partnership Agreement (PJEPA) on the Philippine macroeconomy and key sectors, which include agriculture, manufacturing and trade, small and medium enterprises, and tourism. Jointly conducted in 2003 by the PIDS, PASCN, and the Department of Trade and Industry, these studies aided Philippine representatives during the negotiations for the agreement with Japan from 2004 to 2006.

The PJEPA was ratified on October 8, 2008 after two years of Senate hearings. The studies in this book helped pave the way for the ratification of the PJEPA (then JPEPA) as these were cited and used as arguments on how the country could benefit from the agreement.

Volume II contains papers that present impact analyses on specific sectors and concerns, and how the agreement will affect the domestic economy. This volume also identifies which sectors will benefit from and will be disadvantaged by an economic partnership with Japan.



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