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Prospects for a Philippines-European Union Free Trade Agreement: Implications for Agriculture

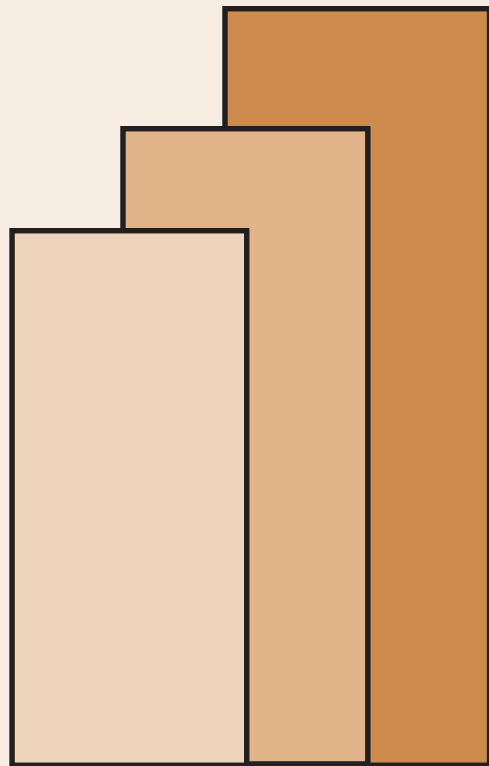
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PROSPECTS FOR A PHILIPPINES-EUROPEAN UNION FREE TRADE AGREEMENT: IMPLICATIONS FOR AGRICULTURE

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Report prepared for the Department of Trade and Industry
Government of the Philippines

Abstract

This study examines the impact of a potential Philippines – EU FTA on the agricultural sector. Static analysis indicates that potential gains to the agricultural sector of the Philippines are limited, primarily owing to the low size of initial agricultural trade with EU (compared to other trading partners), as well as moderate to low tariff and other trade barriers to EU products entering the country. CGE analysis confirms that the overall impact of bilateral tariff elimination leads to an overall increase in agricultural output, accompanied by a decline in price; hence there is an increase in consumption of agricultural products. Impact on poverty is likewise positive, with improvements biased to the poorer households. By subsector, the largest output gains are projected for seaweeds and sugarcane, with 0.80% and 0.50%, respectively; increased access on EU markets are favorable for Filipino exporters of seaweeds, other fiber crops, tobacco leaf, forestry, ornamental plants, raw coffee, abaca, and cocoa. Meanwhile the subsectors that are on the losing side (as shown by declining output) are cattle, raw rubber, chicken, and hogs. Fears about the negative repercussions of Philippines-EU FTA on the poor turns out to be unfounded. Poverty incidence declines, and more so in rural than in urban areas. The greater decrease in poverty gap and squared poverty gap, compared with poverty incidence, implies that those who belong to households below the poverty threshold get the most benefits. It would seem that expectations of large benefits from a Philippines – EU FTA will not be found in agriculture, but elsewhere. Conversely, the agricultural sector does not face significant harm from a Philippines - EU FTA, even one involving sensitive products. Relaxation of trade barriers to EU even for sensitive products is warranted; not only would consumers gain (though minimally), but such a negotiation stance may serve as a powerful bargaining chip for gaining concessions on other areas.

Key words: free trade area, agriculture, impact assessment, computable general equilibrium

1. Introduction

In December 2009, after slow progress in negotiations between EU and ASEAN, the EU began to pursue bilateral free trade area (FTA) negotiations with individual ASEAN member countries. Negotiations with Singapore and Malaysia were launched in 2010. The EU and Singapore concluded a 5th round of negotiations in January 2011 while a 3rd round of talks between the EU and Malaysia is set in May 2011. The EU continues to pursue exploratory, informal talks with other ASEAN member countries with a view to assessing the level of ambition at the bilateral level.

The Philippines and EU are initiating discussions on a possible FTA. To support these discussions, the Philippine Institute of Development Studies (PIDS) has been engaged by the Department of Trade and Industry (DTI) to undertake a pre-feasibility assessment. This research aims to make a contribution by providing a study highlighting concerns specific to agriculture. It also draws extensively on the simulations and analysis done by Cororaton and Corong (2012).

The objectives of this report are as follows:

- i) To provide an overview of the salient features of the agricultural sector for both the Philippines and EU, including a profile of Philippine livelihoods and rural households as well as describe market characteristics of agricultural products that are acceptable to the EU.
- ii) To discuss the patterns of agricultural trade, by commodity, in terms of levels and directions, with respect to or from EU and the rest of the world. This would highlight the relative significance of specific commodities with respect to imports from or exports to EU, the importance of EU as an import source or export destination, and the importance of the Philippines as an import source or export destination of agricultural products from EU. It would also discuss trends in patterns and direction of trade.
- iii) To discuss tariff and non-tariff barriers to trade between the Philippines and EU. The latter barriers would highlight food safety, product standards (including packaging), and the framework for harmonization. These trade barriers are situated in the context of other regional trade agreements that have initiated relaxation of tariff and non-tariff barriers. These agreements will be examined for their effectiveness in addressing these barriers to trade.
- iv) To provide an integrative analysis incorporating quantitative simulations from the macro-study, in relation to the context of the agricultural sector, rural households, market environment, and trade policy.

The rest of the report is structured as follows: Section 2 provides a background reviews the relevant literature on Free Trade Areas and their potential impacts. Section III analyzes the patterns of agricultural trade, focusing on trade between the Philippines and EU. Section IV discusses tariffs and non-tariff barriers that could be addressed by a free trade agreement between the Philippines and EU.

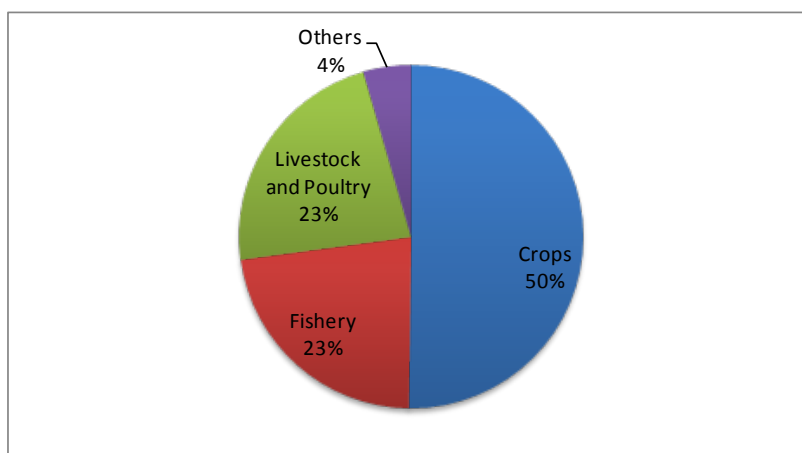
2. Sector background

Philippine Agriculture and Trade

Agriculture sector accounts for one-eighth of the country's economic output, and has exhibited the lowest growth compared with industry and services. However it remains an important sector with respect to *inclusive* growth. More than a third of the labor force depends on agriculture for employment; poverty incidence among agricultural households in 2009 was 40% while it was only 19% among non-agricultural households (Reyes et al 2012). Hence any trade policy with the potential of causing contraction of agriculture requires serious investigation; even if proven beneficial for the economy as a whole (e.g. favoring growth), negative repercussions on the poor may be enough to repeal the policy (as inconsistent with inclusive growth).

Over the last decade, crops contributed more than half of the total agricultural output (Figure 1) Fishery, and livestock and poultry have similar shares of 23% each.

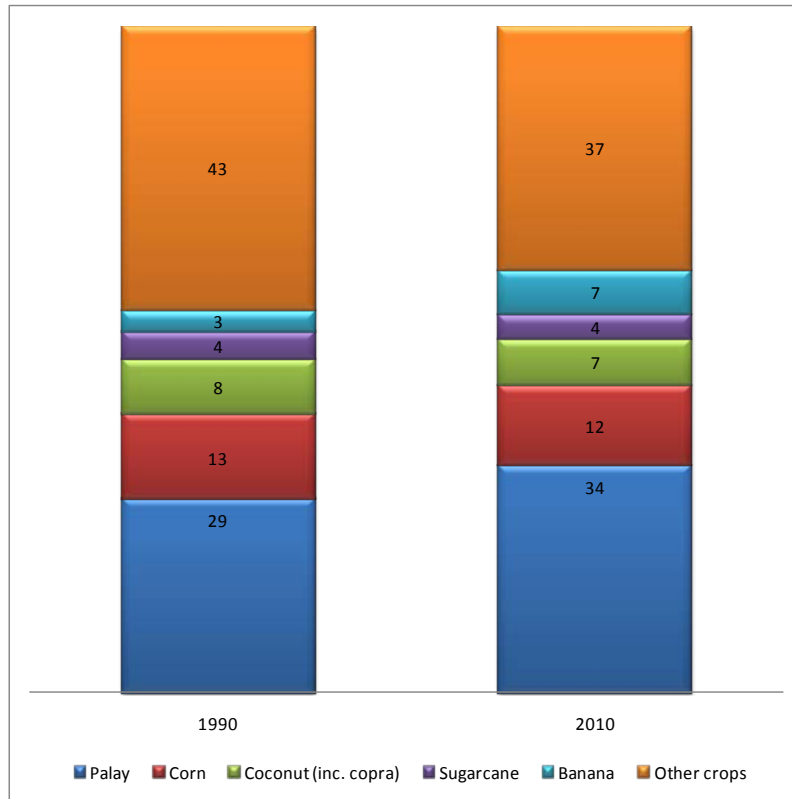
Figure 1: Average shares in gross value added in agriculture, fisheries, and forestry, constant prices, 2001-2010



The top five crops, namely rice paddy, corn, coconut (including copra), sugarcane, and banana comprised about 57% and 63% of the total crop production in 1990 and 2010, respectively (Figure 2). Among these major crops, share increase only occurred in rice paddy and banana. The share of rice paddy rose to 40% in 2010 from 29% in 1990. The share of banana in the total crop production more than doubled which was 7% in 2010 from 3% in 1990. On the other hand, the shares of corn, coconut, and sugarcane decreased. Other minor crops had a combined share of 37% in 2010, lower than its share in 1990.

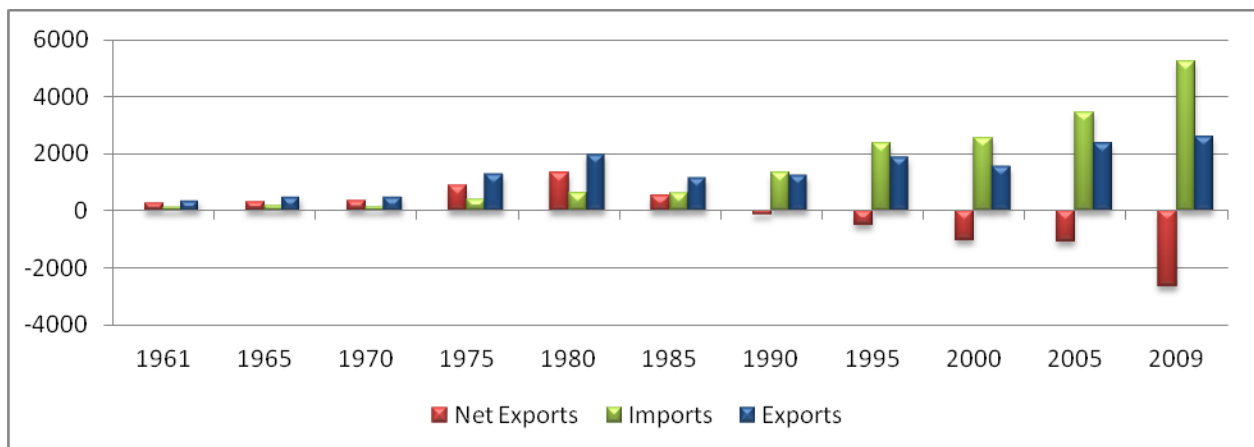
Traditional crops also dominated the shares in area harvested, which was about 85%. Of the total area for agricultural production, the rice paddy and corn accounted for more than a third and a fifth, respectively (Briones, 2012).

Figure 2: Shares in gross value added of crops by type of crop, 1990 and 2010, constant prices (%)



The Philippines was a net food exporter up to the late 1980s. However, in 1990, this trend in food trade was overturned. Imports started outpacing the exports, thus reaching almost P 4.0 B food trade deficit in 2010 (Briones, 2012).

Figure 3: Value of imports and exports, 1961 – 2009 (millions of dollars)



Trade agreements

During the 1980s, various trade reforms were undertaken by the Philippines to facilitate its economic liberalization. The main motivation of these trade agreements was to enhance trade and investment flows. Also, this facilitated cooperation and mutual support on international goals such as global competitiveness (Medalla and Mantaring, 2009). Among its trade expansion initiatives were engagement in multilateral, regional, and bilateral negotiations and agreements.

In 1995, the Philippines joined the World Trade Organization after its establishment in 1994. The WTO Agreement on Agriculture placed a ceiling on tariffs and set deadline for their imminent reduction. It mandated minimum access volumes (MAVs) for sensitive products. Tariff on imports within MAV (in-quota tariffs) were bound at lower rates than those imports in excess of the MAV (out-quota tariffs). The Philippines agreed on the “tariffication” of all quantitative restrictions. This meant that quantitative restrictions were all converted to tariffs; however special treatment was extended to rice (Briones, 2012).

Aside from observing multilateralism in trading, the Philippines was also involved in different regional trading agreements (RTA) as listed in Table 1. These RTAs indicated that the country was gearing towards trade liberalization. RTAs also facilitated the formation of free trade agreements (FTA) especially in the trade of goods, services, and investments.

An FTA is an agreement which mandates its members to abolish both tariff and non-tariff barriers (NTBs). A tariff, which is a form of protection, is a tax imposed on imported items sold in the domestic market. On the other hand, non-tariff barriers are restrictive policies such as quotas, licensing, and product safety policies, which are alternative forms of protection. When these barriers, both tariff and non-tariff, are reduced or fully eliminated, markets will become more predictable, which intensifies trade. This tariff and NTBs abolition would only take effect among member countries, thus non-members bear higher rates (Park, 2006). Within Asia and the Pacific, ASEAN serves as a core of different FTAs among countries.

Table 1: Summary of regional trade agreements of the Philippines

Name of Agreement	Acronym	Year established	Tariff reduction deadline
ASEAN Free Trade Area	AFTA	1992	2020
ASEAN – China Free Trade Area	ACFTA	2002	2018
ASEAN – Korea Free Trade Area	AKFTA	2005	2016
ASEAN – Japan Comprehensive Economic Partnership	AJCEP	2008	2018
Japan – Philippines Economic Partnership Agreement	JPEPA	2008	2018
ASEAN – India Free Trade Area	AIFTA	2010	2023
ASEAN – Australia and New Zealand Free Trade Area	AANZFTA	2010	2020

Source: ASEAN Secretariat (www.asean.org).

The first FTA joined by the Philippines was the ASEAN Free Trade Area or AFTA. The region decided to implement a comprehensive program of tariff reduction. AFTA member countries implemented the Common Effective Preferential Tariff (CEPT) of 0% to 5% for nearly all tariff lines under an agreed time frame. For the Philippines, many of its agricultural products have maintained a 5% tariff. However, rice and sugar have consistently applied high ASEAN tariffs, 40% and 38%, respectively. By 2015, as stated in the agreement, the Philippines shall apply 5% tariff on maize and sugar, while rice will be at 35%.¹

The only bilateral free trade agreement of the Philippines is with Japan, the Philippine-Japan Economic Partnership Agreement (PJEPA). PJEPA implements tariff elimination on 95% of Philippine exports to Japan, while the Philippines applies zero tariff on 90% of Japanese products. Agricultural commodities remained sensitive; among the agricultural products from Japan that are exempted from tariff elimination included tobacco and rice. Nevertheless, Philippine exports such as mango, coffee, and beer among others, immediately faced zero tariff; likewise the Philippines has agreed to eliminate tariffs over a span of 10 years for many agricultural products (Medalla and Mantaring, 2009).

Aside from the usual liberalization measures in goods and services, PJEPA facilitated cooperation in areas such as science and technology, human resource development, small and medium enterprises, and the environment. It has gone through a long process of preparation, consultation and negotiations, finally obtaining ratification from Congress in 2008. Other bilateral agreements under consultation are RP-US FTA, Pakistan-Philippines FTA, and RP-EU FTA (Medalla and Mantaring, 2009).

3. Framework and related literature

Assessing potential gains from FTAs

The removal of trade barriers, whether tariff or non-tariff, between the Philippines and EU, is expected to have varying effects to producers and consumers depending on whether the commodity is exported to or imported from EU.

- Commodities exported by the Philippines to EU: producers gain from increased market access, with probable increase in price. Consumers in the Philippines may suffer from the increase in price due to intensified competition with EU consumers.
- Commodities imported by the Philippines from EU: producers lose from increased market access to EU exporters, with probable reduction in price. Consumers in the Philippines may benefit from the decline in price and opening up of the domestic market to EU suppliers.

These are simply directions of change; the quantitative significance of these gains and losses is another matter. The main framework of assessing potential significance of these gains and losses involves two types of assessment method – examination of static factors; and comparative static analysis (Park, 2006). Static factor analysis involves examination of current patterns to infer

¹ www.dti.gov.ph.

potential impacts of expanded trade. Comparative statics involves comparison between current or base period outcomes, and projected outcomes in the presence of expanded trade. Numerical projection of outcomes relies on either a partial or a computable general equilibrium (CGE) model of an economy; this shall be implemented using the CGE simulations of Cororaton and Corong (2012); for this study we shall be focusing on their results for the agricultural sector.

The static factors affecting trade creation include the following:

- Size of the market - This factor suggests that the larger the collective economic size of the FTA, the larger the chance of creating more trade.
- Evenness of economic development within FTA - Integration is more advantageous if members of the FTA have the same level of income and purchasing power parity.
- Proximity and transport networks - The lower the transportation cost, the greater the potential for expanding trade with opening of markets. Reduced transport cost is associated with closer the geographical location of the countries, and established transportation infrastructure involving land, sea, and air links.
- Initial size of trade within FTA - Countries that are heavily trading with each other reap more benefits when impediments are removed because of an FTA compared to countries trading less with each other. We incorporate here as well the *prospect for increased trade* independent on any free trade agreement, entirely based on examination of past trends.
- Initial tariff structure - a higher initial tariff structure between FTA members poses greater likelihood of creating trade. Opportunities for trade creation are larger if levels of tariff barriers of the Philippines and EU are high. Under this heading we also include the presence of non-tariff barriers which may also impede trade and be a subject of discipline within the FTA.

Previous studies

Bello et al (2004) provide a static analysis of potential gains from a Philippines – Japan free trade agreement. Agricultural exports to Japan at the time consisted mostly of bananas, shrimps and prawns, tuna and bonito, pineapples and asparagus. Japan was the second largest market of Philippine agricultural exports, importing 80 percent of exported bananas, 98 percent of exported pineapples and 61 percent of exported mangoes. Food imports are would likely rise over time, in part owing to the "graying" of the farming population, though it faces the challenge of meeting exacting standards imposed by the Japanese consumer and its regulatory environment. Meanwhile, manufactured fertilizer, agricultural chemicals and materials account for most of the Philippine agricultural imports from Japan.

Previous work relying on comparative static analysis is reviewed in Briones (2012). Javelosa and Schmitz (2006) apply a partial equilibrium model to analyse the impact of removing Australia's ban on banana imports from the Philippines. Their results indicate that removing the import ban would not only increase producer surplus of banana exporters in the Philippines, it would also raise economic welfare in Australia, as benefits from consumers more than offset losses to

domestic banana growers. The size of the impact depends on the magnitude of the supply elasticity of Philippine bananas.

Computable general equilibrium (CGE) models have become a common tool for analysing the impacts of trade agreements *ex ante*. The earliest application of CGE modelling for the aforementioned FTAs is by Adams (1995) for AFTA. The study finds that AFTA raises intra-regional trade and is generally welfare-improving.

The JPEPA was likewise subjected to assessment using CGE (Cororaton, 2004) on an *ex ante* basis (Table 2). The scenario posits elimination of tariffs on manufacturing imports from Japan, together with an assumed 5 percent increase in prices of exports to Japan. The study finds that, while manufacturing expands, agriculture in the Philippines contracts. This is accomplished through exchange rate adjustment: as cost of production in domestic industry falls, the peso appreciates. Poverty levels decline, based on the usual measures (headcount, poverty gap, or squared poverty gap) for all households, as a result of declining relative prices and increasing factor incomes. However, households in rural areas benefit least, while urban households benefit more, and households in the national capital benefit most. The incidence of benefit does seem especially biased against the poor, as the magnitude of poverty is greatest among rural households and least among households in the national capital. The differences in the incidence of benefits are driven by the contraction of agriculture and expansion of industry.

Table 2: Changes in poverty measures based on trade simulation (percentage change from base)

	All households	National-capital households	Urban households	Rural households
Headcount	-0.9	-3.8	-1.4	-0.5
Poverty gap	-1.1	-3.2	-1.2	-1.0
Severity	-1.2	-3.4	-1.4	-1.1

Source: Cororaton (2004)

The possible bilateral FTA between the Philippines and the USA has been analysed by Rodriguez and Cabanilla (2006). The two scenarios most relevant to this paper are: 1) tariffs on US imports are lifted; and 2) tariffs on US imports are lifted, except for agricultural products and food processing. The latter incorporates the usual exemptions of sensitive products from the FTA. In both cases they add a 1 percent increase in the price of exports to the USA. Their analysis shows that, under either scenario, agricultural production and food-processing output generally rises. Output increases tend to be larger under the no-exemption scenario. In terms of welfare impact, gains are expected under either scenario; interestingly, welfare improvement of low income households is slightly lower under a no-exemption scenario compared with the agriculture-exemption scenario (0.26 and 0.28 percent, respectively). This is understandable given that lower income groups may be drawing more of their livelihood from import-competing agriculture.

The foregoing discussion is based on a review of past research. In the following we present original analyses regarding the potential impacts of regional trade agreements, first based on a qualitative analysis focusing on size and trends in intra-FTA trade, and second based on a quantitative model of the agricultural sector adjusting to tariff adjustment caused by trade agreements.

4. Results of the Assessment

Static factors

Size of the market, evenness of economic development, proximity

In 2010, the total population of the EU-27 was 502.5 million inhabitants and its GDP reached US\$ 15.1 trillion (europa.eu). Meanwhile the population of the Philippines was 92.34 million and its GDP was \$212.3 billion. Altogether the Philippines-EU FTA would cover 594.8 million people and with a GDP of \$15.35 trillion. This suggests a large market size, auguring well for the benefit of the FTA; however the incremental market size in terms of GDP is minimal (1.4% increase over EU GDP) owing to the large size of EU GDP compared to the GDP of the Philippines.

On per capita basis, in 2010 the income of the Filipino is only \$2,300 whereas that of the European is well over \$30,000; as the per capita income disparity is large, there is little to be expected by way of increased intra-industry trade.

Geographically, the Philippines and EU are not neighbors. There exists vast distance between the continents they belong to—Asia and Europe. Clearly, there is no land transport links between them, only sea and air links. The high transportation costs between Philippines and EU is a major determinant in the direction of agricultural trade: agricultural produce, fresh, frozen, or chilled products face high costs of entering the EU market. Agricultural products that can be economically shipped from the Philippines to EU (and vice-versa) will likely be in processed form. This accounts for the pattern of trade between the Philippines and EU, discussed in the following.

Size of trade within FTA

Exports of the Philippines to EU account for about a quarter of its agricultural exports (Table 3). In comparison, its exports to ASEAN are relatively low in comparison, totaling less than one-tenth. The top Philippine export commodities are coconut oil; fruits (mainly banana and pineapple); followed by food preparations, and aquatic products.

About 44% of coconut oil exports, a similar percentage of exports of meat and fish preparations, and just 12% of vegetable extracts exports, head to EU. Hence we expect increased market access to EU have the greatest impact for Philippine exporters of these products.

While these shares in Philippine exports appear to be large, the contribution of the Philippines to EU imports is minimal. Of all the coconut/palm oil imports of EU, only 1.48% was sourced from the Philippines; the share of the Philippines in rubber is larger though at 8%. As for the rest of the commodities, the share of the Philippines was very small, (below 1% of total EU imports). Gains to EU consumers (and conversely, losses of EU producers) may be deemed minimal given these shares.

Table 3: Shares in Total Philippine Agricultural Exports by Commodity and Place of Destination, average of 2008-2010 (%)

Commodity	EU	ASEAN	Other countries	Total
Coconut	12.2	0.9	14.6	27.7
Meat, fish and seafood food preparations	4.0	0.2	5.0	9.1
Edible fruit, nuts, peel of citrus, melons	2.2	0.7	15.3	18.2
Vegetable saps, extracts etc	1.5	0.1	1.3	2.8
Vegetable, fruit, nut, etc food preparations	1.3	0.8	7.6	9.7
Fish, crustaceans, molluscs, etc	1.0	0.7	7.1	8.7
Tobacco unmanufactured	0.5	0.3	1.7	2.5
Oil seed, oleagic fruits, grain, etc	0.2	0.2	0.4	0.8
Miscellaneous edible preparations	0.1	0.5	1.9	2.5
Others	0.4	7.6	9.8	17.9
TOTAL	23.4	12.0	64.6	100.0

Source: trademap.org

Nevertheless over time, the share of agricultural products in the total Philippine exports to EU has been increasing rapidly. The share more than doubled from 5% in 2001-2001 to 10.6% in 2009-2010. This increase is largely brought about by the increased share of oils and fats, and of fish and other sea products. Oils and fats exports to EU are increasing possibly because of EU's biofuel sector demand (Cororaton and Corong, 2012).

On the import side, in 2008-2010, EU accounts for only a minor share of Philippine agricultural imports (just 8%); in contrast, 38% of agricultural imports of the Philippines are from ASEAN, mostly due to rice imports (included in the 'Others' category). Philippine imports from EU were dominated by cereal, flour and milk products, miscellaneous edible preparations, and food industry residues. If the Philippines were to reduce its tariff, there may be little positive effect on EU's exports to the Philippines, as well as on Filipino consumers.

Table 4: Shares in Total Philippine Agricultural Imports by Commodity and Place of Origin, Average of 2008-2010, in percent

Commodity	EU	ASEAN	Other countries	Total
Cereal, flour, starch, milk products	1.3	1.4	0.6	3.4
Miscellaneous edible preparations	1.3	3.4	2.6	7.3
Residues, wastes of food industry, animal fodder	1.2	0.8	8.6	10.7
Dairy products, eggs, honey, edible animal products	0.9	0.6	8.6	10.1
Meat and edible meat offal	0.6	0.0	4.6	5.2
Cereals (except rice and corn)	0.3	0.1	10.6	11.0
Sugars and sugar confectionery	0.3	1.3	1.3	2.9
Animal, vegetable fats and oils	0.2	2.4	0.3	2.9
Vegetable, fruit, nut, etc food preparations	0.2	0.3	1.1	1.6
Others	1.5	27.5	16.0	45.0
TOTAL	7.8	37.8	54.4	100.0

Source: trademap.org

Trade barriers within the FTA

Tariffs: Overall tariff levels of the Philippines are declining but are still restricting imports in selected sectors. In 2010, more than half or 60% of the tariff lines were between 0% and 5%. Thirty-four percent of tariff lines lay between 7% and 15%, while the only 7% were at 20%.² The weighted average of tariffs in agriculture have declined from 24% to just 12%; the rate of decline in manufacturing was faster, from a weighted average of 32% to just 6% (Table 5).

Table 5: Weighted average of tariffs by sector, 1990 – 2010, selected years (%)

	Agriculture	Manufacturing
1990 – 1994	23.6	32.3
1995 – 1999	19.5	23.2
2000	16.6	18.7
2005	14.4	15.2
2010	11.9	6.2

Source: Tariff Commission <http://www.tariffcommission.gov.ph/trp.html>.

Most of the commodities that have more than 20% tariff are agricultural products; imports may be smaller precisely because of high tariffs, or due to other trade barriers. Hence taking a weighted average of tariffs based on import share (a standard practice in the literature) is misleading as a measure of aggregate protection. Table 6 shows the major agricultural products, by value of output; sugar has the highest tariff rate of 65%. Other products applying high tariffs are rice and maize at 50%. These commodities account for rice, maize and sugar account for 34%. Together with the longer list of commodities with 40% tariff (pork, chicken, onion, cabbage, carrot, cassava, potato, and coffee), nearly two-thirds of agricultural output is shielded by a tariff wall of 40% or higher. The list of commodities with at least this level of tariff, comprise the typical sensitive list, which are either excluded from or given special treatment in every trade agreement that the Philippines has joined.

Table 6: Tariff tiers in percent and corresponding product categories (AHTN), applied rates

Tiers (out-quota rate)	Product category	Cumulative percentage of output value
65	Raw sugar	3.0
50	Rice, maize	33.6
40	Pork, chicken, onion, cabbage, carrot, cassava, potato, coffee	65.6
25	Lettuce, broccoli, cauliflower	NA
20	Assorted other vegetables	NA
15	Assorted frozen fish products; fruits, groundnuts, pepper, oils	NA
10, 7, 5, 3, 1	Other products	100.0

Notes:

1. Output value is the average value of output (2008-2010) valued at 2000 prices.
2. NA – not available.

Source: Briones (2011).

² www.tariffcommission.gov.ph

The relevance of these tariffs on Philippines-EU trade relations is a different matter however owing to the composition of the trade. On the EU side, the applied and bound tariffs are almost identical. By tariff line, agricultural products are insulated from competition, thus they have higher rates than non-agricultural items (European Commission and EU-ASEAN Vision Group, 2006). EU's simple average MFN tariff on agricultural products is currently 9%. Tobacco products among other agricultural items imported by EU from the Philippines face the highest level of tariff (Table 7).³ This is followed by vegetable and fruit preparations. The rates are moderate, between 15 and 20 percent, with some (but not much) leeway for further reductions. In particular, for the country's biggest export to EU, which is coconut oil, the tariff rate is already low (about 7%). The tariff is a somewhat higher for meat, fish, and seafood preparations, therefore some space for further cuts are possible.

Table 7: Total ad valorem equivalent tariff (estimated) charged by EU on Philippine products (2-digit level)

Commodity	Tariff rates (%)
Coconut	6.7
Meat, fish and seafood food preparations	15.2
Edible fruit, nuts, peel of citrus, melons	8.1
Vegetable saps, extracts etc	1.3
Vegetable, fruit, nut, etc food preparations	17.6
Fish, crustaceans, molluscs, etc	6.1
Tobacco	19.2
Oil seed, oleagic fruits, grain, etc	0.2

Source: macmap.org

On the Philippine side, EU exporters are subjected to the MFN tariff regime as specified under WTO (Table 8). The highest tariffs on EU exports are on confectionary products at 65%; this is followed by meat products (as much as 40%) and miscellaneous edible preparations (3 to 40%). For most products the tariff rates are at modest levels, up to 10 or at most 15%. Reductions in tariff rates for these products may not confer significant advantages to EU exporters of these products to the Philippines.

Table 8: Tariffs imposed by the Philippines on EU exports

Commodity	Tariff rates (%)
Cereal, flour, starch, milk products	3 – 7
Miscellaneous edible preparations	3 – 40
Dairy products, eggs, honey, edible animal products	3 – 10
Meat and edible meat offal	5 – 40
Cereals (except rice and corn)	3
Sugars and sugar confectionery	65
Animal, vegetable fats and oils	3 – 15
Vegetable, fruit, nut, etc food preparations	7 – 15
Tobacco	7 – 10

Source of tariff data: tariffcommission.gov.ph

³ http://www.wto.org/english/tratop_e/agric_e/ag_intro02_access_e.htm#conceptual

Non-tariff barriers. Aside from the tariff barriers, several non-tariff barriers (NTBs) or non-tariff measures (NTMs) distort international trade. The ASEAN Secretariat has compiled NTBs as reported by member countries based on the categories of UNCTAD, summarized in Table 9.

Table 9: Most prevalent NTBs practiced by ASEAN member countries, by number of tariff lines affected (Preliminary estimates)

Non-tariff barriers	Tariff lines
Customs surcharges	2,683
Additional Charges	126
Single Channel for Imports	65
State-trading Administration	10
Technical Measures	568
Product Characteristic Requirement	407
Marketing Requirements	3
Technical Regulations	3

Source: ASEAN Secretariat

A simple count of NTBs provides little idea of the potential impact of such barriers. This is remedied in a study by Dean et al (2006), cited by de Dios (2006), which estimated NTMs effects on prices of commodities. In the case of the Philippines, NTMs raised retail price of fruits and vegetables by 156% and bovine meat retail prices by 82% (Table 10). This is broadly similar to the effects of NTMs in other ASEAN member countries, though Thailand's appear to have the least distortionary effect. Philippine NTBs are most stringent for sensitive products; however as we have seen they comprise only small shares of EU exports to the Philippines, hence relaxing these NTBs within a Philippines - EU FTA would effect minimal changes in import penetration in these products.

Table 10: Price Impact Estimates of Dean et al (%)

Sector	Indonesia	Malaysia	Philippines	Singapore	Thailand
Fruits and vegetables	205	184	156	168	73
Bovine meat	82	97	82	109	75
Processed Food	112	94	105		93
Apparel			-15		

Source: Dean et al. (2006)

Meanwhile with respect to NTBs imposed by EU, 6.6% of Philippine exports to EU face non-tariff measures according to Pasadilla and Liao (2007). Among those are bananas, tunas and sweet biscuits. The non-tariff measures usually implemented on these Philippine exports are “authorization, prior surveillance, product characteristic and labeling requirements”.⁴

These NTBs adversely affect small-scale exporters because the costs of complying with the advanced product safety standards are very high (Pasadilla and Liao, 2007). Nonetheless, the

⁴ The most affected item is tuna; fisheries issues are taken up in a separate PIDS study.

Agreement on Agriculture does not hinder the use of NTBs provided they meet provisions of other WTO agreements, e.g. general safeguard provisions under the General Agreements on Tariffs and Trade (GATT) , and Agreement on the Application of Sanitary and Phytosanitary (SPS) measures. The main objective of the SPS Agreement is to protect the life and/or health of humans, animals and plants against pests, disease-carrying or disease-causing organisms. In general, the WTO Agreements promote reliance on internationally accepted standards, guidelines and recommendations whenever available; sanitary and phytosanitary measures of member countries must be harmonized on the basis of Codex Alimentarius and other international standards.

Member countries may apply stricter standards; however imposition of higher standards requires a scientific basis, with due notice given to other member countries. Moreover the standards must be imposed in a manner that is least restrictive of trade.⁵

Comparative Statics

Next we consider comparative static analysis, projecting changes in economic outcomes upon elimination of tariffs between the Philippines and EU. Unfortunately, reductions of NTBs are omitted in the comparative statics.

Economy wide effects

For the economy as a whole the impacts of the bilateral free trade scenario are as follows:

- Real GDP of the Philippines improves by 0.15%; the price level declines by 0.12%.
- Exports and imports increase by 0.36% and 0.33%, respectively, as the price level declines.
- With lower consumer prices, total consumption is increased by 0.16%.

By basic sector, the tariff elimination boosts exports as well as imports, with net change in output price unclear. Disaggregation of percentage changes by basic sector is shown in Table 11. In general both exports and imports increase; export price increases (except for services), while import price decreases. Agriculture experiences the greatest relative expansion in the volume of both exports and imports. The net effect is positive for output volume of the basic sectors, including agriculture; however output volume in agriculture rises least, compared to industry and services.

Table 11: Effects on Aggregate Sectors in the Philippines, % change from base

	Output		Exports		Domestic demand		Imports		Consumption	
	Volume	Price	Volume	Price	Volume	Price	Volume	Price	Volume	Price
Agriculture	0.074	-0.022	0.381	0.152	0.060	-0.031	0.423	-0.191	0.056	-0.030
Industry	0.133	-0.120	0.368	0.022	0.032	-0.183	0.380	-0.280	0.151	-0.178
Services	0.175	-0.064	0.266	-0.122	0.170	-0.061	0.083	-0.001	0.208	-0.059

Source: Cororaton and Corong (2012)

⁵ http://www.wto.org/english/thewto_e/whatis_e/tif_e/agrm4_e.htm

Output prices decline in all three sectors. Output prices in agriculture declines the least, which appears to favor domestic producers (compared to producers of industry and services). Domestic consumption however grows least for agriculture, with industry and services experiencing a greater decline in consumption price as well as bigger increase in consumption volume.

As the output price of agriculture, which is the most labor-intensive among other sectors, increases relative to industry, the real wage of labor improves. The real wage improvement is slightly higher for unskilled labor (0.44%) than for skilled (0.43%). It follows that returns to capital go down, in this case, a 0.05% fall (the Stolper-Samuelson effect). Skilled labor shifts from the agriculture and industry sector to the services sector, while unskilled labor moves from the agriculture to both industry and services sectors.

Because of this improvement in wage and decline in consumer prices, real income of households increases. The distribution of the increase in income, and its impact on the poor, requires further analysis using the CGE model and microsimulation. The analysis indicates that this real income effect reduces poverty (Table 12). Poverty incidence reduction (0.493 percentage point) in rural areas is higher than urban areas (0.153 percentage point). This implies that more households are taken out of poverty since most of the poor households are situated in agricultural areas. Moreover, this leads to a slight improvement in the overall poverty incidence—a drop from 26.3% to 26%. The greater decrease in poverty gap and squared poverty gap, compared with poverty incidence, implies that those who belong to households below the poverty threshold get the most benefits. That is, not only is bilateral tariff elimination *pro-poor*, it is *pro-poorer*.

Table 12: Simulation results on poverty indicators, bilateral tariff elimination scenario

	Poverty Index	Base	Simulated	Percentage point difference
Philippines	Incidence	26.343	26.019	-0.324
	Poverty gap	7.238	7.103	-0.135
	Squared poverty gap	2.809	2.747	-0.062
Urban	Incidence	12.064	11.911	-0.153
	Poverty gap	2.744	2.684	-0.06
	Squared poverty gap	0.938	0.915	-0.023
Rural	Incidence	40.282	39.789	-0.493
	Poverty gap	11.626	11.417	-0.209
	Squared poverty gap	4.635	4.536	-0.099

Source: Cororaton and Corong (2012)

Effects on agriculture by subsector

The effects of the bilateral tariff elimination on the different sectors within the agricultural sector are shown in Table 13. This table suggests that the output of most agricultural commodities increases slightly due to the FTA. The sub-sectors that have the largest increase are seaweeds and sugarcane, with 0.80% and 0.50%, respectively. The small magnitudes of increase are easily explained in the examination of static factors, namely the small size of initial trade with EU, and the low to moderate levels of initial tariff. Even coconut oil, which exports over two-fifths of output to EU, experiences a lift of 0.14%, in part due to the low initial tariff charged by EU.

Table 13: Changes in output and trade by agricultural sub-sector (%), CGE simulation

Description	Output	Exports	Imports
Seaweeds	0.7975	0.7998	0.4474
Sugarcane	0.5041	0.2941	0.0000
Other fiber crops	0.2983	0.6342	0.8014
Pineapple	0.2672	0.3075	0.0000
Banana	0.2301	0.2843	0.0000
Ocean fishing	0.2164	0.0000	0.0000
Tobacco leaf	0.2119	0.5831	0.0214
Mango	0.2077	0.2940	0.0000
Ornamental, horticulture and herbal plants	0.1813	0.5762	0.4698
Shrimp, prawns and other aquaculture	0.1489	0.3325	-0.3528
Citrus Fruits	0.1470	0.2453	0.3220
Pearl culture and pearl shell gathering	0.1383	0.3375	-0.1768
Coconut	0.1376	0.2026	0.0000
Vegetables	0.0978	0.1863	0.3527
Agricultural services	0.0961	0.0000	0.2474
Other fruits and nuts	0.0939	0.1800	0.3622
Inland and coastal fishing	0.0894	0.0000	-0.0444
Coffee (raw)	0.0843	0.5282	0.3454
Abaca	0.0831	0.5126	0.4119
Other poultry	0.0787	0.1443	4.5689
Cocoa	0.0769	0.5094	0.0000
Other livestock including dairy production	0.0751	0.0636	0.0548
Carabao	0.0623	0.0000	0.0000
Paddy	0.0490	0.0000	0.0000
Other vegetables, roots, tubers	0.0403	0.4573	0.3650
Other crops	0.0389	0.0454	0.0112
Corn	0.0099	-0.0195	0.1994
Forestry	0.0043	0.5805	-0.2697
Hog	-0.0372	0.0000	4.6862
Chicken	-0.0605	0.0492	4.6225
Rubber	-0.1702	0.0000	0.0000
Cattle	-0.6209	0.0000	3.2984

Source: Cororaton and Corong (2012)

The increases in output are driven by increases in exports; in only one case (corn) does export decline. The increased access on EU markets favors Philippine exporters of seaweeds, other fiber crops, tobacco leaf, forestry, ornamental plants, raw coffee, abaca, and cocoa. The export volumes of the said commodities are expected to go up but only by small percentages.

On the import side, nearly all subsectors receive slightly more imports. Again the small increases are to be expected. However the simulation indicates that cattle imports increase by 3.30%, chicken by 4.62%, and hog by 4.69%. Compared to the other import impacts these are extraordinarily large. Not surprisingly therefore, cattle, chicken, and hog, all experience a decline in output (despite small increases on the export side). Rubber also undergoes an output contraction despite experiencing no changes in exports or imports; this is entirely due to resource re-allocation within the domestic economy.

5. Conclusion

To summarize: the potential impact on the agricultural sector is positive, but the gains should not be exaggerated. Static analysis shows that the size of trade, or even potential trade, is small owing to high transport costs between the Philippines and EU. Moreover barriers to agricultural trade, whether tariff or non-tariff, are relatively low for agricultural products that are significant in bilateral trade, with the exception of fisheries (the subject of another study).

These expectations are confirmed in the comparative static analysis using CGE simulations. The output of most agricultural commodities slightly increases as a result of bilateral tariff elimination. The sub-sectors that have the largest increase are seaweeds and sugarcane, with 0.80% and 0.50%, respectively. As output increases, some domestic producers also increase their exports. The increased access on EU markets provides great opportunities for Philippine exporters of seaweeds, other fiber crops, tobacco leaf, forestry, ornamental plants, raw coffee, abaca, and cocoa. The export volumes of the said commodities are expected to go up but by small percentages only. Meanwhile the subsectors that are on the losing side (as shown by declining output) are cattle, raw rubber, chicken, and hog. The output contraction is 0.62%, 0.17%, 0.06%, 0.04%, respectively. Cattle imports increase by 3.30%, chicken by 4.62%, and hog by 4.69%. Note however that Filipino consumers are likely to gain from increased competition, expansion of imports, and reduction in the price. By similar token, Filipino consumers are disadvantaged by rising exports as they face competition from EU buyers, placing an upward pressure on prices.

In terms of sectoral effects, the agriculture is the least positively affected sector compared to industry and services. Netting out positive and negative effects, output prices in agriculture declines by 0.02%; however compared to the industry and services sector this is the lowest reduction.

Fears about the negative repercussions of Philippines-EU FTA on the poor turn out to be unfounded. Poverty incidence reduction (0.493 percentage point) in rural areas is higher than urban areas (0.153 percentage point). This implies that more households are taken out of poverty since most of the poor households are situated in agricultural areas. Moreover, this leads to a slight improvement in the overall poverty incidence—a drop from 26.3% to 26%. The greater decrease in poverty gap and squared poverty gap, compared with poverty incidence, implies that those who belong to households below the poverty threshold get the most benefits. Pro-poor impacts can be explained fairly simply as follows: since the output price of agriculture, which is the most labor-intensive among other sectors, increases relative to industry, the real wage of

labor improves. The real wage improvement is slightly higher for unskilled labor (0.44%) than skilled (0.43%). Because of this improvement in wage and decline in consumer prices, real income of households increases.

These evidences show that the overall impact of Philippines-EU FTA in the agricultural sector is positive but limited. It would seem that large benefits that might be expected from a Philippines – EU FTA will not be found in agriculture, but elsewhere. Conversely, the agricultural sector does not face significant harm from a Philippines - EU FTA, even one involving sensitive products. Relaxation of trade barriers to EU even for sensitive products is warranted; not only would consumers gain (though minimally), but such a negotiation stance may serve as a powerful bargaining chip for gaining concessions on other areas.

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