

Philippine — European Union Economic and Political Relations: An Assessment¹

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In the early 1980s, there was, on Philippine university campuses, very little interest in European studies. Today, after nearly a generation, on every level, even the undergraduates, there is a serious interest in European studies. This, in my view, is a welcome development, even as it comes as a by-product of the process of globalization which has shrunk our world into a global village. I wish in this short essay to cover the economic and political dimensions of the bilateral relationship between the Philippines and the European Union, which currently includes 15 constituent states.² With a view, on the one hand, to the economic dimension of this relationship and, on the other, to its political dimension, I will focus on its trade and investment content, as well as on the various exercises of the power of coercion or persuasion through which one group seeks to impose its will upon another, provided, of course, that such a use of power is inspired by an honest search for what is beneficial and advantageous to every party in the relationship. In this search for what is mutually beneficial, the parties must be driven by their respective interests which, fortunately, often include some shared values that lead to a constructive process of cooperation. The Philippines and the European Union share the principles of liberty, democracy, respect for human rights and basic freedoms, and the rule of law. It is their shared respect for these fundamental principles which forms the basis for their cooperation in trade, finance and investment.

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²The European Union comprises Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the United Kingdom.

The Philippine-European Union trade relationship is the most concrete, meaningful, recurrent and mutually beneficial form of their bilateral cooperation, even as it is commercially driven. This is because what they trade as partners are products that they are very good at producing. Philippine exports to the European Union rose by more than three-fold from \$2 billion in 1993 to \$6.78 billion by 1999, with export growth averaging 22% annually. In the seven-year period 1993-99, about 33.92% of Philippine exports to the European Union were shipped to The Netherlands, 26.89% to the United Kingdom, 21.53% to Germany, 5.52% to France, 2.71% to Belgium, 2.51% to Italy, 2.27% to Ireland, 1.69% to Spain, 0.96% to Sweden, 0.67% to Denmark, less than half a percent each to Austria, Greece and Portugal, with Luxembourg accounting for one-hundredth of a percent of all the export shipments of the Philippines to the European Union. By the end of 1997, the European Union had displaced Japan as the second largest market for Philippine exports, after the United States of America, and this remained the case in 1999.

However, Philippine importation from the European Union has not fared as well, with imports growing just about 8% annually in 1993-1999. During this period, Germany supplied 30.71% of Philippine imports from the European Union, the United Kingdom 14.69%, France 12.53%, Netherlands 10.65%, Italy 7.57%, Belgium 6.04%, Ireland 4.92%, Sweden 4.53%, Finland 3.27%, Spain 2.56%, Denmark 1.27%, Austria 0.95%, with Greece, Luxembourg and Portugal each supplying less than half of a percent. While Philippine importation from the European Union accelerated between 1993 and 1996 from \$1.9 billion to \$3.6 billion, this pace was not sustained. It decelerated some 11% in 1997 to \$4 billion, and by end-1998 the rate of Philippine importation from the European Union had shrunk 30.6% to \$2.790 billion. Behind this sharp drop was retarding growth in the Philippine economy that, since 1997, has resulted in a decrease in its pace of importation from the European Union. It further dipped marginally to \$2.786 billion in 1999.

This trend also characterized the rate of Philippine importation from the United States of America and, to some extent, from Japan up to 1998. By the end of 1999, however, Philippine importation from Japan had risen by 1.7%. For the entire period 1993-99, however, Japan managed to sell twice as much exports to the Philippines as the European Union did, while the United States of America for all its physical distance sold

1.85 times more exports to the Philippines than the European Union. This particular configuration of relative trade performance raises a number of tough questions. Why are the Japanese and the Americans outselling the Europeans in the Philippine import market? Are relative costs of production in the European Union higher than they are in Japan and the United States of America? Are Japan and America necessarily more competitive than Europe in international trade finance? Is European multi-lingualism standing in the way of trade documentation and adding to the overall cost of doing trade? I won't address these questions at this point; I simply raise them.

Let me turn next to the investment flows from the European Union to the Philippines over the same period 1993-99. Going by the records of their registration — which, if these investments are to be serviced by the domestic banking system, needs to be accomplished — with the foreign exchange department in the Bangko Sentral ng Pilipinas, European Union investments in the Philippines during this period totaled \$20,148 billion. Some 93% of these investments are new while 7% are re-investments. As much as 91% are portfolio investments and the other 9% are direct equity investments. European Union investments in the Philippines steadily rose from \$667.1 million in 1993 through 1996 when they peaked at \$4.23 billion, falling to \$4.05 billion in 1997, and dropping sharply to \$2.28 billion in 1998. This sharp decline was the outcome of a large contraction in portfolio investment as the Asian financial crisis developed in mid-1997, scaring away European investors from further investment in the Asia-Pacific region. But, during 1999, as they managed to summon more confidence in the recovery of the region, the European investors increased their investments in the Philippines to \$4.82 billion, surpassing their record for 1996.

The United Kingdom accounts for 74.8% of the European Union investments in the Philippines, with Luxembourg accounting for 9.59%, The Netherlands for 6.73%, Germany for 4.01%, France for 1.40%, Belgium for 1.32%, Sweden for 0.94%, and Ireland for 0.48%. The rest of the Union individually account for considerably less than half of a percent. Finland, The Netherlands, Portugal, and Spain generally (more than 50% of the time) engage in direct equity investments, whereas Austria, Belgium, Denmark, France, Germany, Greece, Ireland, Italy, Luxembourg, Sweden, and the United Kingdom generally engage in portfolio investments.

During the period 1994-1999, 64.3% of direct equity investments from the European Union, totaling \$1.64 billion, were allocated to manufacturing activities in the Philippines, another 11.8% to public utilities, 11.4% to commerce, 10.1% to financial institutions, 1.4% to service industries, 0.5% to mining, 0.3% to construction, with marginal amounts ending up in agriculture and other sectors of the Philippine economy. This pattern of direct equity investments suggests that the European Union is actively helping the Philippines grow in the industrial dimension of its economy to the extent that any expansion of its manufacturing activities absorbs redundant labor released from its farms following gains in agricultural productivity. The logic of agricultural productivity implies that one does not need as many farmhands as before to produce the same amount of food. As these surplus farmhands lose their jobs on the farm, alternative jobs in the industrial sector of the national economy must increase fast enough to absorb them in manufacturing so long as there is a positive growth in the country's labor force. This labor force expands with a population growth that currently averages 2% every 12 months across the Philippine archipelago, or by more than 1.5 million persons.

Beyond adding to its pace of capital formation and creating jobs in the industrial sector of the Philippine economy, the direct equity investments of the European Union also transfer production technology, organizational and managerial skills, as well as abilities for innovation to the Filipino labor. At the same time, because of their global network of markets all over the world, the European Union, by their direct equity investments in manufacturing activities, practically open up international markets to the Philippines without too much start-up costs in trade promotion budgets if the country were to access these global markets on its own account. All told, the overall competitiveness of Philippine manufacturing gets vitally improved in pace with the growing globalization of world production and trade.

Having taken a look at the trade and investment content of the Philippines-European Union partnership, the time has probably come to look ahead and anticipate circumstances in either the Philippines or the European Union which spoil this relationship or perhaps retard its further growth and development in the next century. It should be clear from all the foregoing evidence out of the trade and investment flows during 1997-99 that what happens in the European Union or the

Philippine economy is terribly vital because economic fundamentals either drive up growth or spoil its future.

Among the first circumstances, which have a large potential of messing up the future partnership between the Philippines and the European Union, is the prevalence in both places of fairly high levels of joblessness. Concerning this, the latest count (April 2000) in the Philippines tells us that as much as 13.9% of its national labor force is unemployed, while more than one-fifth of it is under-employed. In many parts of the European Union today, particularly in Finland, France, Germany, Greece, Italy, Sweden and Spain, similar or higher rates of joblessness also prevail even as the European Commission last Friday (25 August 2000) estimated that as much as 8.1% of the civilian labor force in the European Union (EU) are currently unemployed. This is twice as high a rate of unemployment as that in the US economy where unemployment is 4% (July 2000).³ Joblessness at these levels constrain their respective abilities to do more trade with one another, as well as the capacity of the European Union to do more direct equity investments in the Philippines unless real returns on investment adjusted for exchange rate volatility are far better in Philippine industries.

The depreciation of the euro from \$1.1825 downward since 4 January 1999, in both nominal and real effective terms, is a reflection of the high unemployment rate in the European Union. The euro currently trades at \$0.8993.⁴ The consequence is that as the euro continues to depreciate and weaken, it becomes less attractive as a reserve asset for central banks all over the world. The outbreak of the Kosovo war last 24 March 1999 simply highlighted the fundamental weakness of the euro and exposed its vulnerability to a breakdown in peace and security in the outskirts of the European Union. And, as central banks dump the euro as a reserve currency, this will frustrate the emergence of the euro as a dominant currency in global trade and finance well before it even circulates as transferable currency on 1 January 2002. The overall growth in the European Union of 3.3%⁵ while the US economy is surging ahead at the rate of 5.2%⁶ does not help reassure holders of euro

³*International Herald Tribune*, 5-6 August 2000, p.9.

⁴*CNBC Screen*, 29 August 2000, 1115hrs.

⁵For First Quarter 2000, *Eurostat Website Screen*, 28 August 2000.

⁶For Second Quarter 2000, *The Asian Wall Street Journal*, 31 July 2000, p.2.

accounts that the euro will soon regain its inaugural trading value of \$1.1825.

A second circumstance which could disrupt trade and investment flows between the European Union and the Philippines is the enlargement of the European Union over the next several years as it integrates central and eastern Europe into itself. This enlargement program is part of the European Commission's Agenda 2000 which was adopted for funding by the Berlin European Council last 24-25 March 1999. The year before, the European Union initiated bilateral negotiations with Cyprus, the Czech Republic, Estonia, Hungary, Poland and Slovenia on their terms of accession to the Union which include their assumption of the obligations of membership (i.e., *acquis communautaire*) and the adoption of suitable administrative structures. In addition, Bulgaria, Latvia, Lithuania, Romania, and Slovakia have likewise applied for membership in the European Union. As and when this enlargement process gets completed, the European Union will have become a community of 540 million people, with more than one-fifth of the global GDP (gross domestic product) worth \$7918 billion and accounting for over 20% of all world trade.

Arguably, this enlargement can stimulate higher growth in the European Union over the long haul. However, in the transition, as these 11 new members get integrated into the Single Market of the European Union, their market access to the EU Single Market becomes wider with the disappearance of border taxes. On the other hand, the market access of imports from the Philippines continues to be ridden with EU border taxes. Accordingly, trade diversion cutting back on imports from the Philippines would be highly probable, especially in those tradeable goods in which geographic distance is a critical factor in the decision to buy.

A third circumstance, which is interwoven with the enlargement of the European Union, is its objective to implement a common foreign and security policy under its mandate in the November 1993 Treaty of the European Union. In practice, this leads to a common defense policy for the European Union, and possibly its emergence as a global power in its own right. However, before this happens and as the Kosovo war has amply demonstrated, enormous amounts of investment in all manner of armaments including the research and development, which goes into inventing smart weaponry, would have to be allocated by the Eu-

ropean Union in order to raise common standards of military preparedness throughout its enlarged jurisdiction.

That these standards of military preparedness need upgrading has also been fairly evident during the Kosovo war as it extended from week to week with American fighter and transport aircraft as well as naval carriers the most visible and numerous military hardware mobilized by the NATO campaign against Serbia. Europe looked mightily dependent on the United States of America for air transport of troops, strategic reconnaissance and laser-guided bombs, while its military arm in the Western European Union was nowhere to be seen. This pathetic condition of European military preparedness has been the unfortunate outcome of a 10-year cutback in military budgets by governments down to 2.1% of the gross national product (GNP) of Europe, while the United States all along kept its military spending at 3.2% of its GNP.

However, as this needed renaissance in the arms race gets going to make up for a decade of neglect, the European Union risks draining considerable parts of its social surplus in armaments rather than in more productive investments that reduce joblessness and drive up its growth as well as its capacity to import from the rest of the global economy including the Philippines. As the disintegration in recent history of the Soviet Union shows, massive investments today in the tools of war can bleed a community of the very means by which it can expect to grow in the future. When one adds to this the graying of the population in many parts of the European Union, embarking upon a new cycle of the arms race at a time when a large proportion of its people are moving on to retireable age would seem like squandering one's prospects for this millennium.

A fourth circumstance which could stand in the way of a larger bilateral commercial and financial cooperation emanates from Philippine participation in the ASEAN Free Trade Area (AFTA). As decided in the Sixth ASEAN Summit held in Hanoi last December 1998, the establishment of AFTA throughout Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore, and Thailand is to be completed by year 2002. This implies an acceleration in their implementation of the common effective preferential tariff (CEPT) scheme. For the Philippines, by year 2000, it has to bring down its import tariff to 0% for as much as 85% of its Inclusion List. By year 2001, the zero tariff treatment will cover as much as 90% of the Philippine Inclusion List. And by year 2002, the

coverage for zero-to-5% tariff treatment will have extended to 100% of the Philippine Inclusion List.

With this acceleration in its participation in the ASEAN/CEPT program of trade liberalization, the average Philippine tariff on imports from its ASEAN trading partners will have dropped from just over 5% down to a little above 3% by year 2003. For imports from non-ASEAN countries, the full MFN (most-favored-nation) rates apply. This implies that for products which are either directly competitive or close substitutes to those supplied by the European Union, the market access is considerably reduced as the preferential tariff rate on comparable products supplied by the other ASEAN trading partners of the Philippines will have been cut by as much as 40%. There will be trade diversion from exporters of the European Union to those from Philippines' other ASEAN trading partners.

How can exporters from the European Union compete in the import market of the Philippines in the transition to the ASEAN/CEPT Scheme? To get around the ASEAN/CEPT wall, they can relocate their production facilities out of Europe to the Philippines and keep their competitive foothold in its import market. Already, this process of industrial re-structuring has been seized upon by Korean, Japanese and Taiwanese exporters to the Philippines who have read and learned from the signs on the wall since 1993 when the average ASEAN/CEPT rate dropped more than 60% from 12.76% to 5.05% by end-1998. By this time, too, Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand could not impose more than 20% tariff on any one product they have accredited in their Inclusion Lists under the ASEAN/CEPT Scheme. For the whole ASEAN region, the average CEPT rate will have fallen some 30% from 3.74% in year 2000 down to 2.63% by year 2003. Having looked at the large picture, let me next turn to a number of concerns which have surfaced over the last few years and probably still continue to be a source of irritation to both the Philippines and the European Union. The first of these is the European Union's enforcement on 30 June 1998 of the Special Incentive Arrangements (SIA) to its Generalized System of Preferences (GSP). The origins of the GSP go as far back as 1956 when a new chapter on trade and development was added by the Contracting Parties to the General Agreement on Tariffs and Trade (GATT) as they recognized the need to reduce unilaterally their tariffs and quotas on the exports of

developing countries without having to extend these same preferences to the developed countries. Accordingly, in 1970 the European Free Trade Association (EFTA), the European Economic Community (EEC) and the United States of America agreed to give preferences to a list of manufactures they imported from developing countries, which were enforced in 1971 for the next ten years though subject to annual review.

For agricultural products, the European Union's SIA/GSP extend an additional tariff cut of 10% on the Common Customs Tariff (CCT) for very sensitive products, 20% for sensitive products and 35% for semi-sensitive products. In the case of industrial products, the comparable reductions are 15% for very sensitive products, 25% for sensitive products and 35% for semi-sensitive products. However, to be eligible for these additional preferences, developing countries that apply for them commit to legislate domestic laws enforcing (1) the International Labor Organization's (ILO) Conventions No. 87 on workers' right to organize, No. 98 on collective bargaining, and No. 138 on the minimum age for employment; and, (2) environmental standards for sustainable management of tropical forests as defined in the International Tropical Timber Organization (ITTO). Although the European Union's SIA/GSP program for industrial products ended on 31 December 1998 and that on agricultural products concluded on 30 June 1999, what needs to be stressed here is that such a program, which has the effect of trading additional preferences for additional undertakings on labor rights and environmental practices, is not in the spirit of the historically unilateral character of these preferences as enunciated in the 1956 amendment of the GATT. The Philippines as a bona fide member of the International Labor Organization has already assumed the obligations of membership. And, as a member of the World Trade Organization (WTO), the Philippines is actively participating in the WTO Committee on Trade and Environment precisely to highlight the principle of non-discriminatory trade.

As the European Union unilaterally promulgated EC Council Regulation No. 1154/98 on 25 May 1998 implementing its SIA/GSP program, it led to an erosion in the market access of the garment exports of the Philippines to the European Union worth \$187.3 million in 1997, as well as the market access of other industrial products exports worth \$173.2 million. This promulgation is simply a unilateral use or exercise of power by the European Union on its trading partner, the Philippines.

Its ironic consequence is the displacement of Filipino labor in 1998 to the extent that Philippine exporters to the European Union whose market access had eroded by virtue of this promulgation failed to find alternative markets elsewhere in the world market and have had to close shop. When a shop closes, jobs get lost along the way and there are no more workers around to organize into labor unions in the image and likeness of the ILO.

The second outstanding issue in the bilateral relations of the European Union and the Philippines concerns the protracted peace negotiations between the Government of the Philippines and the National Democratic Front (NDF). These negotiations have been the subject of two recent Resolutions of the European Parliament, one on 17 July 1997 and the other on 14 January 1999. In both instances, the European Parliament has requested both the European Commission and the European Council to provide and facilitate support and assistance to both the Philippine Government and the NDF in carrying out their formal peace negotiations, in implementing the 1998 Comprehensive Agreement on Respect for Human Rights and International Humanitarian Law as well as in undertaking development, relief and rehabilitation programs to lay the ground for a just and lasting peace. In addition, the Government has also insisted that these negotiations be held in the Philippines because, by the principle of democratic representation, the larger membership of the NDF reside in the country and not in Europe.

A third outstanding issue concerns the implementation of the Comprehensive Agrarian Reform Program (CARP), which is the subject of the 20 November 1997 Resolution of the European Parliament. Since 1986, the European Union has assisted heavily in this Program, whose implementation since then has had its twists and turns as the financial resources required for a thorough and effective agrarian reform have been difficult to find and as government sometimes took inconsistent motions reversing its own decisions on a number of cases like in Sumilao, Bukidnon and four other though similar cases in Bataan, Bulacan, Cavite and Rizal. The present Government provided a new impetus to put more coherence into the implementation of the CARP program. Its details are included in the Medium-Term Development Plan which the Administration has adopted.

A final outstanding issue involves the capital punishment which current laws in the Philippines allow for heinous crimes. This was the

subject of the 17 September 1998 Resolution of the European Parliament which reaffirmed the June 1998 decision of the European Council of Foreign Ministers to step up action by the European Union against the death penalty. Rather than addressing this Resolution to the Government of the Philippines, the European Parliament would do well to address it to the Congress of the Republic of the Philippines, which under the presidential form of government mandated by the Constitution of the Philippines, has the sole prerogative under the principle of separation of powers underlying the political structure of the Philippines to review the existing law on capital punishment. If the Congress of the Republic of the Philippines finds it in its wisdom to abolish the death penalty, the Government will simply comply with the new law.

In conclusion, it is rather apparent from the foregoing that there is plenty of homework for both the Philippines and the European Union to do in the current millennium toward enriching the fabric of their political relationship to their mutual benefit. A key component of this homework is to achieve sound economic fundamentals in both jurisdictions. These are vital to sustain growth that promotes a deep and broad commercial relation. With growth, there will be more trade between the European Union and the Philippines. Another major part of this homework is the need to keep close consultations with one another to avoid the sort of unilateral exercise of power such as the 25 May 1998 SIA/GSP program which tended to disrupt trade flows between the Philippines and the European Union. Both are *bona fide* members of the World Trade Organization and the United Nations International Labor Organization. Both are competent bodies to handle problems within their respective core competencies. Handling such problems unilaterally conjures up the image of a dominant power imposing its will on and taking advantage of the less powerful. This would be quite difficult to comprehend for parties to a relationship that share a common belief in liberty, democracy, respect for human rights and basic freedoms, and an esteem for the rule of law. 