

Services Liberalization in the Philippines: A Capacity Needs Assessment for AEC 2015

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ABSTRACT

The paper aims to assess and determine the capacity-building needs required to liberalize trade in services in the Philippines. Through the ASEAN Framework Agreement on Services, the Philippines has committed to liberalize various sectors including air transport, maritime transport, construction, financial services, and telecommunications. The overall progress of services liberalization has been modest compared to trade in goods due mainly to constitutional restrictions, limitations on market access, and application of the national treatment principle. Apart from these constitutional and legal constraints, the other obstacles to services liberalization include high cost of doing business, inadequate infrastructure, and governance issues affecting the competitiveness of industries, among others.

Clear gaps in the capacity of national agencies and regulators to effectively implement the country's services liberalization commitments exist. To address these, the paper suggests capacity building and technical assistance as part of a comprehensive trade strategy covering both goods and services, formulating roadmaps for the various services sectors, and enhancing current coordination mechanisms among government agencies, private sector, and civil society.

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INTRODUCTION

Recognizing the importance of the services sector in the ASEAN economies, the ASEAN Economic Ministers (AEM) and ASEAN country officials embarked on a services liberalization project by signing the ASEAN Framework Agreement in Services (AFAS) in December 1995 in Bangkok. AFAS is critical to the formation of the ASEAN Economic Community (AEC). This will necessitate a critical mass of stakeholders of public officials and private and civil society sector leaders to be aware of the significant economic gains to individual countries from services liberalization. Member-countries also need to adopt an appropriate regulatory environment (particularly in less developed ASEAN member-states), strong institutions, supportive infrastructure, and enhanced policy coordination and coherence. A further requirement is effective capacity building among ASEAN member-states across a broad and diverse range of relevant areas to realize this goal.

The paper aims to assess and determine the constraints and capacity-building needs required to liberalize trade in services in the Philippines. This will be done from a systemic, institutional, and sectoral perspective, highlighting selected sectors and cross-cutting and/or economy-wide issues. The paper will propose activities and methods of delivery to address the capacity-building needs arising from identified “binding constraints” to key services. A survey interview of major stakeholders was carried out to gather information on their views, opinions, and experiences on the impact of previous services liberalization, identify issues and constraints, and suggest possible capacity-building activities to facilitate the implementation of the country’s services commitments under the AEC.

The report is divided into six sections. After the introduction, the second section analyzes the current state of the services sector’s growth and structure. The third section reviews the country’s services liberalization policy with focus on the country’s ASEAN services commitments. The fourth section examines the current institutional arrangement and assesses the horizontal issues affecting liberalization and discusses sector-specific issues in sectors such as wholesale and retail, tourism, consulting/legal services, telecommunications, and health. The last section presents the paper’s recommendations.

CURRENT STATE OF THE PHILIPPINE SERVICES SECTOR

Since the 1980s, the services sector has been a major source of economic growth for the Philippines. On the average, the growth rate of the sector increased continuously particularly in the last two decades, from 4 percent in the 1990s to 5.3 percent in the 2000s. Broad growth took place in the sector as most of its subsectors registered consistently rising growth rates during the same periods. In contrast, both agriculture and industry experienced sluggish growth in the 1980s and 1990s with modest gains registered in the current period (Table 1).

Table 1. Average growth rates by sector (in percent, at constant 1985 prices)

Year	1981–90	1991–00	2001–10
Gross domestic product	1.8	3.1	4.7
1. Agriculture, fishery, forestry	1.2	1.9	3.0
Agriculture industry	2.0	2.2	3.0
Forestry	-9.1	-16.7	-1.0
2. Industry sector	1.1	2.5	4.6
Mining and quarrying	2.5	-0.1	13.5
Manufacturing	1.1	2.6	4.1
3. Services sector	2.5	4.0	5.3
Construction	-0.8	5.0	2.8
Electricity, gas, and water	4.7	5.8	4.1
Transport, communication, and storage	3.5	5.2	6.6
Trade	3.0	3.9	5.7
Finance	3.1	4.7	7.3
Dwellings and real estate	2.4	1.9	4.0
Private services	5.3	3.7	7.2
Government services	3.7	2.9	2.7

Source of basic data: *National accounts of the Philippines*, National Statistical Coordination Board (NSCB)

Within the services sector, the transportation, communication, and storage as well as finance and private services subsectors have registered continuously rising growth rates since the 1980s. In the current period, finance posted the highest average growth rate of 7.3 percent together with private services with an average growth rate of 7.2 percent. Transportation, communication, and storage followed with an average growth of 6.6 percent.

The Philippine economy's output structure is characterized by a relatively large services sector (Table 2). Its share continued to increase from an average of 49 percent in the 1980s to 52 percent in the 1990s and 56 percent in the most recent period. Trade constituted the bulk of the services sector followed by transportation, communication, and storage and private services subsectors.

In terms of employment contribution, the services sector has become the largest provider of employment in the most recent period (Table 3). The share of the labor force employed in the sector consistently increased from around 49 percent in the 1980s to 52 percent in the 1990s to 56 percent in the 2000s. The share of industry to total employment has been almost stagnant, even declining from 10.5 percent in the 1980s to 9.5 percent in the most recent period under review.

Table 2. Value-added structure by major economic sector

Year	1981–90	1991–00	2001–10
Agriculture, fishery, forestry	23.4	21.3	18.9
Agriculture industry	22.1	20.5	18.8
Forestry	1.8	0.3	0.1
Industry sector	27.4	26.3	25.4
Mining and quarrying	1.7	1.3	1.7
Manufacturing	25.7	25.0	23.7
Service sector	49.2	52.4	55.7
Construction	7.1	5.6	4.5
Electricity, gas, and water	2.6	3.1	3.2
Transportation, communication, and storage	5.4	6.2	8.4
Trade	14.0	15.4	16.8
Finance	3.5	4.5	5.4
Private services	6.5	7.0	8.3
Government services	4.7	5.2	4.4

Source of basic data: *National accounts of the Philippines*, NSCB

Table 3. Structure of employment (in percent)

Major Sector	1980–89	1990–99	2000–10
Agriculture, fishery, and forestry	48.9	42.0	36.2
Industry	10.5	10.6	9.5
Mining and quarrying	0.6	0.4	0.4
Manufacturing	9.8	10.2	9.1
Services	40.6	47.3	54.3
Electricity, gas, and water	0.4	0.4	0.4
Construction	3.6	5.1	5.2
Wholesale and retail trade	12.9	14.8	18.7
Transportation, storage, and communication	4.5	6.1	7.5
Financing, insurance, real estate, and business services	1.8	2.3	3.5
Community, social, and personal services	17.4	18.6	19.0
Industry, not elsewhere classified	0.02	0.05	0.00

Sources: *Yearbook of labor statistics* (1980–2000) and *Current labor statistics* (2001–2002), Bureau of Labor and Employment Statistics, Department of Labor and Employment; and *Employed Persons by Major Industry Group, Labor force survey* (2003–2010), National Statistics Office

Based on the Philippine balance-of-payments accounts, the average exports growth in services increased substantially from 5 percent during the period 2000–2005 to 25 percent during the period 2006–2010. Net services trade balance shifted from continuous deficits during the first half of the 2000s to surpluses during the last five years. A change in the structure of services exports is evident as exports of travel, transportation, and communication services declined in importance while the average shares of computer and information and other business services increased (Table 4). Business process outsourcing, an important source of services export receipts, is under other business services.

SERVICES LIBERALIZATION

Unilateral liberalization

Unlike goods, services are generally intangible and their imports do not have tariffs. Instead, service industries are characterized by government-imposed restrictions such as the regulation of both market access and the nature and scope of operations of service providers. Considerations relating to consumer protection, high fixed (sunk) costs (increasing returns to scale), prudential supervision, and regulatory oversight often induce governments to put in place measures that regulate cross-border trade in services, require domestic establishment by foreign providers in certain service sectors, or reserve activities for government-owned or controlled entities (Hoekman 2006).

In general, barriers to trade in services are classified in terms of whether they restrict market access in general (e.g., a policy that limits the number of service providers) or specifically affect foreign services suppliers by refusing them national treatment (e.g., a policy that limits foreign equity ownership). Regulatory restrictions can reduce competition and efficiency in the services sector. Entry barriers reduce competition and allow incumbent firms to engage in rent-seeking behavior.

In the Philippines, the first wave of unilateral reforms in the services sector took place in 1987 with the opening up of generation in the power sector. This abolished the monopoly of the government-owned National Power Corporation by allowing private sector to invest and participate in augmenting generation capacity. In 1990, the first build-operate-transfer (BOT) in Asia was passed. In 2001, the Electric Power Industry Reform Act (EPIRA) was legislated. It restructured the industry by allowing competition in generation and supply and regulating transmission and distribution. Another wave of reforms occurred in the early 1990s with the liberalization of the telecommunications industry that was dominated by a private monopoly for more than half a century. The shipping industry was also liberalized with the deregulation of first- and second-class

Table 4. Trade in services (in USD million)

Indicator/Year	2000	2005	2006	2007	2008	2009	2010	2000– 2005	2006– 2010
Services	-1870	-1340	137	2249	1438	2114	1946	-1873	1577
EXPORTS	3377	4525	6444	9766	10194	11014	13243	5%*	25%*
IMPORTS	5247	5865	6307	7517	8756	8900	11297	2%*	14%*
Transportation	-1588	-2163	-2301	-2521	-2887	-2508	-3578		
Exports	464	962	1151	1323	1368	1153	1351	22%	13%
Imports	2052	3125	3452	3844	4255	3661	4929		
Travel	514	986	2269	3270	2175	-368	-606		
Exports	2156	2265	3501	4933	4388	2330	2783	53%	38%
Imports	1642	1279	1232	1663	2213	2698	3389		
Communication	121	407	477	418	257	231	151		
Exports	182	522	575	517	404	354	305	11%	5%
Imports	61	115	98	99	147	123	154		
Construction	-27	59	54	92	57	58	100		
Exports	97	66	69	113	90	78	121	2%	1%
Imports	124	7	15	21	33	20	21		
Insurance	-143	-186	-209	-229	-241	-176	-234		
Exports	12	17	21	22	18	59	77	0	0
Imports	155	203	230	251	259	235	311		
Financial	47	-40	-24	-123	-23	-55	-36		
Exports	80	53	101	87	59	70	38	1%	1%
Imports	33	93	125	210	82	125	74		
Computer and information	-23	27	28	243	320	1657	2042		
Exports	76	89	95	305	400	1748	2151	1%	8%
Imports	99	62	67	62	80	91	109		
Royalties and license fees	-190	-259	-343	-380	-382	-419	-441		
Exports	7	6	6	5		2	4	0	0
Imports	197	265	349	385	382	421	445		
Other business services	-495	-114	263	1605	2376	3923	4797		
Exports	285	525	898	2439	3446	5186	6372	9%	34%
Imports	780	639	635	834	1070	1263	1575		

Table 4. (Cont'd.)

Indicator/Year	2000	2005	2006	2007	2008	2009	2010	2000– 2005	2006– 2010
Personal, cultural, and recreational services	-14	11	19		-5	-8	-18		
Exports	18	20	27	22	21	34	41	0	0
Imports	32	9	8	22	26	42	59		
Government services	-72	-68	-96	-126	-209	-221	-231		
Exports						0	0	0	0
Imports	72	68	96	126	209	221	231		

Source: PIDS and Bangko Sentral ng Pilipinas (Balance of Payments Accounts)

Note: Numbers with * represent percent change, otherwise these refer to average shares.

passage rates. Subsequently, surcharges for insurance premiums were abolished while freight rates for cargoes were deregulated.

In the mid-1990s, the air transport industry was also deregulated thus challenging the supremacy of the country's only designated flag carrier, Philippine Airlines. Restrictions on domestic routes and frequencies and government controls on rates and charges were eliminated. In the late 1990s, the water sector was privatized through competitive bidding won by two firms that were granted concessions to bill and collect water and sewerage services in two separate areas for 25 years.

As early as the 1980s, the financial sector was undergoing reforms through the liberalization of interest rates and the easing of restrictions on the operations of financial institutions (Milo and Pasadilla 2004). In the mid-1990s, Republic Act (RA) 7721 (Foreign Bank Liberalization of 1994) allowed the establishment of 10 new foreign banks in the Philippines. With the legislation of RA 8791 (General Banking Law) in 2000, a seven-year window was provided allowing foreign banks to own up to 100 percent of one locally incorporated commercial or thrift bank with no obligation to divest later.

In March 2000, RA 8762 (Retail Trade Liberalization Law) allowed foreign investors to enter the retail business and 100-percent ownership as long as they put up a minimum of USD 7.5 million equity.² A lower minimum capitalization threshold of USD 250,000 is allowed for foreigners seeking full ownership of

² Singapore and Hong Kong have no minimum capital requirement while Thailand sets it at USD 250,000.

firms engaged in high-end or luxury products. RA 8762 also allowed foreign companies to engage in rice and corn trade.

The initial efforts to liberalize the airline industry facilitated the entry of new airlines in the industry that was dominated by only one airline, Philippine Airlines, for 22 years. Austria (2002) noted that with greater competition on the major routes, domestic travel has grown rapidly after deregulation. Competition arising from promotional and discount fares has continued to open the air industry to travelers who could not afford to travel by air prior to deregulation. Competition has intensified resulting in lower airfare, improvement in the quality of service, and overall efficiency in the industry.

In 2003, the Strong Republic Nautical Highway (SRNH) program was inaugurated through Executive Order (EO) 170 that aimed to improve existing ports to facilitate a road roll-on, roll-off (RORO) terminal system (RRTS). Combining roads, ports, and shipping routes to create a highway through the sea using RORO ferry terminals and vessels, the SRNH would link the islands of Luzon, Visayas, and Mindanao. Along with other legislations, the RRTS would be integrated into the national highway system. The RORO facilities have reduced handling time and stevedoring costs leading to faster transport of goods. The development of the RRTS enabled firms to cut down their transportation and logistics costs with savings of up to 50 percent compared to traditional liner shipping costs (Basilio 2008).

Generally, in sectors such as telecommunications, power, ports, and shipping, the absence of clear rules and appropriate regulatory framework as well as efficient regulators has limited the impact of reforms on competition. In telecommunications, interconnection still remains a regulatory challenge and strengthening the National Telecommunications Commission as an independent regulatory body would be crucial. In air transport, reforms need to be deepened through a complete open skies policy. In ports, a regulatory framework is needed that would separate Philippine Ports Authority's regulatory responsibilities from its development and operations functions. In shipping, strengthening the Maritime Industry Authority (MARINA) is necessary so that it can effectively implement the competitive reforms provided by the law. In both ports and shipping, institution building is important to promote greater competition and effective regulation. This would entail developing new skills, institutional capabilities, and practices in regulating unfair or anticompetitive practices.

Moreover, there are domestic legal barriers to entry and investment in these sectors that must be addressed, particularly constitutional restrictions limiting foreign equity participation to 40 percent. Table 5 summarizes government restrictions and regulations affecting the services sectors. Cabotage, for instance, prevents foreign firms from competing with domestic shipping firms in providing

Table 5. Government restrictions and regulations in the services sector

Sector	Government Restrictions/Regulations
Wholesale and retail trade	<ul style="list-style-type: none"> • Foreigners are not allowed to own land but can lease for a maximum of 75 years. • Foreign investment is not allowed in certain categories such as retail trade enterprises with paid-up capital of less than USD 2.5 million or less than USD 250,000 or retailers of luxury goods. Full foreign participation is allowed for retail trade enterprises with paid-up capital above these levels. • Foreign investors are required to comply with performance requirements: the Retail Trade Liberalization Act 2000 requires foreign retailers, for 10 years after the bill's enactment, to source at least 30 percent (for retail enterprises capitalized at no less than USD 2.5 million) or 10 percent (for those specializing in luxury goods) of their inventory, by value, in the Philippines.
Telecommunications	<ul style="list-style-type: none"> • The Philippine Constitution limits foreign ownership to 40 percent. • Foreigners are restricted from serving as executives or managers of telecommunications companies. • The proportion of foreign directors in telecommunications companies may not exceed that of the foreign component of a company's capital stock. • Foreign equity in private radio communications networks is constitutionally limited to 20 percent. • Operation of cable television and other forms of broadcasting and media is also reserved for Philippine nationals.
Maritime	<ul style="list-style-type: none"> • Foreign equity limits to 40 percent. • Monopolistic structure of public ports controlled by the Philippine Ports Authority.
Air transport	<ul style="list-style-type: none"> • Foreign equity limits to 40 percent.
Road	<ul style="list-style-type: none"> • Foreign equity limits to 40 percent.
Electricity	<ul style="list-style-type: none"> • Foreign equity limits to 40 percent.
Water	<ul style="list-style-type: none"> • Foreign equity limits to 40 percent.
Health services	<ul style="list-style-type: none"> • Foreign equity ownership limited to 40 percent for hospitals (full foreign ownership allowed for health maintenance organizations).
Postal services	<ul style="list-style-type: none"> • Government monopoly
Education	<ul style="list-style-type: none"> • Foreign equity limits to 40 percent

Source: Aldaba and Pasadilla (2010)

shipping services as they are only allowed to directly transport passengers or cargo to designated international ports like Manila International Container Port, Manila South Harbor, Batangas, Limay (Bataan), and Davao. Foreigners are also not allowed to own land but can lease for a maximum of 75 years.

Regional liberalization through AFAS

Since 1997, ASEAN has emphasized the need to liberalize services trade through the adoption of the AFAS. The AFAS aims to substantially eliminate trade

restrictions in services among member-countries and promote efficiency and competitiveness of ASEAN service suppliers. Aside from the main obligations of market access and national treatment, AFAS establishes general guidelines for mutual recognition, denial of benefits, dispute settlement, institutional mechanism, and other areas of cooperation in the services sector. Similar to the General Agreement on Trade in Services (GATS), the AFAS adopts a “positive list or bottom-up” approach in service trade liberalization wherein only those sectors that are ready to liberalize are listed by the member-countries. For each sector or subsector on the positive list, commitments are made for market access and national treatment across each of the four modes³ of supply (United Nations et al. 2002). Trade in services liberalization under AFAS is directed toward achieving commitments beyond the member-countries’ commitments under the GATS. Presently, ASEAN has concluded eight Packages of Commitments.

The Philippines has also signed seven mutual recognition arrangements (MRAs) in the following professional services: Engineering Services (December 9, 2005), Nursing Services (December 8, 2006), Architecture (November 19, 2007), Land Surveying (November 19, 2007), Medical Practice (February 26, 2009), Dental Practice (February 26, 2009), and Accountancy (February 26, 2009) [see the section on MRAs for a more detailed discussion].

Table 6 lists the various sectors included in the commitments that the Philippines made from the 1997 first package up to the 2009 seventh package. There has been an expansion in the services sectors covered particularly from 2006 to 2009. With only two sectors (business services and tourism) covered in the initial package in 1997, the Philippines has expanded its offered sectors starting in the second package in 1998 to include air transport, maritime transport, construction, financial services, and telecommunications. It further widened coverage in the fifth package in 2006 to include all transport and auxiliary services, computer services, distribution, rental and leasing, environmental, health-related, and social services. The sixth package added research and development, real estate, services related to energy and power generation, audiovisual services, recreational, cultural, and sporting services. The seventh package in 2009 added more subsectors, including religious services. However, upon examining the seventh package, many of the subsectors are still unbound in terms of modes 3 and 4. Furthermore, there are

³ Mode 1: Cross-Border Supply, where only the services cross the borders (independent of the suppliers or consumers). Services travel through telecommunication or sending of documents electronically.

Mode 2: Consumption Abroad, where consumers cross the borders to consume services.

Mode 3: Commercial Presence, where suppliers and capitals cross the borders to establish local offices or subsidiaries.

Mode 4: Movement of Natural Persons, where the suppliers are physically present in a country on a temporary basis.

limitations on market access and national treatment for many of the subsectors especially for modes 3 and 4.

Examining the services restrictiveness index covering AFAS and ASEAN +1 free trade agreements, Ishido and Fukunaga (2012) showed that the Philippines has the lowest level of commitment relative to other ASEAN countries based on the calculated Hoekman Indices.⁴ Note that the ASEAN average for the AFAS Seventh Package was also low at 0.36, with Thailand at 0.50, Cambodia at 0.41, Indonesia at 0.36, and the Philippines at only 0.33.

Previous AFAS assessment studies (Thahn and Bartlett 2006; Poretti et al. 2009) concluded that the various rounds of negotiations that took place so far have not produced substantive preferential liberalization for the country as the Philippines' AFAS commitments rarely go beyond what it pledged in its GATS Schedule of Specific Commitments at the end of the Uruguay Round. Comparing the Philippine commitments under the GATS and AFAS, the coverage and depth of the two frameworks is substantially similar, with the AFAS only minimally going beyond what the Philippines bound at the multilateral framework (Thanh and Bartlett 2006; Poretti et al. 2009).

The services sector has become an important and continuously expanding provider of both output and employment. Developing a more efficient services sector would have both direct and indirect effects on economic growth and would lead to an increase in aggregate productivity. An efficient services sector would make other sectors in the economy become more competitive. For instance, high-quality services in sectors like transport or telecommunications could affect the production costs and competitiveness of firms in all sectors of the economy (Aldaba and Pasadilla 2010). Note however that, though the Philippines has implemented unilateral liberalization in the sector since the late 1980s, the country still remains protective of the services sector. Discriminatory and market access barriers still characterize the sector in general. Remaining restrictions include foreign equity limitations, economic needs tests, and domestic regulations affecting business operations.

Trade in services is an important component of the country's development strategy. To transform the sector into a major source of growth requires substantial efforts to make it more competitive and efficient. Introducing competition through services liberalization under the AEC 2015 might serve as a catalyst to foster the sector's competitiveness. The empirical literature on the linkages between services liberalization and economic growth shows that policy reforms

⁴ The Hoekman Index is a measure of the GATS-style degree of commitment in the services sector. The method assigns values to each of eight cells (4 modes and 2 aspects, market access or national treatment as follows: a value of 1 is assigned when the sector is fully liberalized; 0.5 when limited but bound; and 0 when unbound [government has not committed to liberalize]). See Ishido and Fukunaga (2012).

Table 6. Philippine commitments in the ASEAN Framework Agreement on Services (AFAS)*

AFAS Package	Sectors Covered
First Package (1997)	<ul style="list-style-type: none"> • Business services • Tourism
Second Package (1998)	<ul style="list-style-type: none"> • Air transport • Business/Professional services • Construction • Financial services • Maritime transport • Telecommunications • Tourism
Third Package (2001)	<ul style="list-style-type: none"> • Transport services
Fourth Package (2004)	<ul style="list-style-type: none"> • Transport services • Maritime services
Fifth Package (2006)	<ul style="list-style-type: none"> • Business services • Computer services • Rental/Leasing services without operators • Telecommunication services • Construction and engineering-related services • Distribution services • Environmental services • Health-related and social services • Tourism and travel-related services • Maritime transport • Rail transport services • Road transport services • Services auxiliary to all modes of transport
Sixth Package (2007)	<ul style="list-style-type: none"> • Business services • Computer-related services • Research and development services • Real estate services • Rental leasing without operators • Other business services • Services related to the supply of energy • Services related to power generation • Communication services • Telecommunication services • Audiovisual services • Construction and engineering-related services • Distribution services • Environmental services • Health-related and social services • Tourism and travel-related services • Recreational, cultural, and sporting services • Maritime transport • Rail transport services • Road transport services • Services auxiliary to all modes of transport

Table 6. (Cont'd.)

AFAS Package	Sectors Covered
Seventh (2009) Package	<ul style="list-style-type: none"> • Business services • Computer-related services • Research and development services • Real estate services • Rental leasing without operators • Other business services • Communication services • Telecommunication services • Audiovisual services • Construction and engineering-related services • Distribution services • Retailing services • Environmental services • Health-related and social services • Tourism and travel-related services • Recreational, cultural, and sporting services • Maritime transport • Rail transport services • Road transport services • Pipeline transport • Services auxiliary to all modes of transport • Services related to the supply of energy • Services related to power generation • Religious services

* Eight packages were already signed; however, there are still no details on the Eighth Package
Source: ASEAN Secretariat

that increase competition and improve regulatory oversight result in improved performance of the sector concerned. As earlier pointed out, an efficient services sector has indirect consequences for economic growth. For instance, a competitive and efficient services market will result in a more competitive and efficient manufacturing sector. Moreover, high-quality services could also result in increasing the attractiveness of a country for foreign direct investment (FDI). To realize these, a sustained process of domestic policy reforms and changes in the regulatory environment aligned with our regional and multilateral liberalization commitments would be crucial.

OBSTACLES TO SERVICES LIBERALIZATION AND THE NEED FOR CAPACITY BUILDING

The institutional arrangement for trade

Trade policymaking in the Philippines is done by consensus through the Tariff and Related Matters (TRM) Committee. The TRM was organized in 1987 to advise the president and the National Economic and Development Authority (NEDA) Board on tariff and related matters (including trade and investment agreements

and shipping matters) and on the impact of international developments on the country as well as to coordinate national agency positions and recommend the country's positions in international trade negotiations. Under the TRM, there is a special Technical Committee on WTO Matters (TCWM) whose main function is to discuss and recommend Philippine positions/strategies on issues regarding the implementation of the country's commitments in the World Trade Organization (WTO) and continuing participation in the multilateral trading system. The Department of Trade and Industry-Bureau of International Trade Relations (DTI-BITR) provides technical support to the TCWM.

For services, the NEDA, being the lead agency of the TCWM's Services Subcommittee, acts as the main coordinator. The other agencies (Department of Environment and Natural Resources, Department of Transportation and Communication, Department of Trade and Industry, Department of Tourism, Department of Labor and Employment, Department of Energy, Bangko Sentral ng Pilipinas, Professional Regulation Commission, and Commission on Higher Education) handle trade issues affecting their particular sectors. Pasadilla (2006) argues that the current system is inefficient and characterized by institutional failures such as: (i) turf mentality among government agencies that paralyze interagency committees in formulating an overall position; (ii) lack of appreciation and capacity for trade research that should inform negotiating positions; (iii) unclear delineation of authority; and (iv) lack of suitable mechanisms for consultation and feedback on negotiation progress and impact. Given these weaknesses, Pasadilla (2006) suggests the creation of a government body with an official mandate to lead all international trade negotiations and coordinate with other government agencies and design final trade strategies and positions.⁵

Horizontal constraints

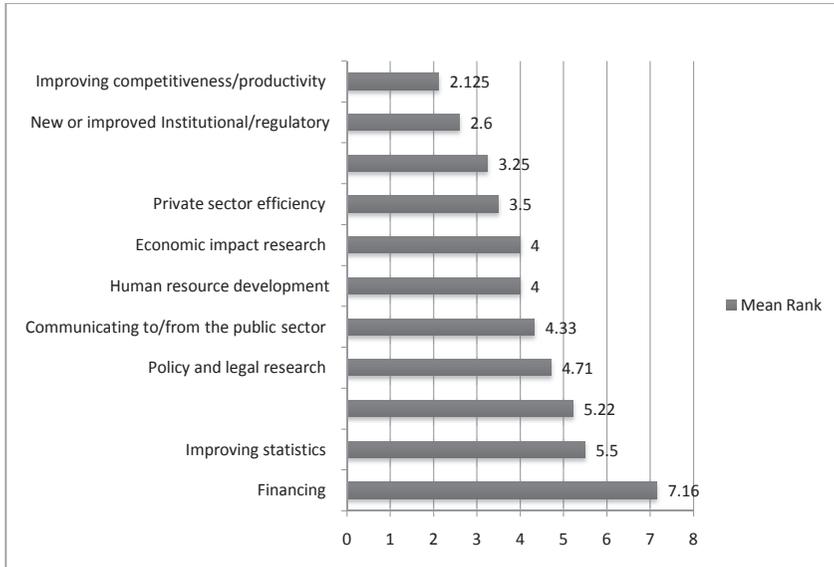
A survey interview of 21 major stakeholders⁶ from the government, private sector, and academe was carried out to gather information on their view, opinions, and experiences on the impact of previous services liberalization, identify issues and constraints, and suggest possible capacity-building activities to facilitate the country's services commitments under the AEC.

The "nationalistic" provisions in the Constitution (Article XII, Sections 2, 3, 10, 11, and 18) are the primary provisions affecting Mode 3 (foreign investments) in particular.⁷ While substantial progress has been made in liberalizing the

⁵ The problem with a pure coordinative role is that agencies are not obliged to follow the "anointed coordinator" because they treat each others as peers.

⁶ Composed of former government officials (12); representatives from research think tanks (2), exporters' group (2), and chamber of commerce (3); and researchers and academics (2).

⁷ <http://www.gov.ph/aboutphil/constitution.asp> (accessed on February 25, 2011).

Figure 1. Top cross-cutting constraints

Source: Author's compilation based on survey responses.

country's FDI policy, certain significant barriers to FDI entry still remain (Table 5). In terms of Mode 4, the labor market test stipulated in Article 40 of the Labor Code is a requirement for legitimate alien employment in the country.

Figure 1 shows the topmost important issues, namely, (i) improving competitiveness/productivity; (ii) new or improved institutional/regulatory issues, (iii) issues associated with transitional adjustment costs from liberalization; (iv) private sector efficiency; (v) economic impact research and human resource development issues; and (vi) communicating to/from the public sector. Respondents indicated that these key cross-cutting issues affect the sectors of logistics, health care, telecommunications, and legal services. These issues are discussed below.

Competitiveness/Productivity

Together with private sector efficiency, competitiveness and productivity are seen as the most important constraint affecting services liberalization.⁸ The private sector's perennial complaint is the high cost of doing business in the country. Firms need to be competitive to face heightened competition arising from liberalization.

⁸ Many respondents argued that private sector efficiency and firm productivity and competitiveness are directly related.

The environment in which firms operate must also be conducive to the growth of productive and efficient firms and industries.

Institutional/Regulatory issues

Respondents indicated institutional weaknesses and lack of coordination among the different national agencies responsible for formulating services policy and implementing the country's services commitments as key constraints. They perceived that the government has not done enough to align the positions of various sectors with the national interest. While the NEDA is the lead agency tasked to coordinate negotiations and other affairs related to the services sector, many stakeholders agreed that coordination on trade-related matters has been weak. This can be attributed to the diverse nature of the services sector as many government agencies are involved in the coordination and regulation of many subsectors. A lead agency with a strong mandate is needed whether this will be NEDA or DTI. Some interviewees also noted that legislators must be involved in policy discussions as they are the ones crafting and amending laws pertaining to the services sector.

Respondents also pointed out the generally weak institutions and governance failure in the Philippines. The country continues to suffer from a reputation of bureaucratic inefficiency, excessive red tape, and widespread corruption. In the 2011 *Doing Business* ranking, for example, the Philippines placed 156 out of 183 countries (IFC/WB 2010). It also ranked poorly in international comparisons of the enforcement of law and contracts, and competition measures. Property rights in the countryside remain insecure especially in the remaining areas under land reform. Excessive risks in large-scale investments can also arise from the bias, incompetence, or outright corruption in some regulatory agencies and other oversight bodies, as well as from a culture of litigiousness, encouraged by misplaced judicial activism. Local governments also impose their own share of arbitrary requirements and demands for corruption rents affecting investment and employment decisions of many small- and medium-scale enterprises.⁹

Communicating to/from the public sector

One of the major constraints in the facilitation of services liberalization is the lack of awareness and appreciation of key stakeholders of the benefits that these reforms will bring. Even among the bureaucracies involved in the process of liberalization, awareness is very low. Understanding liberalization and its national economic benefits among the private sector will soften the protectionist stance of the key professions. Lack of awareness also happens because of government's

⁹ These were statements from the draft Philippine Development Plan 2011–2016.

failure to sustain an information drive or simply to become transparent in its processes particularly in disseminating its main strategy and negotiation stances. There is also a need for fruitful engagement with the various stakeholders in the services sector and to revive the Philippine Services Coalition (PSC) so that the diverse services sector can be more organized. The private sector also seems to have a negative perception that the ASEAN and its secretariat cannot effectively implement all the agreements it had forged. It would help if multistakeholder forums are regularly held (at least annually) to update and discuss issues related to trade in services such as those held in Viet Nam in 2005 and in Singapore in 2007.

Economic impact research and studies

Some respondents pointed out the lack of an overall trade in services liberalization strategy. Although the Philippine Development Plan noted several services sectors (e.g., business process outsourcing, IT-related services, tourism, and construction) as key toward sustained economic growth, details of a comprehensive strategy cannot be found. Moreover, details on how the country will address issues confronting the sectors once these are opened up with respect to the AFAS commitments and the fulfillment of the AEC by 2015 are absent. Any specific plan or program for the services sectors must emanate from such an overall strategy.

The main difficulty in crafting such a strategy is the diversity of sectors and stakeholders involved. The comprehensive strategy must have the following elements:

- in-depth analyses of the impact of sector liberalization (cost and benefit analyses);
- a package of policy reforms and programs to facilitate the liberalization process;
- a strategy for information dissemination, constituency building, networking, and advocacy;
- adjustment alternatives and capacity-building initiatives in the transition toward liberalization; and
- a strategy for resource mobilization to finance adjustments during the transition.

For more precise information and evidence-based policymaking, there should also be reliable and available statistics and studies on the services sector. Analytical studies on the services sector especially on subsectors are scant with the most recent literature being those of Pasadilla (2006) and Poretti et al. (2009).

Human resources

Respondents noted that both NEDA and DTI need to recruit more staff members who are capable and competent to cope with various responsibilities (negotiations,

technical studies, coordination, advocacy, and information dissemination) as the process of services trade liberalization intensifies. The recent rationalization program in government has prohibited agencies to hire new staff. It has also been difficult to maintain good people in government because of the low compensation thus the high vulnerability of being pirated by the private sector and donor organizations. While consultants are able to assist in some of these needs, dependence on them will not be fruitful in the long run.

Financing

Respondents highlighted the importance of providing resources for various activities deemed important in the process of trade in services liberalization. These include funding for capacity building, coordination and networking, and grants for conducting studies and generating consistent and readily available statistics for the government and the private sector. More importantly, financing for “safety nets” is needed to support programs for potential losers in the transition toward liberalization. Financing for research and development (R&D) may also be needed to promote innovation as private sector funds are usually insufficient in this area. There should be advocacy for increased government allocation and a more systematic resource mobilization strategy in partnership with the private and civil society sectors. Government must also effectively coordinate available donor funding for these purposes.

Vertical constraints

Internal trade (wholesale and retail)

Foreign ownership is still restricted in small enterprises. Under RA 8762, foreigners can own enterprises with capital over USD 7.5 million, or those that provide luxury products with capital over USD 250,000. It was also only recently that the Supreme Court upheld the constitutionality of the Retail Trade Liberalization Act of 2000 or RA 8762, a decade after it was questioned by lawmakers as supposedly being anti-Filipino. Petitioners argued that RA 8762 violated provisions in the Constitution that places the national economy under the control of Filipinos to achieve equal distribution of opportunities, promote industrialization and full employment, and protect Filipino enterprise against unfair competition and trade policies. The Supreme Court noted that the petitioners were unable to show that the implementation of the law would prejudice them or inflict damage to them as taxpayers or legislators. What would be needed is to continue advocating for reforms allowing small and medium-sized foreign retailers through amendments to the law. An important component of this is to have strong consumer groups.

Tourism and air transport

A major issue in the tourism sector is the need to improve infrastructure like airports and roads. The opening up of air transport is a key concern. More recently, President Benigno Aquino III has signed two executive orders that will liberalize air transport services in areas outside Metro Manila to boost the tourism industry. His twin directives are contained in EO 28 and EO 29, which he signed on March 14, 2011. “Pocket open skies policy” in which foreign airlines would now be allowed to add flights to other parts of the country outside of their regular trips will promote domestic tourism by providing travellers with more and varied choices of access to the Philippines through improved and increased aviation services. There is still a need, however, for a sustained campaign on the benefits of an open skies policy.

Tourism and health care

Another issue important to tourism is the promotion of health care, retirement, and wellness as a “rising sector” identified by the local and foreign chambers. A key ingredient for the success of this sector is allowing foreign medical professionals in the target markets to practice in the Philippines. Hospital administrators interviewed in the survey explained that these professionals are needed to attract foreign clients (e.g., Japanese and European). Their entry, they argued, would not create a massive inflow of foreign medical doctors in the country as income differentials are still wide. It is therefore important to convince local medical practitioners that the benefits to openness far outweigh the costs. The conduct of market studies, dialogues, seminars, and workshops would be required.

Legal services¹⁰

Section 14, Article XII of the Constitution states that “[t]he practice of all professions in the Philippines shall be limited to Filipino citizens, save in cases prescribed by law.” As one law dean mentioned, “many Filipino lawyers have a protectionist mind” and they view the right to practice in the local bar as an adjunct of sovereignty. The Philippines only allows citizens who are residents and who acquired legal education in the country to practice the legal profession (Roque, undated). The emergence of cross-border practice, not only as potentially adopted by the Philippines, but also as currently engaged in by Filipino lawyers abroad, may necessitate adjustments in terms of the curriculum in law schools. The ASEAN Law Association, in its 2003 General Assembly, identified the need to train lawyers who are commercially relevant in an era where cross-border

¹⁰ Derived mostly from the speech of Supreme Court Justice Dante O. Tinga at the Commencement Exercises of the Ateneo de Manila School of Law on April 27, 2008.

transactions are increasingly the norm and to sensitize law students to the larger issues of globalization such as human rights and the environment.

Legal practitioners involved in providing international legal services are generally interested in providing “producer” or intermediate services concerned with commercial transactions and not “consumer” services that are typically final services (i.e., family, matrimonial, estate, personal injury, among others). Foreign lawyers are also not interested in obtaining a right of audience in courts of host jurisdictions except for a right to appear in international commercial arbitration. Generally, a foreign lawyer’s interest is in providing advisory legal services in home country law, third country law, and international law. These services comprise less than 20 percent of all the activities of the law profession. Supreme Court jurisprudence, however, recognizes the possibility of liberalization of the legal profession; in the case *Tanada vs. Angara*, the highest court ruled that the country’s membership in the WTO results in the derogation of its sovereignty but this is done in exchange for greater benefits (Roque, undated).

As cross-border practice becomes more prevalent, the need will arise for the adoption of international agreements governing the code of conduct of lawyers across countries. There should also be revisions in the curricula of Philippine law schools to include greater emphasis on international and comparative laws. Government could also enhance Mode 3 mechanisms where foreign entities are able to practice law and accounting through a commercial presence that ties up with local firms and also Mode 4 processes as the country already had previous experiences in having its lawyers contracted by foreign firms to represent them in projects implemented in other Asian countries while private firms and the government itself has hired foreign lawyers for representation in international cases (Roque, undated). Lawyer groups could also use the *Tanada vs. Angara* case as legal basis for the liberalization of legal profession (Roque, undated).

*Health care*¹¹

There has been rapid migration of doctors and nurses in recent years resulting in fears of the local health care system collapsing. Filipino health care professionals are underpaid compared to their counterparts in the region and this has motivated them to work overseas. There are also concerns that opening up the health care system to foreign service providers may result in a two-level health system that could crowd out local patients and divert resources to service foreigners. The country lacks the necessary data and information to help manage the plight of the health care industry and promote its potentials. Stakeholders noted that the country’s

¹¹ Derived mostly from Poretti et al. (2009).

health care statistics on key information such as number of hospitals, current and needed investments in health care, and number of professionals in the country and deployed abroad are not available. Existing mechanisms for industry-government dialogues are informal. Oftentimes, the issues of the industry are not heard on a regular basis. Stakeholders also complained about the lack of consultations and lack of capacity of certain negotiators to formulate a more holistic negotiations agenda for health care investments and services. Stakeholders noted the need to strengthen regional cooperation at the sectoral level to better appreciate regional developments in relation to professional development and regulation in the health care industry. In addition, they noted the need to enhance mutual recognition and licensing standards to allow competitive Filipino professionals to compete evenly as well as to encourage investments and technology transfers into the country.

CAPACITY GAPS AND NEEDS FOR TECHNICAL ASSISTANCE

The discussions with stakeholders show that there are clear gaps in the capacity of national agencies and regulators to effectively implement the country's services liberalization commitments. The different agencies do not have the financial resources and the technical capability to conduct in-house research to prepare comprehensive strategies, cost-benefit studies, and adjustment policies on liberalization. These agencies often rely on academic institutions or think tanks to conduct these studies, which are usually funded by foreign organizations. Apart from institution building, capacity strengthening is needed in trade research and strategy formulation; information, awareness, and advocacy campaigns; and basic services trade courses designed for regulators and lawmakers, and civil society groups. Table 7 summarizes the various capacity building and technical assistance needed to facilitate trade in services liberalization in the country based on the constraints identified.

CONCLUSION AND RECOMMENDATIONS

Trade in services is an important component of the country's path toward development and thus the impetus for continued ASEAN services liberalization in preparation for AEC 2015 should be sustained. Aligned with the approach of regional and multilateral liberalization in services is a sustained process of domestic policy reforms and changes in the regulatory environment that will promote expansion and innovation among the various players in the Philippine services sector. To achieve this, government must effectively partner with the private sector to craft an overall strategy for Philippine services. They should collaborate in addressing the various constraints, capacity gaps, and technical assistance needs to help realize the substantial benefits and opportunities that

Table 7. Key constraints and capacity-building needs

Constraints to Services Liberalization	Capacity Gaps and Technical Assistance Needs	Capacity-Building Program and Technical Assistance	Possible Delivery Modes
Lack of competitiveness and productivity; private sector inefficiencies	<ul style="list-style-type: none"> - lack of activities and programs to reduce cost of doing business - lack of activities and programs to promote entrepreneurship and innovation - lack of activities and programs advocating investment-friendly macroenvironment 	<ul style="list-style-type: none"> - public-private sector dialogues to tackle issues related to cost of doing business and investment-friendly environment - programs to boost entrepreneurship, R&D, and innovation 	<ul style="list-style-type: none"> - institution-building programs - establishment or enhancement of public-private sector mechanisms like consortium, coalition, etc. - workshops and fora on related issues - studies on how to reduce costs of doing business and improve investment environment - market linkages, market studies, technology transfers
Institutional and regulatory weaknesses	<ul style="list-style-type: none"> - lack of a comprehensive strategy on services sector liberalization and sectoral and subroadmaps - weak coordination among government agencies in issues related to the services sector - weak public-private engagements especially at the sectoral and subsectoral levels 	<ul style="list-style-type: none"> - crafting a comprehensive strategy on services sector liberalization and sectoral and subroadmaps - activities to strengthen coordination among government agencies in issues related to the services sector - enhancing public-private/civil society engagements especially at the sectoral and subsectoral levels 	<ul style="list-style-type: none"> - institution building for strengthening the coordination mechanism among government agencies through planning workshops, training programs, writeshops, etc. - institution-building program for establishment or enhancement of public-private sector mechanisms like the Philippine Services Coalition - planning workshops, secretariat support, and the like
Inadequate communication to/from the public	<ul style="list-style-type: none"> - lack of stakeholder and public awareness on the benefits of services liberalization - lack of information campaigns on the benefits of services liberalization - lack of key statistics on the services sectors - weak public-private engagements especially at the sectoral and subsectoral levels - negative perception on ASEAN's capacity to deliver 	<ul style="list-style-type: none"> - enhancing public-private/civil society engagements especially at the sectoral and subsectoral levels - studies on benefits and costs of liberalization - strengthening data collection and management for the services sectors - ASEAN-wide activities to inform stakeholders and discuss important issues 	<ul style="list-style-type: none"> - institution-building program for establishment or enhancement of public-private sector mechanisms like the Philippine Services Coalition - planning workshops, secretariat support, and the like - institution-building program for research institutes (e.g., Philippine APEC Study Center Network) - research grants, policy dialogues, grants to improve statistical data collection - ASEAN-wide workshops and fora

Table 7. (Cont'd.)

Constraints to Services Liberalization	Capacity Gaps and Technical Assistance Needs	Capacity-Building Program and Technical Assistance	Possible Delivery Modes
Human resource issues	<ul style="list-style-type: none"> - need to recruit more staff members who are capable and competent in handling various responsibilities (e.g., negotiations, technical studies, coordination, advocacy, information dissemination), which will increase as the liberalization of trade in services intensifies - lack of negotiating skills for some of the agencies involved with the services sector 	<ul style="list-style-type: none"> - crafting a strategy for human resource development for agencies involved in the services sector - capacity-building program for negotiators 	<ul style="list-style-type: none"> - interagency planning workshops and writeshops - actual training workshops, e-learning, mentoring
Financing issues	<ul style="list-style-type: none"> - lack of funding for capacity building, coordination, and networking, and grants for conducting studies and generating consistent and readily available statistics for the government and the private sector - sustainability of institutions and capability programs 	<ul style="list-style-type: none"> - mechanism for donor coordination - strategies for resource mobilization 	<ul style="list-style-type: none"> - coordinated mechanism for capacity-building programs and technical assistance - workshops and seminars on resource mobilization and financial sustainability

Source: Authors' compilation based on survey responses

can be gained from services trade liberalization. At the ASEAN level, ASEAN member-states (AMS) and the ASEAN Secretariat must work together to impress upon their members the critical importance of achieving the objectives of AEC.

The recommendations of the study are as follows:

Crafting and implementing a comprehensive trade in services strategy

- Draft a comprehensive strategy for trade in services aligned with the Philippine Development Plan 2011–2016.
- Strengthen the sharing of information across sectors.
- Enhance government-private sector/civil society coordination to conduct studies and develop a database that will provide information for policymaking and drafting subsectoral roadmaps.
- Broaden public awareness and undertake an information campaign on regional integration efforts such as the GATS, AEC, and AFAS, and disseminate the opportunities they bring to the services sector.

Building the capacity of the private sector

- Create roadmaps (with government coordinating this activity) for each subsector including identifying benchmarks toward enhancing their global competitiveness.
- Provide technical assistance to the private sector in organizing road shows, fairs, and exhibitions; design new services on export delivery systems to better serve the needs of customers (e.g., networking, one-stop shop, bundling, value-added concepts); and utilize technological developments to improve competitiveness especially of SMEs.
- Promote a culture of entrepreneurship and innovation.
- Help organize service providers into a consortium to synergize competencies; strengthen market intelligence, data gathering, and support for the management of information useful for sectoral development.

Enhancing institutions that support trade in services

- Address internal policy coordination weaknesses; institutionalize public-private sector mechanism to deliberate on the services strategy.

One possible framework is the US model of industry trade services advisory committees (ITACs) that provide inputs to the US Trade Representative. These ITACs, totaling 30, are legally mandated and their inputs are properly evaluated for inclusion in strategies and positions in negotiations.

- Strengthen coordination mechanisms and linkages among government agencies to support the competitiveness drive of various services subsectors.
- Conduct training and capacity building for government negotiators.

Priority areas of capacity building and technical assistance

- Craft a comprehensive services sector development strategy.
- Enhance the coordinating mechanism among government agencies.
- Enhance the collection of statistics and conduct studies on the services sector; build or strengthen existing consortium of research institutions and think tanks that carry out research on the services sector (e.g., Philippine APEC Study Center Network).
- Build a mechanism for continuous engagement among government, private sector, and civil society (e.g., revive the Philippine Services Coalition).
- Help build the private sector's capacity and competitiveness.
- Come up with an ASEAN-level information dissemination campaign to make stakeholders aware of the ASEAN Secretariat's activities in monitoring agreements and in assisting AMS in the process of liberalization and integration.

*Delivery methods for providing technical assistance and capacity building*¹²

- Develop a coordinated mechanism for selection of capacity-building programs and beneficiaries.
- Conduct more effective needs analysis and post-training monitoring and evaluation.
- Assign a responsible agency with a sense of ownership and ability to sustain efforts for capacity building
- Use nonconventional forms of delivering technical assistance such as e-learning, advisory services, mentoring, market linkage, and technology transfer.
- Conduct research cum policy dialogues and fora.
- Enhance or build institutions and coordinating mechanisms.

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¹² Derived mostly from Poretti et al. (2009) Table 7.

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