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LAW AND ECONOMIC DEVELOPMENT

The PHILJA Judicial Journal

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The PHILJA Judicial Journal

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THE PHILJA JUDICIAL JOURNAL

CONTENTS

Officials of the Supreme Court of the Philippines .... *iv*
Officials of the Philippine Judicial Academy .... *v*

I. SPEECHES

Law and Economics: Courts and the Economy
Justice Ameurfina A. Melencio Herrera 1

A Vision for Effective Economic Governance: The Need for a Partnership between the Courts and the Different Sectors of the Economy
Chief Justice Reynato S. Puno 5

Courts and the Economy: An Economist's Perspective
Dr. Cielito Habito 15

Inspirational Message
Ambassador Lilia R. Bautista 24

II. LECTURES

Basic Economics for International Economic Law
Dr. Luis F. Dumlao 28

International Economics and Sovereignty: The Concept of National Welfare as a Motivation for Compliance with Treaty Obligations
Dr. Marissa Maricosa A. Paderon 46

Sovereignty, the Philippines and the WTO
Atty. Jeremy I. Gatdula 61

Interwar Period: 1918–1939
Ms. Cristina M. Bautista 81

CONTENTS

Bretton Woods
Mr. Raphael B. Madarang 95

Challenges in Implementing the WTO Obligations in the Philippines
Atty. Jeremy I. Gatdula 100

Do Trade Remedies Really Remedy?
Dr. Marissa Maricosa A. Paderon 111

Anti-Dumping under International and Philippine Trade Law
Atty. Jeremy I. Gatdula 122

Trade Remedies: Some Definitional Issues
Atty. Jeremy I. Gatdula 144

The Fog of Trade
Atty. Jeremy I. Gatdula 155

The Road Ahead: Responding to Uncertainties in the Multilateral Trading System
Atty. Jeremy I. Gatdula and Mr. Raphael B. Madarang 165

Towards the Development of Philippine Agricultural and Service Exports in the Light of the Doha Round of Negotiations
Mr. Raphael B. Madarang 210

ASEAN Trade in Focus
Mr. Raphael B. Madarang 233

RTAs: Building Blocks or Stumbling Blocks? (Are Regional Trading Agreements Good or Bad?)
Dr. Marissa Maricosa A. Paderon 239

A Review of the Economic Decisions of the Supreme Court (An Excerpt)
Atty. Cecille L. Mejia 249

CONTENTS

The Color of Money
Dr. Luis F. Dumlao 266

The International Monetary Fund Articles of Agreement and the Current Framework for Sovereign Debt Renegotiations: "An Expanding Role for Standby Arrangements in National Economic Policy Making in Developing Country Debtors"
Prof. Sedfrey M. Candelaria 279

The Economic Theory of Globalization
Victor S. Venida, Ph.D. 335

Law and Economic Development in the Philippines
Victor S. Venida, Ph.D. 380

III. INTERNATIONAL JURISPRUDENCE

Brazil – Measures Affecting Dessicated Coconut 407

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Law and Economics: Courts and the Economy*

Justice Ameurfina A. Melencio Herrera

Chief Justice Reynato S. Puno
Your Excellency, Ambassador Beckingham
Your Honors All of the Supreme Court and the Court of Appeals
Distinguished representatives of the Academe, Business,
and the Private Sector

The Academy is, indeed, pleased and honored to hold this *Roundtable Discussion on Law and Economics* with Supreme Court and Court of Appeals Justices and selected representatives from the private sector, business, and the academe. Its significant theme is *Courts and the Economy*.

This is actually the culminating activity for PHILJA's capacity building project on *Law and Economic Development Issues for the Philippine Judiciary* since we launched it last October 2006 in the Supreme Court. The Academy has held two 2-day seminar workshops for research attorneys of the appellate courts in November 2006; for commercial court judges in December 2006; and for the Court of Tax Appeals Justices and Court Attorneys just last March 2007.

The objectives of the series have been to increase the working knowledge of judges not only of basic economics, but also of international economics and sovereignty, trading agreements and their role in the regulation of trade, the mechanics of interest rates, inflation and deflation, including dispute settlement.

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* Opening Remarks delivered at the *Roundtable Discussion on Law and Economic Development Issues for the Philippine Judiciary, Theme: Courts and the Economy* held on April 19, 2007, at Camp John Hay Manor Hotel, Baguio City.

This is in line with the overreaching goal of the Academy to stretch economic literacy and equip our judges and court attorneys with the necessary knowledge to address economic-oriented issues and to correlate it to decision making. For we can reasonably expect more economic issues to be decided by our courts considering the various economic legislations passed by Congress and the increasing globalization of various issues.

For having made this series of programs possible, we reiterate our profound appreciation to the British Embassy and His Excellency, Ambassador Beckingham, and to the Ateneo University's School of Law and Economics Department. There was meaningful collaboration with PHILJA's own Commercial Law Department headed by Dean Cesar Villanueva, ably assisted by Associate Dean Sedfrey Candelaria who heads PHILJA's Department of Special Areas of Concern. We assure His Excellency that the Manual of Reference on Law and Economics that will be formally presented at the end of the discussion will be made available to all concerned.

The Supreme Court has actually led the way in stressing the significance of economics in the life of the nation via the several chamber-to-chamber dialogues it has held with the business community knowing that it can be beneficial for the courts to network with business and corporate leaders. It is one way of promoting understanding of the criticisms against the judiciary by some sectors on the judiciary's role in economic development. It is a way of focusing on the promotion of effective economic governance through an enhanced and mutually beneficial interaction between the courts and the different sectors of the economy.

For governance has become the order of the day. In the past, governance was left to the executive and legislative branches of government. Presently, the judiciary is being called upon to participate in governance as it relates to the pursuit of economic development. As a paradigm shift, stress is now also given to court management and governance in the realization of, among other factors, the economic cost of time, money, and effort in all judicial endeavors.

The key role of the judiciary in the economic well-being of the country has also been recognized by the world's leading developmental institutions like the World Bank, the United Nations Development Program, and the Asian Development Bank. They have admitted the need for a "well-functioning judicial system that enables the State to regulate the economy and empower private individuals to contribute to economic development by confidently engaging in business, investments and other transactions." The recent roundtable discussion between Philippine and American commercial court judges on February 27, 2007, also brought out the international consensus on the central role played by the judiciary in creating a good business environment. It is also accepted that a positive relationship exists between the quality of the judicial system and the level of foreign investments. As a recent example, extrajudicial killings are hurting the inflow of investments to the country. The Supreme Court responded by issuing Administrative Order 25-2997 on March 1, 2007, designating specific court branches to handle such cases. The Academy, too, has reacted by scheduling a training program for the judges so designated. So, too, the decision of the Supreme Court in upholding the constitutionality of the Mining Act of 1995 (RA No. 7942) highlighted the role of the Court in economic growth.

And so today, the interaction continues, thanks to the Chief Justice's authorization and all Your Honors' cooperation and that of the academe and the private sector. We thank you all for sharing your vision for effective economic governance through an enhanced and mutually beneficial interaction between the courts and the different sectors of the economy.

Let us all look forward to a stimulating exchange of views.

Madame Justice Ameurfina A. Melencio Herrera was appointed Chancellor of the Philippine Judicial Academy in March 1996, four years after her retirement from the Supreme Court where she served as Senior Associate Justice from 1979 to 1992. She was the chairperson of the Court's Second Division and of the House of Representatives Electoral Tribunal. She is a forerunner in bar reforms and a recipient of numerous awards both here and abroad. The second woman to be appointed to the High Court, she has been hailed for her intellectual credentials, integrity, morality and righteousness. Described as the illustrious granddaughter of the President of the First Philippine Republic, General Emilio Aguinaldo, Madame Justice Herrera graduated valedictorian from the UP College of Law, topped the bar, and thereafter cut a fulfilling career path on the Bench from the Court of First Instance of Baler, Quezon, to the highest court of the land.

As PHILJA Chancellor, Justice Herrera was recognized as one of the world leaders in judicial education. She was chair of the Asia Pacific Judicial Educators Forum's (APJEF) Executive Committee and was the International Organization for Judicial Training's (IOJT) Deputy Regional President for Australasia. Under her leadership, the Academy introduced Court-Annexed Mediation, Appellate Court Mediation, Mobile Court-Annexed Mediation, and Judicial Dispute Resolution.

A Vision for Effective Economic Governance: The Need for a Partnership between the Courts and the Different Sectors of the Economy[*]

Chief Justice Reynato S. Puno

Her Majesty's Ambassador,
His Excellency, Mr. Peter Beckingham,
The PHILJA Chancellor,
Madame Justice Ameurfina A. Melencio Herrera,
Former Secretary of Economic Planning and NEDA Director General, now Director, Center for Economic Research and Development of the Ateneo de Manila University,
Dr. Cielito F. Habito,
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Member of the Department of Constitutional Law of the PHILJA,
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Incumbent Dean of the Ateneo School of Law, and
Chairperson of the Department of Commercial Law of the PHILJA, Dean Cesar L. Villanueva,
Atty. Andrew Jeffries,
Partner and Head of Litigation for Asia of Allen and Overy, Hongkong,
Dr. Victor S. Venida, of the Department of Economics of the Ateneo de Manila University,
My colleagues on the Bench,
Friends, Ladies and Gentlemen,

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* Message delivered at the *Roundtable Discussion on Law and Economic Development Issues for the Philippine Judiciary*, *Theme: Courts and the Economy* held on April 19, 2007, at Camp John Hay Manor Hotel, Baguio City.

Good morning.

I have the unenviable task of beginning this day by setting forth my vision, at this early hour, to achieve effective economic governance, specifically, the role of the courts *vis-à-vis* the different sectors of the economy. Truth be told, when Madame Justice Melencio Herrera invited me to address this august body, I had second thoughts, given that economists and judges have different goals and tools of the trade. Economists use econometrics and graphs to influence policy, while judges wield gavels and pens as they rule upon the legality of acts based on policies already formulated and implemented by the other two great branches of Government. Be that as it may, there is no denying that, in the words of PHILJA's team which organized today's roundtable discussion, "good and consistent jurisprudence based on law, as well as time-efficient resolution procedures," is imperative "to attain predictability, transparency, and accountability."

I focus today on four general areas of the economy and law: foreign trade, electronic commerce, labor (or the services industry), and intellectual property rights. I trust you shall agree with me, that in this day and age of ever-increasing globalization, these four fields deserve mention.

Among the more recent legislative developments concerning foreign trade are found in Republic Acts Nos. 8751, 8752, and 8800. Section 1 of the Countervailing Act of 1999, Section 3 of the Anti-Dumping Act passed that same year, and Section 29 of the Safeguards Measures Act of 2000, uniformly contain provisions permitting redress to the Court of Tax Appeals ("CTA") within 30 days from receipt of notice of a final ruling or department order. Then, as mandated by Section 19 of RA No. 9282, to question the decision or ruling of the CTA en banc, one files a verified petition for review on *certiorari* with the Supreme Court pursuant to Rule 45 of the 1997 Rules of Civil Procedure. Today's roundtable discussion is thus propitious, to ensure that

even Justices are kept up-to-date with what are, admittedly, more esoteric fields of law.

Turning to another somewhat recent legislative enactment which poses interesting legal questions, there is the Foreign Investments Act (RA No. 7042, as amended by RA No. 8179). Parenthetically, allow me to provide a disclaimer, that lest I be accused of proffering an advisory opinion, my statements today should be deemed good and valid for academic purposes only.

The Foreign Investments Act seeks "to attract and encourage foreign investments to expand livelihood and employment opportunities for Filipinos,"[1] and defines a "Philippine national" in Section 3(a). However, whether, and/or how, this definition impacts upon the Anti-Dummy Law,[2] remains to be seen. In like manner, the effect, if any, of Section 3(d) of the Foreign Investments Act, which defines or describes the scope of activities that constitute "doing business" within the Philippines, must be definitively adjudged, for purposes of the substantive provisions of the Foreign Investments Act or the procedural requirements concerning service of summons under the Rules of Court. I look forward to Dean Villanueva's views on this subject.

Still on foreign trade, but this time outward-looking, there is RA No. 7844, or the Export Development Act of 1994. Interestingly, Section 21 thereof makes it a crime to violate, whether willfully or through gross negligence, the provisions of the statute, and even extends to expelling from office—not only the responsible officers—but even the chief executive and operating officers. I have no doubt that Father Bernas, an authority on constitutional law, will share his thoughts as to whether the law's broad reach passes constitutional muster.

I am also confident that we shall be benefited by the experiences and views of Atty. Andrew Jeffries who I am certain

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1 *See* Section 2 of RA No. 7042, as amended by RA No. 8179.

2 Commonwealth Act No. 108, as amended by Presidential Decree No. 715.

will kindly share his expertise as regards the role of the law in the world of high-finance, stocks, securities, leveraged buy-outs and the like.

The ubiquitous nature of the Internet, coupled with its ability to breach territorial borders with a click of the mouse, brings to fore the importance of the E-Commerce Act of 2000 (RA No. 8792). On this score, the Court promulgated the Rules on Electronic Evidence by way of A.M. No. 01-7-01-SC, which took effect on August 1, 2001.

Admittedly, the easy-access to cyberspace has spawned a plethora of new fields of litigation, whether in the form of the unauthorized downloading of copyrighted materials or cyberspace-libel through blogs. It has been reported that the Recording Industry Association of America (RIAA), the trade group that represents the recording industry in the United States, has filed over 20,000 lawsuits involving allegedly illegal distribution of music through file-sharing or using the Internet to distribute music via peer-to-peer software.[3] Also, interestingly, an entire website has been devoted to libel and related lawsuits against bloggers.[4] For our purposes today, however, what ties e-commerce, file sharing, and Internet-defamation together is the question of jurisdiction—absent a binding choice-of-law-and-forum contractual clause—where the contending parties are found in different States.

Some courts have adopted the "passive personality principle of jurisdiction," which grants a State's municipal courts jurisdiction over crimes committed by foreigners against nationals of the State wherein a plaintiff or complainant sues,

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3 *See* <http://en.wikipedia.org/wiki/RIAA>. *See also MGM Studios, Inc. v. Grokster, Ltd.,* 545 U.S. 913 [2005].

4 http://www.medialaw.org/Content/NavigationMenu/Member_Resources/Litigation_Resources/Materials_by_Issue/Lawsuits_Against_Bloggers/Lawsuits_Against_Bloggers.htm

even though the defendant or respondent resides abroad.[5] Simply put, a municipal court's jurisdiction is determined by the nationality or national character of the offended party.[6]

Thus, in *Dow Jones & Company v. Gutnick*, decided by the High Court of Australia on December 10, 2002,[7] an Australian national was allowed to sue Dow Jones, a company based in the United States, before an Australian court, for an allegedly libelous article that was published online. However, the case was settled in November of 2004, with Dow Jones agreeing to pay Mr. Gutnick some US$440,000.00 in fees and damages. In the same vein, last July 3, 2006, it was reported[8] that the English High Court ruled that Britain's recording companies could sue the Russian digital music site known as "AllofMP3.com" in the United Kingdom—even though the Russian website had no operations in the United Kingdom, but sold copyrighted songs to consumers in the United Kingdom via the Internet.

While the subject of enforcement of a foreign judgment is clearly provided for in Rule 39, Section 48, of the 1997 Rules of Civil Procedure, plainly, the bench and the bar should review and refine the bases of jurisdiction for civil, commercial, and criminal matters, in the light of existing principles of conflicts of law (e.g., *forum non conveniens* and minimum contacts) and criminal law (e.g., Article 2 of the Revised Penal Code).

Anent labor or the services industry, allow me but a brief statement. Where the Filipino laborer is concerned, wherever he or she may toil, so long as there is a reasonable minimum

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5 *See Harvard Research on International Law: Jurisdiction With Respect to Crime*, Am. J. Int'l L. 435, 578 (1935). *See also* The Restatement (Third) of Foreign Relations Law, § 402.

6 David J. Harris, Cases & Materials in International Law 265 [5ed., 1998].

7 The text of the decision may be viewed here: <http://www.kentlaw.edu/perritt/courses/civpro Dow%20Jones%20&%20Company%20Inc%20v%20Gutnick%20%5B2002%5D%20HCA%2056%20(10%20December%202002).htm>.

8 <www.reghardware.co.uk/2006/07/03/bpi_wins_right_to_sue_allofmp3/>.

contact between our courts and the dispute or the litigants, our courts shall not shirk from its duty to dispense justice in accordance with the appropriate labor laws and regulations.

I have chosen to discuss the field of intellectual property rights last, for reasons which I shall explain later. Suffice it to say, intellectual property law has come a long way from the Spanish Copyright Law of 1879, to RA No. 8293 or The Intellectual Property Code of 1998 and the WIPO Internet Treaties of 2002. But insofar as foreign trade is concerned, the Supreme Court noted:

> Protectionism and isolationism belong to the past. Trade is no longer confined to a bilateral system. There is now 'a new era of global economic cooperation, reflecting the widespread desire to operate in a fairer and more open multilateral trading system.' Conformably, the State must reaffirm its commitment to the global community and take part in evolving a new international economic order at the dawn of the new millennium.[9]

Last November of 2007, the Supreme Court, the PHILJA, and the Intellectual Property Office (IPO) co-sponsored a three-day seminar for over 20 commercial court judges at the Palm Grove, Power Plant, Rockwell in Makati City. The seminar covered various topics in intellectual property law that fall within the ambit of the duly designated commercial courts. This partnership between and among the Supreme Court, the PHILJA, and the IPO seeks not only continuing judicial education, but appropriate training for the court personnel, whether stenographers or sheriffs, with the end in view of producing bench books for judges and manuals for the court personnel when dealing with intellectual property cases. This partnership likewise seeks to achieve an efficient case monitoring system for intellectual property disputes, from the IPO/trial court level, the appellate courts, and the Supreme Court.

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[9] *Mirpuri v. Court of Appeals*, G.R. No. 114508, November 19, 1999, 318 SCRA 516, 557.

We now come full circle. My vision for the role of courts in achieving effective economic governance is simple and two-fold.

First, we all want the "predictability of consistent jurisprudence based on law." We all want "time-efficient resolution procedures" so that legal victories are not Pyrrhic victories. The role of the courts has become increasingly difficult in the light of new legislations they are called upon to apply. Courts are called more often now to hear appeals from rulings of regulatory agencies which use economic analyses for administrative decision making. These agencies may be required by statute to rely on economic principles and analyses in considering the "reasonableness of cost," determining the rates that are "just and reasonable," or simply formulating decisions that are "economically feasible." In other cases, these agencies use economic theories to predict the consequences of a particular act and determine whether that act is in accord with the statutory mandate. Economic analysis has pervaded such diverse fields as securities, tort, contract, and antitrust litigation. Indeed, these economic issues are complex and pose delicate problems in ascertaining the proper scope of judicial review. And judging from today's environment and pending bills on regulatory reform, the economic issues facing the courts will become even more delicate and intricate in the years to come.

In all these situations, non-economist judges are required to understand the often arcane economic issues involved in esoteric disputes. Many of our judges are generalists, not intensively schooled in economic theory and unmindful of the limits to their institutional competence. Most cannot be expected to be proficient in the mathematical equations of quantitative economics any more than they can be expected to master the blueprints of complex technological mechanisms or computer software programs. Many simply evaluate agency actions on such catch-all grounds as whether they were committed "in grave abuse of discretion," based on "substantial evidence," "not in accordance with law," or simply "arbitrary,

whimsical, and capricious." These legal standards leave enormous leeway for judicial examination of substantive and procedural aspects of agency decision making.

Thus, judges must always be reminded that they must not substitute their respective policy choices for those of the agency to which Congress has entrusted implementation of the laws. While judges must not neglect their offices, they must neither usurp the prerogatives of the other two branches. They must focus instead on the specific transactions or institutions that have been regulated. They must find out what the case is really about by going to the transactional roots of the controversy. They should also carefully look into the statute, and its legislative history and intent, for evidence that Congress had preferences or left instructions as to how economic (and non economic) theories are to be considered.

The gradual introduction of sophisticated economic concepts and techniques into the system of administrative law likewise offers great promise for heightening the rationality of both agency behavior and judicial review. Thus, the launch of the Supreme Court-PHILJA-IPO partnership last November 2006 and today's roundtable discussion are perfect examples of what we need so that we get what we want. We need to keep our judges and court personnel educated and up-to-date, especially in the less mainstream and/or rapidly-developing fields of law. We need PHILJA to continue its vocation of tending to the minds of our judges and court personnel. We need to improve our systems, so that we know what cases are filed, what type of cases are filed, when they are filed, and how long they stay within the system—for having this data on-hand or available at the click of a mouse shall likewise serve the functions of securing transparency and accountability. Finally, we need the support of both governmental and non-governmental institutions to make these realities within our lifetime.

Second, the Judiciary needs good people. The transparency by which proceedings before the Judicial and Bar Council are conducted, coupled with the provisions of RA No. 9227, shall go a long way to induce the "able lawyers," to become "willing

lawyers," insofar as donning the robes of justice is concerned. Equally important, the general public has a measure of participation to ensure that the "able and willing lawyers" are hard-working, competent, and honest. It goes without saying that the Supreme Court shall spare no effort to keep the ranks of the Judiciary clean. Concretely, even at the trial court level, in 2004, the High Court admonished 2 RTC judges, 4 were censured, 45 were dismissed from the service, 5 were fined, and 4 were reprimanded. In 2005, 8 RTC judges were admonished, 27 were dismissed from the service, 6 fined, and 4 suspended. In the case of our judges in the MeTCs, MTCCs, MTCs and MCTCs for the year 2004, the High Court admonished 3, censured 3, dismissed 38 from the service, fined 6, and reprimanded 3. For year 2005, the data show that 7 were admonished, 23 fined, 4 reprimanded, and 5 suspended. Just recently, we dismissed from the service some Court of Appeals personnel, including a lawyer, and a Court of Appeals Justice. More are expected to follow. While, on one hand, our judges must be protected from sourgraping losing litigants, rest assured, on the other hand, the Supreme Court expects, and our nation deserves, that only those who deserve to wield that gavel actually do so.

I extend my sincerest measure of gratitude to the PHILJA, the Ateneo Law School, the Ateneo de Manila Department of Economics, and the British Embassy, for conducting today's roundtable discussion, for precisely, this is the form and type of support that is needed so that the justice system, in general, and courts, in particular, play their proper role in achieving effective economic governance. Good day to you all.

Chief Justice Reynato S. Puno was appointed the 22nd Chief Justice of the Supreme Court on December 7, 2006. As Chief Justice, he chairs the Court's First Division, and heads the *Court Systems Journal* Committee and the Committee on Revision of the Rules of Court. Prior to his appointment as Supreme Court Associate Justice, he was: Associate Justice of the Intermediate Appellate Court and the Court of Appeals, Deputy Minister of Justice, acting Chair of the Board of Pardons and Parole, Solicitor and Assistant Solicitor General, and City Judge of Quezon City.

Chief Justice Puno obtained his Bachelor's Degree in Jurisprudence and his Bachelor of Laws Degree from the University of the Philippines. He obtained his Master of Comparative Laws degree, with high distinction, at the Southern Methodist University, and his Master of Laws at the University of California, Berkeley. He completed the academic requirements for a Doctor of Juridical Science degree at the University of Illinois, Champaign. He was the first Filipino to receive the Distinguished Global Alumnus Award from the Dedman School of Law, and was conferred six honorary doctorates.

Among Chief Justice Puno's most prestigious awards are: Ten Outstanding Young Men Award (TOYM), Araw ng Maynila Award as Outstanding Jurist; UP's Most Outstanding Law Alumnus; Grand Cross, Order of the Knights of Rizal; Gold Medal, Grand Lodge of Free and Accepted Masons of the Philippines; and Centennial Awardee in law by the United Methodist Church where he is an active lay preacher and chair of the Administrative Council, Puno Memorial United Methodist Church.

Courts and the Economy: An Economist's Perspective[*]

Dr. Cielito Habito

Mr. Chief Justice
Her Majesty's Ambassador,
Ambassador Beckingham
Chancellor and Madame Justice Ameurfina A. Melencio Herrera
Justices of the Supreme Court,
Justice Angelina Sandoval-Gutierrez,
Justice Antonio T. Carpio and
Justice Adolfo S. Azcuna
Justices of the Court of Appeals
fellow speakers and colleagues of Ateneo
friends from Philippine Judicial Academy
ladies and gentlemen,

I am considerately privileged to be addressing this distinguished body. And, indeed, it is a topic obviously close to my heart. I should actually say in fact or either be guilty or claim credit to the fact that when I was a head of NEDA in 1990 under President Ramos, I believe we came out with the first ODA assistance package that was actually addressed to the judiciary. This was the time the UNDP gave a small grant to begin what the parties should continue via this partnership with the British government. And so, as I said, this topic is quite close to my heart. Well my job is to bring the perspective of the economist, maybe I could add as a former economic policy maker into this discussion on the Courts and the Economy. I guess I would start with what we economist in the academe

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* Delivered at the *Roundtable Discussion: Law and Economic Development Issues for the Philippine Judiciary, Theme: Courts and the Economy* held on April 19, 2007, at Camp John Hay Manor Hotel, Baguio City. *Transcribed.*

would normally teach our students about the proper role of government in the economy. Well I would like to invite your attention to the screen. I remember when I was in the cabinet I used to explain that the reason I got away with being one of the less recognized cabinet members in the Cabinet of President Ramos was that I always directed my audiences to look at something else whenever I spoke; so nobody ever remembered my face. I would like to ask you to refer to the screen.

First and foremost, we teach our students that the role of government in economics is to maintain order and to enforce contracts. It also has to step in to correct what we call "market failures." This is what the Chief Justice referred to as the laissez faire philosophy that, in theory, the market would work properly to ensure sufficient allocation of resources when markets do fail. And that is when the government should step in. It must promote competition, especially regulate monopolies when there is inequitable economic power. It must also pursue macroeconomic stability. The government is at the best place to address the issue of stabilization of the entire aggregate economy. It also has to promote social objectives which are not always met. Again, this is one of the market failures. In fact, allowing the markets to work by themselves would not necessarily address equity and would not address security considerations. In the end, the common conclusion is that government should do all of these but not compete with private business or engaging in the economic production which is often better done by the private sector. In short, I often put it this way, government has no business being in business.

Now very briefly, the market failures are caused by a few things. I would not go through this, this is not a course in economics, but there are unfamiliar things like externalities, external costs and benefits. We are more familiar with the common external costs like pollution which, of course, is a cost to the society not felt by the producers themselves. The government thus has to step in to ensure that there is not too much of these external costs that impose on society. There is a problem of public goods wherein the cost of these goods

depend on what we call non-excludable or non-rival. It will never be efficient to let private producers provide these goods. There will be a free rider problem on the part of the consuming public and therefore it will never be clear what the true values to society of these goods are. Also, the private sector will be unequipped to determine how much is the best or the proper quantity to produce and that is why the government thus has to step in. Again, when you have unequal access to information, that happens now in our modern economy, benefits are skewed towards those possessing more information, especially in this so-called information age.

Now we have said the government has to step in to promote more competition. And it is not the competition that the Chief Justice has referred to wherein the survival of the fittest is at issue. It is a competition that is named necessary by the fact that one, when there is a monopoly power we invariably end up with higher prices, restricted supply of products, and there is also going to be a persistence of excessive or what we describe as unearned profits, or what economists technically call *economic rents.* Therefore, people engage in what we call rent-seeking behavior. And in this kind of a complex, more competition is desirable, competition that would promote lower prices, better quality and more supplies. But there are cases, as we keep explaining on natural monopolies, where monopolies can be desirable because of the economy of scale when one producer may actually be able to produce goods more cheaply than having several producers. I think the most familiar example would be utilities like electric power. We do not want to have two Meralcos serving one particular community because it will be costing too much to have more than one firm.

Of course, macroeconomic stabilization is something that has to be left to the government. That is what the economic managers are for. Stabilization here means stabilizing prices and therefore promoting lower inflation; stabilizing production and therefore incomes; and thereby promoting steady economic growth, stabilizing employment or preventing high levels of unemployment which invariably lead to poverty, and

of course stabilizing foreign exchange rate, a more modern concern. In fact, what we really want is not necessarily a lower exchange rate but a smooth movement in exchange rate. We do not want wild swings which lead to unpredictability in doing business.

This is the objective I think that the government must be most concerned about in addressing the failures of the market system of the economy. Again, providing for equity, which it does by progressive taxation and that is taxing more from the rich and less from the poor. Of course, expenditure policies that hopefully would also be biased for the less endowed in the society would include things like asset reform. The overall reduction of poverty or the eradication thereof through transfer programs, subsidies, and public services especially in the areas of health, education and livelihood assistance.

Social protection defines this service and I would like to emphasize to some that this is the protection of people against others or protecting them against themselves. The Chief Justice mentioned, lottery, dangerous drugs, gambling. These are the habits that need government action to protect people against themselves. Of course, the overall objective of achieving the common good also necessitates providing for national defense and providing for environmental protection which would not necessarily be the concern of private economic players.

In the end, law and economic policy to my mind have a shared goal of promoting the common good. The common good doesn't mean a unanimous achievement of the benefits of any particular policy or sets of policies. When I was a policy maker myself, I liked to define good policy as policy that promoted the greatest good of the greatest number. Now, in this regard, I have come to recognize that public interest is not necessarily equivalent to promoting private business interest. And I think this is where a lot of our problems lie often: business interests try to contend that their interest is uneven with the public interest. But, if you look at the test of the greatest good of the greatest number, that is where it may fall apart. If we subscribe

to the premise that the ultimate objective of law and that of economic policy is to promote the common good and the theory at least it should imply that there must be a convergence of what constitutes good laws and what constitutes good economic policies.

Now, let me just make three general observations when problems arise making this issue of the courts and the economy come to the fore. The first case is when law is perceived inconsistent with the common good. I submit that this is often more because of legislative shortcomings. I hate to use legislative failures but I will elaborate on this as I go along. A second case is when policy implementation is inconsistent with the law. Here, it may be a fault or shortcoming of the executive when certain procedures that have been adhered to an implementation of the law have been inconsistent with the nature of the law in fact. And the third case is when interpretation of law or policy may differ across different branches of the government.

Now let me just go through each of these in depth. In the first case, when the law is inconsistent (and I put a question mark because often this is a perception issue) I have observed that some people think that the law is inconsistent with common good and some people define the common good differently. Now, very concrete examples in recent memory would be the Sin Taxes Law, where a lot of people would argue that the eventual result of the Sin Taxes Law in the end is not consistent with the common good because, allegedly, certain private parties were actually better served by that law than the greater majority of the tax paying public. Another issue is the Oil Industry Deregulation. Again there are different perceptions on whether deregulation really served the public interest or the common good or the greatest good of the greatest number, as I said, or whether it is only serving the interest of a few economic entities. On the provision on automatic debt service, again, there is a debate whether it is a good idea to be providing that automatically or it should be open to congressional intervention. How much of the budget should

be allotted to that service. The mining code is obviously another very controversial issue and, again, there is debate on what in the policy would serve or not serve the common good. And then more recently, as I have been writing about in my last three columns in the Inquirer, the Open Skies policy where on one hand one group would contend that reciprocity is defined in the very strict sense of quick procuring of a number of flights is what would serve the common good; but others say no, the reciprocity should actually reckon into the equation: employment generation, investment creation to recent development as part of the benefits that we ought to be or what we are going to be getting from open stocks. Now the question that arises out of this case is: *Should courts go beyond the letter of the law and determine what constitutes "common good"?* And again as we have come to recognize, there seems to be two schools of thought among the legal matters. One is perhaps what we refer to as judicial activism where perhaps the answer to the first question is in the affirmative; but there may be another position that might be described as judicial statesmanship, which I detect from the Chief Justice's remarks is where he is leaning more towards, rather than trying to prevail on the other branches the judgments of the Supreme Court on what is common good. It may be more prudent to actually stay clear of making that kind of interpretation. The question also related to this is: *Are courts the competent authority or equipped to determine what serves the "common good"?* And I suppose this is what this engagement of sharing between economists and legal minds is also trying to address.

Now the second case is when the policy implementation is inconsistent with law, and recent concrete examples have been the NAIA III and the PIATCO case wherein the main problem, I believe, arose from the fact that certain provisions in the law including how projects should be evaluated were not allegedly faithfully adhered to. For example, the eventual contract that emerged in this deal which was subsequently implemented turned out did not go through the proper process. So yet in the end, it is the failure of the executive to adhere to the proper

procedures and the legal restrictions. Again, in general, questionable procurement or contracts often lead to these Temporary Restraining Orders from losing bidders when they point out the flaws in the process of awarding certain contracts. I was a victim of that myself, in a sense, when I retired from the government in 1998. My retirement benefits were held back for about 18 months, because as NEDA director-general I was in the *et al*. of some of these suits by losing bidders and it took months before the Ombudsman finally threw them out as nuisance cases. Such things thus lead to delays in projects.

The question that arises is: *Is the common good better served by ignoring the wrong that has been done by another branch of government*? Again on the basis of trying to avoid delays that may affect the economy, it may be argued, or on not wanting to risk discouraging investors because of court intervention. Of course we all know there's a lot of pointing out that certain court decisions may be sending bad signals to investors and so on. So would that be justification for the courts to ignore the wrong that has been done by another branch of the government. Related to that, again: *Can the courts keep the executive from repeating the same wrongs?* Or does the executive branch keep doing the same mistakes and therefore keep leading to these kinds of questions going back to the judges and the courts. Finally the third case is when the interpretation of the law or the policy may differ across differrent branches of government. Again the celebrated case was the Manila Hotel case many years ago when the interpretation of what comprise the "national patrimony" became the central question–whether a hotel can in fact be part of the national patrimony. Currently, there is an issue that I feel very strongly about, having been, the former chief of NEDA, and this is the attempt on the part of the President, in fact, of Malacañang to amend the Implementing Rules and Regulations of the BOT Law by saying that the NEDA-ICC should no longer evaluate individual projects. And this is an interpretation of the law itself which says that it is a list of BOT projects that the ICC must evaluate. And now they are trying to take this literally and say okay it is only a list. The

individual approval must be done by the proponent agencies themselves. And I have expressed reservations about these by saying that it's like putting the zoo under the care of the crocodiles. It is something that worries me a great deal, I have to admit. Yet, this is really a product of interpretation of the wording of the law that says it is a list that has to be approved rather than individual projects themselves. So again these are questions that can lead to more court cases. And so the question that will arise is: *With co-equal branches, should the judicial interpretation ultimately prevail?* Should we say that at the end the Supreme Court has the final word on what the proper interpretation is. Or, *is a dialogue or coordination possible between the branches to achieve a better convergence of their interpretations?* When I was the head of NEDA that again may either claim credit or take the blame for the establishment of the LEDAC, the Legislative Executive Development Advisory Council. Actually it was when I first assumed office at NEDA that we rallied Congress to establish the LEDAC; and it was very quickly legislated into law. It has become a very effective forum for coordination between the legislature and the executive.

Later on, I did make some feeble attempts to see if a JEDAC was going to be possible. We did have dialogues with the clerk of court particularly in the context of TROs on Government projects, but we were not able to move beyond that. But, again, I impose this question: *Is it possible to have some kind of a forum for a more regular dialogue or coordination also between the executive and the judiciary that in interpreting certain provisions of policy and law, there may be a better convergence or it would make it unnecessary to bring the matter to court?*

Finally, let me just give some implications of all of these. First, in circumstances of clear legislative or executive shortcomings, it seems that it's going to be difficult for the courts to really keep their hands off. And there are some people that the public or society would not look up to as the final arbiter. Second, under the policy of judicial activism, if that stands for judicial statesmanship or the other, courts would require expert advice. I guess this dialogue right now between economists

and legal minds is precisely helping to serve this. Third, maybe we could be exploring avenues for improved dialogue and coordination through this idea of JEDAC or something similar if strong mechanisms for that are pushed.

In the end, I think, it is better communication, better sharing of information and knowledge that would help prevent all of these problems that we have been seeing in the area of court involvement in the economy so that we can all hopefully be seen moving as one in promoting the economic progress of this country.

Dr. Cielito Habito is a Professor of Economics at the Ateneo de Manila University and Director of the Ateneo Center for Economic Research and Development (ACERD). He is a Professorial Lecturer at the University of the Philippines–Los Baños. He sits in the Board of several private corporations and foundations. He is a columnist of the Philippine Daily Inquirer.

Under former President Fidel V. Ramos, he was Secretary of Socioeconomic Planning and Director-General of the National Economic and Development Authority and served as top adviser for the President's economic reform program and development strategy.

He has authored numerous books, monographs, journal articles, papers presented in local and international conferences, and government policy papers on economic policy issues, quantitative economic modeling, and sustainable development. He was awarded the Philippine Legion of Honor in 1998 and The Outstanding Young Men (TOYM) in 1991.

He has a Ph.D. and a Master of Arts in Economics from the Harvard University, U.S.A., and a Master of Economics degree from the University of New England, Australia. He earned his Bachelor of Science in Agriculture degree, Agricultural Economics major, *summa cum laude*, at the UP-Los Baños.

Born on April 20, 1953, in Cabuyao, Laguna, he is married to Pilar Relova, with whom he has five children.

*Inspirational Message**

Ambassador Lilia R. Bautista

Participants to the Seminar-Workshop on Law and Economic Development Issues,
Ladies and Gentlemen:

Let me start by saying that in no other international fora are economic development issues more alive today than in the World Trade Organization (WTO).

Trade liberalization, the main objective of multilateral trade negotiations, is expected to result in economic growth, and faster economic growth can lead to poverty reduction, if not eradication. Today, all over the world, 1.3 billion people live on less than one dollar a day, one-half of the world, or nearly three billion people, live on less than two dollars a day.[1] Approximately 790 million people in the developing world are still chronically undernourished, almost two-thirds of whom reside in Asia and the Pacific.[2]

Faced with the existing poverty in developing countries, hope was high that the Doha Round of multilateral trade negotiations, which is supposed to be a development round, will be true to its name. The Doha declaration clearly states that "International trade can play a major role in the promotion of economic development and alleviation of poverty x x x. In this context, enhanced market

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* Inspirational Message delivered at the *Seminar-Workshop on Law and Economic Development Issues for the Philippine Judiciary* held on March 27–28, 2007, at the Quezon City Sports Club, Quezon City.

1 Larry Elliot, A Cure Worse than the Disease, *The Guardian,* January 21,2002.

2 *World Resources Institute* Pilot Analysis of Global Ecosystems, February 2001 (in the Food Feed and Fiber section).

access, balanced rules, sustainably financed technical assistance and capacity building-programmes have important roles to play.[3]

Historically, GATT (General Agreement on Tariff and Trade) in 1947 was essentially a forum of reciprocal tariff cuts. In 1964, after the birth of a new trade and development organization (UNCTAD) in the United Nations, Part IV was appended to GATT for a limited special and differential treatment for developing countries. The Uruguay Round expanded it and under the WTO, there are under 97 provisions on S&D divided into five categories of special and differential.[4]

The problem with these provisions is that they are not specific enough to be legally binding except for longer time frame and lower tariff cuts in some provisions. Moreover, assuming a developed country takes positive steps to grant preferential tariffs to developing countries outside the WTO, they may impose conditions which developing countries may have difficulties in complying. In hearings on GSP, opposition has been premised on non-trade issues such as human rights.

The Doha round has been stalled but that should give the Philippines an opportunity to adopt a comprehensive plan for suggested changes in the WTO and internal adjustment measures for more competitiveness of our industries.

For a start, to gain market access, legally binding special and differential treatment should be granted to developing countries in the various WTO Agreements. Researchers like yourselves must study proposed changes in these agreements. While it may be argued that reciprocal reduction in tariff by both developed and developing countries is the essence of trade liberalization, exception can be made for developing countries in various stages of development which still need tariff protection. After all, five of the six fastest-growing developed countries during the Age of Capitalism (1950–1973) were high tariff countries with Japan in the lead. With

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[3] Paragraph 2 of the Doha Declaration.

[4] Working Paper 2, Special and Differential Treatment for Developing Countries, South Centre, Geneva, Switzerland, pp. 1–6, 1999.

its protectionist policies, it developed its car industry with high tariff and subsidies from the government.[5] History shows that developed countries have not strictly pursued free trade since the late 19th century. Most countries have used protectionism and, in particular, tariff, in order to promote their industries in the 18th century until 1960, except during 1860–1880.[6]

UNCTAD studies[7] show that only in countries which insisted on gradual liberalization where the results of liberalization was positive. One theory is that liberalization is the outcome of development rather than a prerequisite. India and China did not start with liberalization but followed the historical pattern of liberalizing trade as they grew richer. The other theory is that liberalization must be gradual and selective. The latter will only work with special and differential to developing countries of certain category. Regardless of what type of liberalization is done, adjustment measures are necessary and should be part of domestic policy reforms.

For other countries, domestic policy reforms centered on encouraging foreign investment which accelerated adjustment to trade liberalization. New industries brought about by foreign investors absorbed people who lost their jobs. The use of foreign investment as a tool should be explored further. Political will to push uncompetitive industries to those where we have comparative advantage is a must. The private sector and the academe can certainly help in identifying these sectors and the necessary adjustment measures.

In fine, trade liberalization for developing countries should be gradual and selective as part of our long-term industrial policy.

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5 Ha-Joon Chang, Why Developing Countries Need Tariffs, South Centre and Oxfam, pp. 56–58, Nov. 2005.

6 *Id.* at 87–88.

7 Sam Laird and Santiago Fernandez de Cordoba, UNCTAD IV, V, 2005; and Sam Laird, Coping with Trade Reforms, UNCTAD, Feb. 19,2006.

In closing, let me thank the Ateneo Law School and School of Economics and the British Embassy for making this seminar possible.

Ambassador Lilia R. Bautista has a long and varied career in public service. It was during her tenure (2000–2004) as Chair of the Securities and Exchange Commission (SEC) that it was reorganized and became foremost in the fight against corruption, infused with a sense of urgency in delivering best public service. It advocated corporate governance by issuing the Corporate Governance Code and implementing plans for a dynamic business climate. She was Acting Secretary, Senior Undersecretary, and Special Trade Negotiator at the DTI. She was also ex officio chairperson of various corporations and offices such as the Board of Investments, and became the Philippine Ambassador and Permanent Representative to the United Nations, WTO, WIPO, ILO, WHO, Human Rights Commission, and other international organizations in Geneva.

Ambassador Bautista holds a Law degree and a Master in Business Administration degree from the University of the Philippines, and a Master of Laws degree from the University of Michigan as Dewitt Fellow. She was also a Prentice-Hall Scholar at New York University in Corporate Finance and Reorganization, a UNDP grantee in a Special Negotiation Course at Georgetown University, and an Eisenhower Fellow. She has received numerous awards in law and public administration, including The Outstanding Women in the Nation's Service (TOWNS) award. She was awarded by Pope Benedict XVI for her contribution to the church and the state. She has published articles on reforms in securities regulation, Intellectual Property Rights, and Foreign Investment and Technology Transfer.

*Basic Economics for International Economic Law**

Dr. Luis F. Dumlao

Principles of Economics[1]

There is no uniform definition for economics. But generically, **ECONOMICS** is the study of allocation of scarce resources among alternative uses to meet desired ends. This implies something not obvious but many, for some reason, overlook, that the ultimate end of economics is "to meet desired ends."

For example, balanced government budgets are good because they normally result in better fiscal position that will ultimately enable governments to afford expenditures that meet human needs. But extreme fixation to balance the budget is not good in itself because there are instances when it is not what is best for the people. In the case of extreme unemployment, balancing the budget can actually worsen joblessness. The same goes with international economics. Often, free trade is good economics because they coincide with what is good for the people especially consumers. But adopting free trade as an absolute national policy is not good because there are times when it can actually hurt people. Suppose that country X claims to practice free trade on their agricultural produce when they are actually the most protective. Free trade with country X can unfairly worsen the condition of domestic farmers and fishers. Hence, extreme fixation with traditional economic means like balanced budgets and free trade is bad

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* Delivered at the *Seminar-Workshop on Law and Economic Development Issues for the Philippine Judiciary* held on March 27–28, 2007, at the Quezon City Sports Club, Quezon City.

1 Reference readings: M1, M2, G1, G2. M1 means Chapter 1 of Mankiw, 2004, G1 Means Chapter 1 of Gwartney et al., 2006.

economics in the sense that policy makers switch the role of the means (balancing budget, free trade, etc.) and the end (meeting human needs).

As introductory material, one should look at 10 basic principles of economics.

1. People face tradeoffs. There is no such thing as a free lunch. Balancing budgets have benefits for fiscal position but it is not free for it hurts employment. Free trade is usually good for consumers but it is not free, for the country's producers are forced to compete and may cause job loss. Corruption-free governments are good but they do not come free because it usually comes in the cost of putting people to jail.

2. The cost of something is what you give up to get it. For example, attending a continuing professional education course requires one to give up two types of costs. The first is the actual or accounting cost or the cost it takes to pay for the room, instructor, etc. The second is non-accounting cost. Because when one attends the course, then one is unable to work, to spend more time on leisure, to sacrifice some degree of stress, etc. The two costs combined together become the **OPPORTUNITY COST** or economic cost of attending a continuing professional education. Another example, closure of an airport (because of irregularities) has opportunity cost in the form of depreciation cost of the facility, lost opportunity to generate revenue through concessionaires, less tourists and investors coming to the Philippines because of outdated airport facilities, etc. In these examples, if one chooses to still go to continuing professional education or to close a new airport for irregularities, the cost of the choices are those given up.

3. Rational people think at the margin. People do not think of "to totally fast or to eat like a pig." People think whether to eat the next spoonful. Businesses do not think of employing 10,000 people all at once or

employing none at all. They think whether to hire the next person is good business or not, and they continue to hire until it is no longer good business to hire the next person.

4. People respond to incentives. Behavior changes based on the actuarial benefit and actuarial cost. Suppose a property is worth P1 million and one is 100 percent certain of its value. Then the actuarial benefit of having that property is 100 percent of P1 million which is P1 million. Suppose the penalty of stealing that property is P2 million and the probability of getting caught is 25 percent. Then the actuarial cost of stealing is 25 percent of P2 million which is P0.5 million. Because the actuarial benefit is greater than the actuarial cost, the probability that one will steal it is greater.

5. Trade can make everyone better off. The basis is Adam Smith's **LAW OF ABSOLUTE ADVANTAGE**. If John is a good lawyer, and Juan is a good doctor, the two can trade services and they will both be better-off. Another basis is David Ricardo's **LAW OF COMPARATIVE ADVANTAGE** to be discussed in detail later.

6. Markets are usually a good way to organize economic activity. This is due to competition. For example, in the presence of competition, producers compete to outbid each other and compete to have the best products. In the end, the ones that sell cheapest and with the best quality win, and this is good for society.

7. Government can sometimes improve market outcomes. The previous number states that markets are "usually" but not always a good way to organize economic activity. There are such things as market failures. They can happen in natural monopolies, in dumping and unfair practices.[2] Government can improve market outcomes

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[2] The issue of intellectual property rights (IPR) is a hotly debated issue in international trade. Should governments protect IPR of musicians? Probably yes to encourage musicians to compose better music. Should African governments protect IPR of pharmaceuticals

if it protects property from crime, protect it from cronyism, etc. It can intervene by imposing regulations on vehicles that do not account for the pollution that they dump into the environment. It can improve economic outcomes if it is able to achieve more equitable distribution.

8. A country's standard of living depends on its ability to produce goods and services. This is at the heart of neoclassical ideology.

9. Prices rise when the government prints too much money. As a comment, printing more money than is necessary can be good, but it is of no cost. It usually causes higher inflation.

10. Society faces a short-run tradeoff between inflation and unemployment. Is it really short-run? Gerald Epstein, Joseph Stiglitz, and other heterodox economists think the issue is more complicated than stated.

Despite the agreement of economics being a scientific discipline, economists disagree on so many issues. This happens because of **DIFFERENCE IN SCIENTIFIC JUDGMENTS**. For example, on one side, some say that globalization forces competition which inherently raises the quality of goods and decreases their prices for the benefit of consumers. On the other side, some say that globalization increases monopoly and monopoly inherently deteriorates the quality of goods and increases their prices at the expense of consumers. Another example, some say that financial liberalization will encourage finance capitalists to invest in the Philippines; while some say that financial liberalization will result in capital flight because of the "bird in the cage" argument.[3]

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on AIDS virus cures when more than a half of some populations are dying of AIDS? (Remember: the end of economics is to meet human needs.) That is harder to say *yes* to. Should RP strictly implement IPR on computer engineering software that can improve the country's labor force? That is more hotly debated.

[3] If one opens a "bird cage," will more birds come in or go out?

Economists also disagree because of **DIFFERENCE OF VALUES**. Some say that government should rule in favor of PIATCO so that investors will be encouraged to invest here. Others say government should rule against PIATCO to send a message to foreign investors not to take advantage of the corrupt environment in the Philippines. But economists strongly agree on several important issues as well. For example, economists agree that free trade with the ASEAN block is good. Development economists strongly agree that developing economies should unite as a group when negotiating for globalization.

Supply and Demand[4]

Simply put, the **SUPPLY CURVE** states that *ceteris paribus* sellers are more willing and able to supply goods and services as price increases. Note that the definition includes the assumption of **CETERIS PARIBUS** or "all else being equal." The assumption imposes the condition that nothing else changes including time, productivity, rental of capital, wage of labor and cost of raw materials. If indeed nothing else changes, supply increases when price increases.

The relation has to do with the profit of the firm, noting that:

1. **PROFIT** is revenue less cost.
2. **REVENUE** is number of units sold times price of each unit.
3. **COST** includes rental of capital, wage of labor, cost of raw materials, etc.

As price increases, firms receive greater revenue per unit sold. Hence profit increases and firms supply more. Figure 1 graphically shows the effect by a **MOVEMENT ALONG** the same supply curve say from point A to point B.

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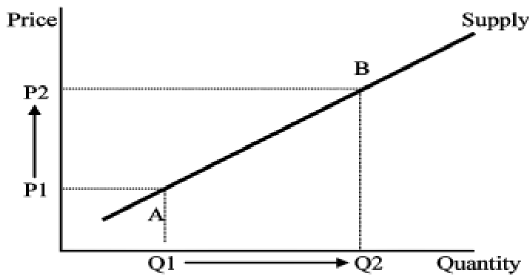
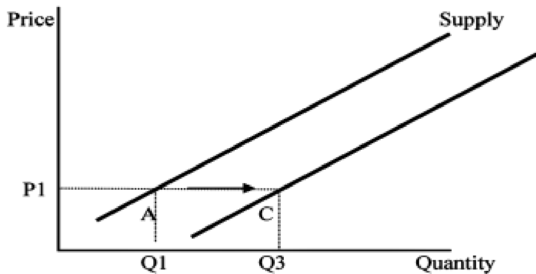
[4] Reference readings: M4, G3, G4.

Figure 1



In reality, other factors like rental of capital, wage and cost of raw materials change. The decrease of any of the three decreases cost. The decrease of cost increases profit and so the firm increases supply. Figure 2 shows the effect by a **SHIFT** of the supply curve to the right, say from point A to point C. Even as price remains at P1, supply still increases to Q3. More generally, decrease of cost shifts the supply curve to the right and increase of cost shifts the supply curve to the left.

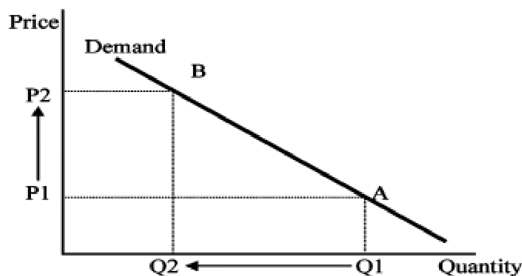
Figure 2



Simply put, the **LAW OF DEMAND** states that *ceteris paribus* consumers are less willing and able to buy goods and services as price increases. One cannot emphasize enough of the importance of the combination of willingness and ability. The poorest of criminals might be **WILLING** to hire the best of lawyers, but may not be able to because of lack of economic resource. The richest of corporate executives is surely **ABLE** to hire the average lawyer, but is not willing to settle for mediocrity. One should be willing and able to really buy.

The relation between demand and price has to do with substitution effect and income effect. Suppose the price of accounting services increase, clients will tend to substitute bookkeepers for accountants and so the demand for accountants decreases. This is **SUBSTITUTION EFFECT**. Now suppose the price of accounting services per hour increases, clients will be less able to afford accounting services. To the extent that clients' income is able to afford less, this is **INCOME EFFECT**. Figure 3 shows that increase of price results in a **MOVEMENT ALONG** the same demand curve say from point A to point B.

Figure 3



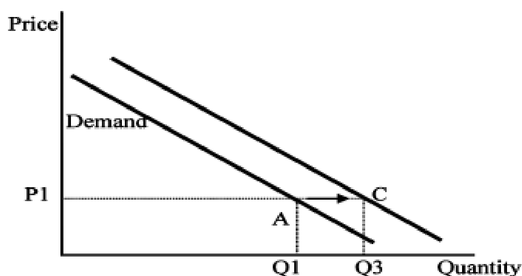
In reality, other factors like prices of related goods and services, taste, and income change. Related goods are of two types, namely, complements and substitutes. Put simply, COMPLEMENTS are goods or services that are consumed together. For example, soft drink and pizza or coffee and sugar are complements because consumers usually buy them together. SUBSTITUTES are goods or services that are not consumed together. For example, soft drink and iced tea are substitutes because consumers usually buy one or the other but not both. When price of a complement decreases, demand for the other good increases. For example, when price of pizza decreases, consumers demand more of it. Since consumers eat pizza with soft drink, consumers also demand more soft drink. When price of a substitute increases, demand for the other good increases. For example, when price of iced tea increases, consumers demand less of it. Since they drink less iced tea, they usually consume more soft drink.

Other factors that affect demand outside of *ceteris paribus* include income and taste. If income increases, say, through salary increase, even without changing price, demand for a normal good increases but demand for an inferior good decreases. An example of a normal good in the Philippines is Toblerone and an inferior food is Goya. When income increases, consumers buy more of Toblerone and less of Goya. If there is favorable change of taste to a good or service, demand increases. In sum, demand increases even without changing price when:

1. Price of a **complement** decreases;
2. Price of a **substitute** increases;
3. **Income** changes; and
4. Through favorable change of **taste**.

Figure 4 shows the effect by a **SHIFT** of the demand curve to the right, say from point A to point C. Even as price remains at P1, demand still increases to Q3. If the opposite of any of the four occurs, the demand curve shifts to the left.

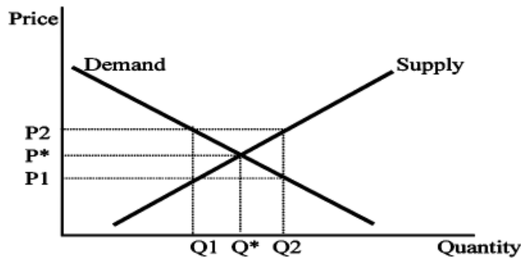
Figure 4



Combine the supply and demand curves and one gets Figure 5. If price happens to be P1, supply is Q1 and demand is Q2. Since supply is less than demand, buyers outbid each other for the limited supply to the point that price increases to P*. If price happens to be P2, supply is Q2 and demand is Q1. Since supply is greater than demand, sellers outbid each other to limited buyers to the point that price decreases to P*. Regardless

of where price starts, competition forces it to go to P* where supply and demand are both Q* or where supply and demand intersect. At such, **EQUILIBRIUM** condition is met because no inherent factor will change price, nor supply and demand.

Figure 5



Consider the market for legal service.

1. Suppose that wages of paralegal and secretaries increase. The cost of legal service increases. This squeezes profit and supply shifts to the left. The new supply and demand intersection results in higher equilibrium price and less quantity. The same would happen if say rent of office space increases, price of office supplies increases, etc.

2. Suppose that recession hits the economy. Incomes decrease and demand shifts to the left. The supply and new demand intersection results in lower equilibrium price and less quantity.

3. Suppose that the professional fee of non-lawyer arbitrator increases. Consider that non-lawyer arbitrators are substitutes of lawyers. People would prefer hiring lawyers and demand for legal services shifts to the right. The supply and new demand intersection results in higher equilibrium price and greater quantity.

ELASTICITY[5]

ELASTICITY refers to the percentage response of one variable resulting in a 1 percent change of another. In other words, it refers to the percentage responsiveness of an economic variable to a change of another. One of the most common elasticity is the price elasticity of the demand. The **PRICE ELASTICITY OF DEMAND** refers to the percentage change of demand resulting from 1 percent change of price. To be noted is that it is measured in terms of its absolute value.[6] If demand changes by 1 percent resulting from a 1 percent change of price, the relation is 1 to 1 so that elasticity is 1. This means that demand is **UNITARY ELASTIC**.

If demand changes by more than 1 percent, say 2 percent, resulting from a 1 percent change of price, the relation is 2 to 1 so that elasticity is 2. To the extent that demand is sensitive or responsive to changes in price, the demand is **ELASTIC.** If demand changes by less than 1 percent, say 0.5 percent, resulting from a 1 percent change of price, the relation is 0.5 to 1 so that elasticity is 0.5. To the extent that demand is not sensitive or unresponsive to changes in price, the demand is **INELASTIC**.

Consider some simplified international economics applications. In the United States (US) market, given the price of and demand for Philippine-made products, suppose that the US imposes an import tariff. As a result, Philippine-made products will be taxed just to enter the US market. Consequently, price will increase. The increase of price then will decrease demand. Ultimately, exporters will lose revenue. As to how much the Republic of the Philippines (RP) can demand compensation out of the tariff proceeds depend on the elasticity. If technicians measure the price elasticity as unitary

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5 Reference readings: M5, G19.

6 For example, if demand decreases by 2 percent due to 1 percent increase of price, the elasticity is "decrease 2 percent" divided by "increase 1 percent" or $^{-2\%}/_{1\%} = -2$. But since it is expressed in absolute terms, price elasticity of demand is 2 not –2.

elastic, RP should demand for the whole revenue generated from tariff just to compensate exporters. If elastic, RP should demand for the whole revenue plus some addition just to compensate exporters. If inelastic, RP can demand for a portion of the revenue and still be able to compensate exporters. Alternatively, RP may voluntarily impose export tariff, a portion of its revenue can be used to compensate exporters, plus additional leftover revenue.

INCOME ELASTICITY OF DEMAND refers to the percentage change of demand resulting from 1 percent change of income. If demand increases when income increases, or if demand responds positively to income increases, then the good is a **NORMAL GOOD**. For example, when income increases, clients are better able to pay for legal services so that demand for legal services normally increases. In this sense, legal service is a normal good. If demand decreases when income increases, or if demand responds negatively with income increases, then the good is an **INFERIOR GOOD**. For example, when income increases, clients demand less of inferior services from barangay legal interns because they are able to pay private legal services. In this sense, barangay legal interns' service is an inferior good.

Consider an international trade example. Suppose that Philippine-made compact disc (CD) is normal in Indonesia and inferior in Malaysia. If the Indonesian economy is expected to grow, demand for CD also grows and so RP has every reason to support Indonesia's growth. If the Malaysian economy is expected to grow, demand for CD will shrink and so RP needs to design an international trade strategy of producing and selling another good more normal to Malaysia, like CDs of original Filipino music.

CROSS PRICE ELASTICITY OF DEMAND refers to the percentage change of demand resulting from 1 percent change of price of another commodity. If demand increases when price of another commodity increases, or if demand responds positively to price of another commodity, the goods are **SUBSTITUTES**. For example, soft drink and iced tea are substitutes. If demand decreases when price of another

commodity increases, or if demand responds negatively to price of another commodity, the goods are **COMPLEMENTS**. For example, soft drink and pizza are complements.

Soft drink, iced tea, and pizza are easy examples. But in reality, determining commodities whether substitutes or complements is more difficult. The difficulty then necessitates economists and statisticians to determine whether the cross price elasticity is positive or negative. Take the example of RP corn and US corn. Suppose that RP corn is P25 per kilo and US corn is P30 per kilo. Since RP corn is cheaper, US corn producers lose in outright competition in the RP market. Suppose that US provides a subsidy to its farmers so that US corn is now cheaper at P20 per kilo. If they are substitutes, demand for RP corn decreases and RP government is obliged to complain for unfair trade. If they are complements, demand for RP corn increases. In this sense, US just gave RP farmers a favor. As to how they can be complements, it is possible that RP hog growers are feeding an alternative produce. For instance, RP corn at P25 per kilo is cheap enough but RP does not produce enough corn so hog growers are better-off using alternative feed that is a little more expensive. But because US sells corn at cheaper prices, there will be enough supply of cheap US corn to complement the shortage of RP corn. Hence, hog growers use more corn from both countries.

MARKETS AND WELFARE[7]

CONSUMER SURPLUS refers to the excess of how much consumers are willing and able to pay over the actual price. For example, suppose that Juan is willing to pay for a specific legal service P750 per hour and yet he pays the market price of P500. Then his consumer surplus is P250. But there are other consumers in the market who avail of legal service. The sum of all their surpluses results in the market's consumer surplus and this is one objective way to measure consumer welfare.

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[7] Reference readings: M7, M8, M9, G5.

PRODUCER SURPLUS refers to the excess of market price over how much producers are willing and able to sell. For example, suppose that Attorney Maria is willing and able to avail of legal service at P400 per hour and yet she gets paid the market price of P500. Then her producer surplus is P100. But there are other lawyers-producers in the market. The sum of all their surpluses results in the market's producer surplus which is an objective way to measure producer welfare. The sum of the market's consumer and producer surpluses yields to the market's welfare.

In many debates including those in international economics, welfare is discussed in terms of **EFFICIENCY**. That is, the maximum benefit that can be extracted by maximizing the sum of consumer and producer surpluses. Unfortunately, mainstream economics unwittingly belittle the importance of welfare in terms of **EQUITY**. That is, the best way to distribute the surpluses. One of the reasons has to do with the lack of tools to quantitatively measure equity. But this is no excuse; just because one cannot quantitatively measure morality does not mean society should ignore moral issues altogether. So outside the textbook and mainstream issues of efficiency, international economic legal experts, negotiators, and society at large should always keep in mind issues of equity.[8]

INTERDEPENDENCE AND GAINS FROM TRADE[9]

The most elementary basis of trade is through Adam Smith's LAW OF **ABSOLUTE ADVANTAGE**. One may explain this through

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[8] Graphically, the equilibrium price and quantity or the intersection of supply and demand is the actual price all consumers pay to all producers. If one draws a line from the vertical axis to the intersection, one gets two triangles. One is on top of the line and below the demand curve. The other is below the line and above the supply curve. The triangle on top is the consumer surplus and the other triangle is the producer surplus. One can quantitatively measure both by calculating their respective area.

[9] Reference readings: M3, G17, G18.

example. Suppose that RP can produce more rice and US can produce more corn. The two can specialize in the product that they can produce more, trade, and both can be better-off. A metaphorical example would be a lawyer specializing in legal matters, a doctor specializing in medical matters, the two trading services of specialization and then the two will be better-off.

The second most elementary basis of trade is through David Ricardo's LAW OF **COMPARATIVE ADVANTAGE**. Suppose that the US can produce more of both rice and corn than RP. Suppose also that the advantage of US over the Philippines on rice is less than the advantage on corn. Then RP can specialize on rice where it is least disadvantaged, US can specialize on corn where it is more comparatively advantaged; both trade, and both can be better-off. The law is a little harder to comprehend especially without the aid of a table or graph, but one can still explain the law several ways. One way to do so is by using Dominick Salvatore's metaphorical example of the lawyer and the secretary.

Suppose Attorney Maria is better at legal work and typing than Pedro the high school graduate secretary. One alternative is for Maria to do both. The two consequences follow. First, Maria's time on legal work is limited because typing takes time. Second, Pedro ends up unemployed. Another alternative is through the law of comparative advantage. Maria's comparative advantage on legal work is greater because Pedro cannot do it at all. Pedro's comparative disadvantage is least in typing because at least he can type. Hence, Maria specializes in legal work and Pedro specializes in typing. The two consequences follow. First, Maria spends all her time on legal work and most likely profit more. Second, Pedro spends all his time typing and he is now employed. And both are better-off.

The examples cited are overly simplified relative to what happens in reality. But it should not stop one to wonder about questions that come up in reality. For example, what are the gains from trade if world price is greater than domestic price? Because the Philippines is relatively small compared to the rest of the world, it tends not to be able to affect world prices no

matter how much it opens. So when producers from the Philippines export, they are able to sell at greater prices, they get additional producer surpluses and they reap the benefit of world trade. This is the case with Filipino domestic helpers in Hong Kong, blue collar engineers in Saudi Arabia, nurses and doctors in the US, teachers around the world receiving higher salaries, including exporters of leather gloves, computer chips, and bananas.

As much as producers benefit, domestic consumers lose because they now pay higher prices for domestic helpers, engineers, nurses, doctors, teachers, leather gloves, computer chips, and bananas, and lose some consumer surplus. So why do not consumers complain as much? The first reason is not because they do not complain but because they are not heard enough because they lack consumer advocacy organizations as opposed to producer advocates.

The second reason implicitly has to do with the impact on consumers and producers. A case in point is the banana. A consumer of banana usually allocates a relatively, small portion of income to consuming banana. But a producer of banana usually sources a big portion of income from producing banana. In more extreme scenarios, a producer of banana sources all income from producing banana. Thus, if trade takes away P1 million of consumer surplus, consumers lose financially but they do not really lose so much satisfaction. Contrary, if trade gives P1 million of producer surplus, producers gain financially and they gain much more satisfaction. And if producers happen to be the poor, like banana farmers, the P1 million surplus results to greater social gain. This is an issue of equity that mainstream debates unwittingly belittle.

What are the gains from trade if world price is less than domestic price? By importing cheaper goods and services, consumers pay less, their consumer surplus increases, and they reap the benefit of world trade. On the other side, domestic producers are forced to exit the market or to compete by lowering their price. This decreases their producer surplus. This is the case with indigenous firms producing textile, farm, and

fishery products. So why do producers complain more visibly than consumers? There are two reasons. First, producers are more organized and so they are able to speak together. This is the case with labor unions and farmers' trade associations.

Second, the impact to individual producers is greater than that of individual producers. A case in point is sugar. Give P1 million of additional surplus to consumers and they gain financially but not much satisfaction because the P1 million is only a relatively small part of consumers' whole income. Take the same P1 million of surplus from producers and they lose financially but they lose much more satisfaction because the P1 million is a big part of their income. In extreme cases, production of sugar is their only source of income. And if producers happen to be the poor, like sugar farmers in the Visayas islands, the P1 million surplus results in greater social gain. Again, this is an issue of equity that mainstream debates unwittingly belittle.

What are the efficiency gains from tariff? In mainstream texts, tariffs increase price of imported goods and services. To the extent that consumers pay more for imports, they lose some consumer surplus. To the extent that domestic producers do not have to lower their price as much just to compete, they gain producer surplus. And to the extent that imports are taxed, government gains revenue. It can be shown that the sum of loss of consumers is greater than the gain of producers and government. Hence, efficiency as measured by the sum of all gains decreases. Hence, tariff is not a good economic policy.

What are the equity gains from tariff? In the process, some of the loss of consumer surplus is transferred to producer surplus and government revenue so there is really some redistributive effect. If consumers are excessively more affluent than producers, the redistribution improves equity. If government revenue is used for anti-poverty and development programs, the redistribution improves equity. Hence, tariff may be a good political economic policy. If consumers are not as affluent and if government does not spend the revenue for the less-than-affluent, the redistribution worsens equity.

What are the efficiency gains from quota? What are the equity gains from quota? What do cross-country comparisons say about world trade? What do historical data on each country say about international economics policy? Why did the Doha World Trade Organization negotiations fail—at least so far? Among many others, these complicated theoretical, practical and legal questions pop up these days in the age of globalization. There are no easy answers but they have to be inevitably debated.

Main reference (mainstream/textbook views)

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Papers downloadable from <http://www.networkideas.org/>.

Topics covered

I. Principles of economics: M1, M2, G1, G2.

II. Supply and demand: M4, G3, G4.

III. Elasticity: M5, G19.

IV. Markets and welfare: M7, M8, M9, G5.

V. Interdependence and gains from trade: M3, G17, G18.

Optional topics

VI. Public finance: M10, M11, M12, G5, G6, GST1, GST5, GST12.

VII. Equitable distribution: M20, GST3.

Notations

M1 means Chapter 1 in Mankiw, G1 means Chapter 1 in Gwartney, et al. GST1 means Special Topic 1 in Gwartney, et al.

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*International Economics and Sovereignty: The Concept of National Welfare as a Motivation for Compliance with Treaty Obligations**

Dr. Marissa Maricosa A. Paderon

The objective of this session is to familiarize the class with the legal issues relating to international economic law, focusing primarily on the oft-perceived conflict between sovereignty and compliance with treaty obligations.

The first part discusses the rationale for trade and the value of interdependence. It then provides a background of international trade theories. As it proceeds to the arguments for or against free trade, the class will also be introduced to various trade policy instruments used in promoting a more liberal or a more protected trade regime.

Rationale for Trade

The rationale for trade rests on the assumption that the international markets can more closely approximate the ideal of a perfectly competitive market than can domestic markets alone. The main reason is that in international markets, there are more consumers and producers thereby making it difficult for monopoly power to emerge. In contrast, there are less consumers and producers in domestic markets, thereby making it easy for a few or even one firm to dominate the market.

* Delivered at the *Seminar-Workshop on Law and Economic Development Issues for the Philippine Judiciary* held on March 27–28, 2007, at the Quezon City Sports Club, Quezon City.

The rationale for trade can be further understood through three basic theories:

1. *Vent-for-surplus theory*. A country with surplus resources can realize extra gains from utilizing these surplus resources to produce goods for international markets. This theory assumes that there is excess production capacity for available domestic demand.

   The benefits of trade are such that there will be more jobs, profit and other incomes; lower production costs and prices; minimized losses and opportunities lost from underutilized resources. An example is the case of processed meat.

2. *Productivity theory*. International trade allows domestic producers and laborers to face greater competition that would stimulate greater efficiency and productivity to survive and thrive. This theory assumes that there will be intense competition between local and foreign firms. Exporting local firms and workers will have to increase productivity and efficiency if only to survive international competition.

   The benefits will include more viable, competitive firms. Firms can sustain over the long-term. They can guarantee jobs and incomes. There will be higher productivity, higher income for workers, and a well-trained and effective labor supply. An example of this is the case of successful firms in Korea.

3. *Theory of comparative advantage*. This theory argues that even if each country can produce everything, differences in production conditions make it sensible for each one to specialize in producing what it can do best and exchange those products for what other countries can produce better and more cheaply. Thus, an underlying idea here is that it can be inefficient if everyone attempts to be self-sufficient.

Interdependence and the Gains from Trade

To illustrate further, we have to understand the importance of interdependence and the gains from trade. Remember, economics is the study of how societies produce and distribute goods to satisfy the wants and needs of its members. How do we satisfy our wants and needs in a global economy. Do we want to do everything by ourselves? Do we want to specialize and trade with others?

Specialization and exchange is an efficient way to address problems caused by scarcity. Exchange means interdependence, and interdependence has become a norm because more people have realized that they are better-off when they specialize and exchange. This means that people gain more consumption possibilities.

For instance, why did countries join the World Trade Organization? They expected gain from trade through specialization based on comparative advantage.

International Trade Theory

The historical development of international trade theory started during the period of 1500–1750 with *mercantilism*. The mercantilists believe that the country's resources should be used to enrich and make the country powerful both economically and politically. Its economic policies focus on bullionism (or accumulation of wealth as reflected in the country's holdings of precious metals or bullions such as gold and silver), and protectionism. Its guiding principle is 'zero-sum-game'[1] in which the country's economic gain will be at the expense of the other country.

By the early 18th century, some economists challenged the mercantilists that a nation's wealth is not reflected in its accumulation of the precious metals but in its productive

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1 This is a game like poker where the winnings of a player equal the losses of the other player.

capacity; that there are different patterns of trade occurring in the world and several factors determine the country's trade pattern. Several theories have been used to explain such patterns.

1. *Classical trade theory*. At the core of classical trade theory are the principles of absolute advantage and comparative advantage.

   Adam Smith gave the theory of *absolute advantage* to explain that each nation should specialize in the production of a good in which it could produce more efficiently or cheaply than other nations. The theory is based thus on absolute labor productivity. In those times, goods were valued based on labor hours or labor content. The more hours of labor spent on the good, the more expensive is the good.

   A few decades later, David Ricardo developed an alternative trade theory based on *comparative advantage*. The main idea is that a country should specialize in the production of a good if its relative opportunity cost in the production of one good is lower than any other country. Thus, this theory is based on relative efficiency.

   To illustrate the difference between absolute advantage and comparative advantage, consider the data below.

Table 1. Costs of Producing Computer and Wheat in terms of Resource Units

	Australia	*Thailand*
Computer	2	3
Wheat	1	4

Table 1 shows that Australia can produce both computer and wheat with less units of resources. Thus, Australia has an absolute advantage in both products.

Table 2 however shows that if based on which country has a lower opportunity cost, Thailand has the comparative advantage in the production of computers while Australia has the comparative advantage in the production of wheat.

Table 2. Opportunity Costs of Producing Computer and Wheat

	Australia	*Thailand*
Computer	2 tons of wheat	0.75 tons of wheat
Wheat	0.5 computer units	1.3 computer units

In Thailand, to produce one computer unit, the resource requirements will mean giving up 0.75 tons of wheat only. If Australia will produce that computer, it will have to give up 2 tons of wheat. Thus, Thailand has a lesser opportunity cost.

By lesser opportunity cost, this means, less is given up of the other good, or less is sacrificed or there is a lesser trade-off. Comparative advantage therefore implies a relatively more efficient use of a resource.

2. *Neoclassical trade theory*. The neoclassical trade theory is actually based on a basic model developed by Eli Heckscher (1919) and Bertil Ohlin (1933)—as it is often referred to as H–O theory—called factor endowments theory or factor proportions theory. The H–O model postulates that countries will export goods that use their abundant factors relatively intensively and import goods that use their scarce factors relatively intensively. Thus, the determinant of trade is the country's factor or resource endowment. In the original model, these resources are labor and capital. The Philippines, for

example, has so much labor relative to capital, so being labor-abundant the country should specialize in labor-intensive goods. Other economists extended the H–O theory in the succeeding years.

3. *Post H–O theories*. Other models developed after the HO theory are as follows:

    - *Factor proportions with human capital*. Keesing (1966) and Baldwin (1971) recognized a third factor besides plain labor and capital, and that is human skill. Countries well-endowed with professional personnel and highly skilled labor will specialize in the export of skill-intensive goods.

      Wassily Leontief empirically tested the original H–O model using US data to explain the so-called Leontief paradox. He found that contrary to the theoretical expectation, the US, which was presumably capital-abundant, was exporting more labor-intensive goods and importing more capital-intensive good, hence referred to as Leontief paradox. So one explanation to this is that the supposedly labor-intensive goods should be more appropriately considered as skills-intensive. The US level of human skills is high given its significant number of engineers.

    - *Imitation lag hypothesis or technological gap theory*. This theory is attributed to Michael Posner in 1966. Technology is not the same and available everywhere, and that there is a delay in the transmission or diffusion of technology from one country to another. So there are imitation lags and demand lags. Imitation lag refers to the time it takes for a particular country to produce a good with a new technology. Demand lag refers to the time it takes the consumers to familiarize themselves with a new good.

- *Product cycle theory*. This theory was contributed by Raymond Vernon in 1966. A product normally passes through a life cycle: it is initially introduced as a new product in the home country, then it starts maturing and exports begin, and then it is standardized. As production procedures are standardized, the production itself is relocated to a low-cost country. The theory thus postulates a "dynamic comparative advantage" as the country's source of exports shifts throughout the product's life cycle from the home country where the product was originally developed to the low-cost country where the product is standardized and mass-produced.

- *Linder Theory*. This is also referred to as an overlapping demand model developed by Staffan Buenstan Linder (1961). It utilizes a demand-oriented approach, which postulates that the kind of goods that a country exports reflects its per capita income level. Moreover, trade will be more intensive between countries having the same preference or income.

  For example, consider the kind of trade among ASEAN members. Will they be competing with each other? It depends. Actually, they may be importing and exporting goods within the same category, but these goods are differentiated products, that is, products differentiated from each other by style, accessories, design or some other characteristics. Trade is intensive between them because of same preference.

- *Krugman model*. This model (1979, 1983) states that while factor endowments determine the types of goods that a country can export and import, product differentiation and scale economies determine trade and gains from trade. Scale economies refer to the decrease in average costs as the scale of

production increases. There can be internal or external economies of scale. Internal economies of scale arise when average costs fall as the firm size itself is expanding. External economies of scale arise when the average costs fall as the industry expands, even if the individual firm size does not.

With economies of scale and monopolistic competition, each country produces a limited number of differentiated goods and international trade weakens potential possibilities of choices. Economies of scale through intra-industry trade takes in intermediate products to export specialized goods. Intra-firm trade bestows advantage due to organization, market access, or technology access.

Intra-industry trade occurs when a country is both exporting and importing items classified in the same product category. The reasons include product differentiation, transport costs and geographical location, dynamic economies of scale, degree of product aggregation, and different income distribution.

4. *New trade theory*. Among the most important ones in the new trade theories are the strategic trade model, endogenous growth/trade model and the gravity trade model.

    - *Strategic trade model*. Among the major empirical studies that have brought about this model are those of Krugman (1984, 1986); Brander and Spencer (1985); and Grossman and Helpman (1991). The model indicates how a home country can potentially benefit from a trade policy instrument. It involves the consideration of policy instruments that governments are allowed to use and thereby sequence decision making. Thus, the government can use the trade policy as a strategy to maximize benefits.

    - *Endogenous growth/trade model*. Technology and knowledge spillovers are key mechanisms that link international trade and endogenous growth.

Endogenous growth model is one that tells that the factors that determine growth are within the model itself. Grossman and Helpman (1991) show that trade can boost a country's research and development by transmitting technological information, increasing competition and entrepreneurial effort, expanding market size in which the innovative firms can operate.

- *Gravity model*. Tinbergen (1962) and Helpman (1999) used an equation framework to predict the volume of trade on a bilateral basis. They wanted to select what economic variables can best explain or give a "best fit" equation that can explain the volume of trade between the two countries. The common variables are national income, distance, population, and a variable for economic integration.

INSTRUMENTS OF TRADE POLICY

The instruments of trade policy are those tools or measures that a country can use to implement a trade policy. The trade policy, which will be discussed further below, may be one that is more towards an open, liberal trade regime, or one that may be towards a close, protectionist regime.

1. *Tariff*. This is a tax levied on imported goods. This can reduce the volume of international trade. A tariff may be classified as specific, ad valorem, or combined. "A specific tariff is an import duty that assigns a fixed monetary tax per physical unit of the good imported."[2] For example, 7.00 pesos per liter of oil. "An ad valorem tax is levied as a constant percentage of the monetary value of one unit of the imported good."[3] For example, 10 percent. A combined specific-ad valorem may also be used. Formulas can vary from product to product and

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[2] Dennis Appleyard, et al., *International Economics*, 250 (5th ed., New York: McGraw-Hill Companies, Inc., 2006).

[3] *Id.*

from country to country. For example, it may even be specific or ad valorem or whichever is higher.

2. *Export tax*. This is a tax levied only on home-produced goods that are destined for export and not for home consumption. The tax can be specific or ad valorem. Like a tariff, it reduces the size of international trade.

3. *Export subsidy*. This is really a negative export tax or a payment to a firm by government when a unit of the good is exported. Therefore, it is intended to increase the flow of trade.

4. *Quantitative restrictions (QRs)*. These are direct restrictions on imported (exported) goods traded by the country. Quantitative restrictions include quotas, licensing, mixing regulations,[4] voluntary export restraints and prohibitions or embargoes.

   a. *Import quota*. This is a direct restriction on the quantity of some goods that may be imported. The restriction is usually enforced by issuing licenses to some groups of individuals or firms.

   b. *Voluntary export restraint (VERs)*. This is a quota on trade imposed from the exporting country's side instead of the importer's side. It is generally imposed at the request of the importer and agreed to by the exporter to forestall other trade restrictions.

   c. *Local content requirement*. This is a regulation that requires that some specified fraction of the final good be produced domestically. It may be specified in physical units or stated in value terms.

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[4] Mixing regulations. There are two kinds of practices: Regulation that specifies the proportion of domestically produced content in that final good sold in the local market; Regulation that specifies for any imports of a given product, the proportion of the final good that must be purchased domestically. The more common practice is the local content requirement.

d. *Prohibitions or embargoes*. This is a ban on imports (exports) of specified good.

5. *National procurement*. This refers to purchases by government or strongly regulated firms domestically although these goods are more expensive than imports.

6. *Health, safety and phytosanitary regulations*. These are regulations to ensure that products coming from abroad do not carry diseases that could be hazardous to the environment or to the health of humans, animals and plants.

7. *Technical, administrative and other regulations*. These are government rules and regulations that impede the flow of trade like safety requirements, product control requirements, labeling, and consular formalities.

8. *Exchange controls*. These are restrictions on the availability of foreign exchange used to buy imported items.

Issues in Trade and Development

There are two main issues to be discussed below: (1) free trade versus protectionism, and (2) outward- as against inward-oriented industrialization. In the development of economic theory, the idea of free trade was advocated by Adam Smith as an ideal trade policy. There are several reasons supporting free trade. Free trade allows both parties to optimize the use of its resource endowments. There is a more efficient resource allocation on an international level. There is increased product specialization. It increases the product choices for consumers. It can lead to transfer of technology. It can also accelerate economic growth.

On the other hand, there are also significant reasons why some people do not like free trade, and instead prefer the opposite, that is, some trade protection. There are static arguments as well as dynamic, or strategic, arguments for protection.

Static arguments for protection. First, there is the domestic market failure argument. There exist in both the consumer market and the factor market (the markets for raw materials, labor and capital) some distortions. These may be due to positive externalities, such as job creation, or negative externalities such as pollution. Second, argument for protection is the desire to increase domestic employment. A third argument is the need for national security. This national defense argument points to the cases of sectors very vital to the country in case of war or emergency. Finally, it is also argued that the government needs revenues from the tariff impositions.

Dynamic or strategic arguments for protection. The protection measure may be used as a strategic trade policy or as a counter strategic behavior. An example is a tariff policy to decrease the monopolistic influence of a big trading country. Another reason behind protection is the infant industry argument. Supposedly temporary, this is a protection used for young firms that are deemed to have potential comparative advantage. There is also the argument on spillover effects, such as those resulting from technology spillovers or some facility that gives marginal social benefit greater than the social cost.

Krugman (1993) cites a broad political economy argument for free trade. He says:

> free trade is a pretty good, if not perfect, policy. While an effort to deviate from it in a sophisticated way will probably end up doing more harm than good.[5]

Trade and industrialization are very much related. Balassa (1980) provided a conceptual framework on the process and strategies of industrial development for developing countries in Latin America, East Asia and South Asia. He divided industrialization in two stages.

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[5] Paul Krugman, "Free Trade: A Loss of (Theoretical) Nerve? The Narrow and Broad Arguments for Free Trade," *The American Economic Review*, Vol. 83, No. 2, pp. 362–366 (1993).

The first stage is where there is replacement of domestic production of imports of non-durable (e.g., consumer goods like clothing, shoes and household goods) and of other inputs (e.g. textile fabrics, leather and wood). The second stage is where there is replacement by domestic production of the imports of intermediate goods, producer and consumer durables (e.g., machinery, equipment and household appliances).

Another way to characterize these stages is to say that the first stage is intensive in unskilled labor, where there is low level of output, and where operations do not require a network of suppliers of parts, components and accessories. The second stage, on the other hand, is capital intensive. It is subject to economies of scale. The efficient plant size could be higher than domestic requirements. Higher costs at low levels of output may increase further with organizational and technical inefficiencies.

Economies of scale in the second stage refers not to plant size but to horizontal and vertical integration. Horizontal integration requires reduction of product variety. For example under the Philippine Car Manufacturing Program, there may be a limit of passenger cars to five models. This will allow longer production runs and lower production costs through efficiency, savings on expenses from moving from one operation to another, and use of special machinery. Vertical integration involves the manufacture of standardized parts, components and accessories and other vital intermediate inputs on an efficient scale in separate plants. Costs are substantially reduced with subdivided production process among plants of efficient size.

In relation to trade, the industrialization strategy may be outward-oriented or inward-oriented. Outward orientation means providing similar incentives to production for domestic and export markets. Inward orientation means biased production for domestic rather than export market.

The East Asian newly industrialized countries are said to have accelerated their development through outward-oriented industrialization strategy. Export firms obtained inputs from domestic or imported sources. They availed of exemptions from indirect taxes on inputs and outputs, and exemptions from duties on imported inputs. Export goods got equal treatment. The incentive system was automatic and stable.

Balassa's conclusion is that those countries with outward-oriented industrial policy had higher sustained growth rates in export, employment, and GNP than the inward-oriented countries.

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Sovereignty, the Philippines, and the WTO[*]

Atty. Jeremy I. Gatdula

There is this comment commonly known to all and that is that "all politics is local."[1] Corollary to this is the comment made by Professor John Jackson that "all economics is international." It is in these two comments that a lot of the tension has arisen with regard to the development of "jurisprudence" on international economic law and the present developments in the multilateral trading system.

This tension is essentially distilled into one word and that is: sovereignty. It is this word, this concept, by which the present rules on international trade are most shaped, by which jurisprudence struggles with, and by which the World Trade Organization is in the shape that it is right now.

The interesting thing about this concept is that it has all been written off by legal scholars as a mere "nuisance." An eminent legal personality commented that sovereignty is not the concept that it was when the concept was first determined in the 17th century, under the so-called Westphalian concept of the same.

That may all be well and good but when you see the developments happening in all the other parts of the globe that you see that the comments and observations of intellectuals, as is sometimes the case, register a disconnect with what happens in the real world. Thus, you see France trying to block the entry of foreign players into its domestic business environment, the EC doing the same to a number of American

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1 Uttered by US Congress House Speaker Tip O'Neil.

firms, all under the guise of security or upholding of competition policy laws. While not discussing the merits of the said grounds, the fact still remains that foreign investment and trade is being hampered. If one still does not see the possibility of a strong reliance on the concept of sovereignty, as pushed by an increased nationalism, on the part of nations, particularly the developed countries, one only has to look at Chinese and Vietnamese shoes intended to be exported to Europe to get the point.

So the fact still remains that, far from an "eroded" concept, sovereignty is still strongly relied upon by politicians, lawyers, and government officials of States. The problem here is that, what exactly is sovereignty that so many are relying on? When you listen to our elected representatives, trade activists, musicians and artists, pundits, and even your law professors, what exactly is this concept of sovereignty?

The fact is that the concept of sovereignty is highly ambiguous and this essentially is why there is this tension between international trade and domestic laws, between national rights and the multilateral trading system. If there is indeed a defined concept of sovereignty then that definition would most probably be only in the mind, with only the most tenuous link to reality.

Thus, unless this "sovereignty" is resolved, there would only be continuing problems in the multilateral trading system, from implementation to that of dispute settlement system.

I. Ambiguity of Sovereignty in Philippine Law

Every law student has memorized the definition of sovereignty as written in the textbooks. Thus, Justice Isagani Cruz writes in his political law that sovereignty is the "supreme and uncontrollable power inherent in a State by which that State is

governed."[2] Thus, according to Justice Cruz, there are two kinds of sovereignty: legal and political:

> Legal sovereignty is the authority which has the power to issue final commands whereas political sovereignty is the power behind the legal sovereign, or the sum total of the influences that operate upon it. In our country, Congress is the legal sovereign, while the different sectors that mold public opinion make up the political sovereign.
>
> Sovereignty may also be internal or external. Internal sovereignty refers to the power of the State to control its domestic affairs. External sovereignty, which is the power of the State to direct its relations with other States, is also known as independence.
>
> Sovereignty is permanent, exclusive, comprehensive, absolute, indivisible, inalienable, and imprescriptible.[3]

Dean Mariano F. Magsalin, Jr., in his book, goes on to discuss sovereignty as follows:

> Sovereignty: The supreme power of the State to command and enforce obedience, the power to which all interests are practically subjected and all will subordinate. It is also defined as freedom from outside control in the conduct of internal and external affairs.
>
> Dual Aspect. Internal sovereignty is the supremacy of a person or body of persons in a State over the individuals or association of individuals within the area of its jurisdiction. External sovereignty is the absolute independence of one State as a whole with reference to other States.
>
> Kinds. Legal sovereignty is the possession of unlimited power or authority that by law involves the power to issue final commands. Political sovereignty is the sum total of all the

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[2] Isagani Cruz, *Philippine Political Law* 24 (1991) (citing Garner, *Political Science and Government*). Nachura defines sovereignty in the same way; see Antonio B. Nachura, *Outline Reviewer in Political Law* 20.

[3] *Id*., as to the attributes of sovereignty, Cruz was citing *Laurel v. Misa*, 77 Phil. Rep. 856.

> influences in a State which lie behind the law. It is also described as the power of the people.
>
> Characteristics:
>
> Permanence. Sovereignty continues to exist without interruption as long as the State itself exists.
>
> Exclusiveness. There can be but one supreme power in the State legally entitled to the obedience of the inhabitants.
>
> Comprehensiveness. Sovereign power extends over all persons, associations, and things within territorial limits.
>
> Inalienability. The State cannot cede away any of its essential elements without self-destruction.
>
> Imprescriptibility. The powers of the State cannot be lost as a consequence of its non-assertion or non-exercise through a period of time.
>
> Unity. The power cannot be divided without producing another State."[4]

Those definitions, concepts, and enumerations of characteristics and attributes are all pretty well and good for the law student to study and memorize, in preparation for exams (most particularly the Bar exam), and in essence such are the intentions anyway of the authors. However, in practice, the said definitions do nothing by way of guidance.

Going back again to the definition of sovereignty: "supreme and uncontrollable power inherent in a State by which that State is governed." The words, while high-sounding and majestic, as befit the concept they are supposed to define, are hard to actually put down in the messy world of reality.

Sovereignty is supreme? Supreme as to whom? Definitely not as against other States. Supreme over the people? What then of the concept called the political sovereign? Even then, as one of two important Supreme Court cases on sovereignty shows, the same is not supreme and could be bargained away as is necessary. It is "uncontrollable." What does uncontrollable

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4 Mariano F. Magsalin, Jr., *Philippine Political Law* 68 (2002).

mean? How in practice can this uncontrollability be illustrated? Even then, our Supreme Court cases show a sovereignty that is manageable not uncontrollable.

We leave the third clause and focus on the fourth first: "by which that State is governed." This does not make sense. The State is not governed by sovereignty, sovereignty is an attribute of the State. If not, then this would be contrary to the concept of the legal sovereign and of internal sovereignty.

Again leaving the third clause and moving first to the attributes of sovereignty, one can see that again the same leaves no cause for guidance. The attributes were culled from the Supreme Court case of *Laurel v. Misa*, by which it is enumerated as follows: permanent, exclusive, comprehensive, absolute, indivisible, inalienable, and imprescriptible.

Perhaps, no discussion is possible on the attribute of permanent and exclusive. Note, however, that with the concept of *pacta sunt servanda*, exclusivity is a little bit mitigated because if the State itself is obligated to comply with its international obligations then indirectly so do its citizens. With regard to the attribute of comprehensive ("sovereign power extends over all persons, associations, and things within territorial limits"), this is not exactly accurate as persons or organizations granted State immunity (as differentiated from diplomatic immunity or immunity from the jurisdiction of local courts) are not exactly under the sovereign powers of a State. As to the "absolute" attribute and "indivisible," what do they exactly mean? They have not been defined either by jurisprudence or by that of legal commentators. If "indivisible," would such have a bearing if our republic becomes a federal society? What, in practice, could be meant? It is interesting to note that in *Tañada v. Angara*,[5] the Supreme Court uses the following words:

> By their inherent nature, treaties really limit or restrict the absoluteness of sovereignty. By their voluntary act, nations

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[5] *Tañada v. Angara,* 272 SCRA 18.

> may surrender some aspects of their State power in exchange for greater benefits granted by or derived from a convention or pact.

And it continues:

> [As illustrated by numerous existing treaties of which the Philippines is a party to], the Philippines has effectively agreed to limit the exercise of its sovereign powers of taxation, eminent domain, and police power. The underlying consideration in this partial surrender of sovereignty is the reciprocal commitment of the other contracting States in granting the same privilege and immunities to the Philippines, its officials and its citizens.

Of "inalienable," what is the extent of this "inalienability" as can be seen vis-à-vis the case of *Tañada*?

We go now to the third clause and this is most interesting: "inherent in a State." This presupposes that sovereignty is that which is necessary to be there in order for a State to be considered as such. So we go now to a discussion on what is a State.

"State," as defined by Cruz, is a group of people, living together in a fixed territory, organized for political ends under an independent government, and capable of entering into international relations with other states.

The following is what the definition of a State is as enunciated by the Supreme Court: "A community of persons, more or less numerous, permanently occupying a definite portion of territory, independent of external control, and possessing a government to which a great body of inhabitants render habitual obedience."[6]

The foregoing definitions, presumably, were culled from that definition contained in Article 1 of the 1933 Montevideo Convention on Rights and Duties of States:

> the state as a person of international law should possess the following qualifications: permanent population, defined

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[6] *Collector of Revenue v. Campos Rueda*, 42 SCRA 23.

> territory, government, and capacity to enter into relations with other states.

Two things: the Montevideo Convention did not exactly define what a State is, it merely described what are the attributes that a State should have. Secondly, the Montevideo Convention has traditionally been accepted as reflecting generally the requirements of statehood under customary international law.

For our purposes, we will not discuss the other three attributes (people, territory, government) and, instead, focus on the fourth: the capacity to enter into relations with other states. This is not exactly the concept of sovereignty. This fourth requirement actually denotes an attribute of independence. In order to conduct relations with other states, a state must be legally independent from the authority of any other State.

The concept of sovereignty is different from the concept of independence. This much alone is admitted by the writings of two of our legal experts. Justice Cruz goes on in his International Law that:

> Independence has been described as the external aspect or manifestation of sovereignty, that is, the power of the State to direct its own external affairs without interference or dictation from other States. The degree of its freedom in this regard determines the status of the State as an international person.[7]

Father Bernas goes on to define sovereignty in the following sense:

> Sovereignty means independence from outside control. The Montevideo Convention expresses this in positive terms as including the 'capacity to enter into relations with other States'. This latter element of sovereignty, however, is dependent on recognition.[8]

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[7] Isagani Cruz, *International Law* 30–31.

[8] Bernas, SJ, *An Introduction to Public International Law* 71 (2002).

> So note must be made that Cruz says that "independence has been described as the external aspect or manifestation of sovereignty." Bernas, elaborating on his first sentence, states that "capacity to enter into relations with other States," is an "element of sovereignty."

The point is, independence is different from the concept of sovereignty, and sovereignty is not the "capacity to enter into relations with other States." Taking the foregoing with the above dissection of the accepted local definitions of sovereignty and attributes enunciated by the Supreme Court, do we really have any practicable workable idea of what sovereignty is? The seemingly inescapable conclusion is: none.

II. Sovereignty as an International Law Concept

Notably, the intellectual origins of international law run concurrently with the development of sovereignty. Two leading figures were Hugo Grotius and Gentillus, both theologians by training. Their thesis simply was that international law was municipal law writ large. However, note that boundaries of nations do not move as the boundaries of private estates do. The doctrine of equality of States was introduced into the theory of international law by the naturalist writers. Thus:

> By nature all nations are equal the one to the other. For nations are considered as individual free persons living in a state of nature. Therefore, since by nature all men are equal, all nations too are by nature equal the one to the other.[9]

This doctrine sees equality despite differences in size, power, wealth, etc. See Article 2(1) of The United Nations Charter (UNC): the organization is based on the principle of the sovereign equality of all its members.

Due to the problems of the concept of equality, the better view however is to equate equality with independence. The following are the legal consequences of sovereign equality:

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[9] *Public International Law* 74 (Lord Templeman and Robert M. Maclean, Eds., 1997, citing Wolff).

a. Prima facie jurisdiction over a territory and the population living there.

b. States have a duty of non-intervention in the area of exclusive jurisdiction of other states.

  – No state can claim jurisdiction over another.

  – The courts of one state cannot question official acts of another state taking effect within the latter's jurisdiction.

  – Municipal courts will not exercise jurisdiction over a foreign sovereign in his public capacity.

c. Jurisdiction of international tribunals depend on the consent of parties.

  – In the *Eastern Carelia Case of 1923*, the Permanent Court of International Justice (PCIJ) ruled: it is well established in international law that no state can, without its consent, be compelled to submit its disputes with other states either to mediation or to arbitration or to any kind of pacific settlement.

  – Finally, note that international law has no concept of *stare decisis.*

As to the concept of domestic jurisdiction, it is the principle that certain matters are within the exclusive competence of states and are not subject to international obligations (i.e., granting of nationality, treatment of nationals). Thus, as provided for under the UNC, Article 2, paragraph 7:

> Nothing contained in the present Charter shall authorize the United Nations to intervene in matters which are essentially within the domestic jurisdiction of any State or shall require the Members to submit such matters to settlement under the present Charter; but this principle shall not prejudice the application of enforcement measures under Chapter VII.

In practice, however, Article 2(7) has been given a narrow interpretation, UN organs taking the position that if a matter is

contrary to principles and purposes or peace and security, UN may override domestic jurisdiction considerations.

> The corollary of the independence and equality of States is the duty on the part of States to refrain from intervention in the internal or external affairs of other States. x x x The general position is that the 'reserved domain' is the domain of State activities where the jurisdiction of the State is not bound by international law: the extent of this domain depends on international law and varies according to development.[10]
>
> The relativity of the concept of the reserved domain is illustrated by the rule that a State cannot plead provisions of its own law or deficiencies in that law in answer to a claim against it for an alleged breach of its obligations under international law.[11]

This limitation of the concept of domestic jurisdiction is also illustrated by the power of a State to impose customs tariffs, which is presumably a purely domestic concern but nevertheless is regulated as well by international law.

Going back to sovereignty, there seems to be a consistent lack of unanimity even as to international law commentators in other jurisdictions as to what sovereignty is. Thus, for Glahn, sovereignty is the "ability to regulate its internal affairs without outside interference or control."[12] This, however, is very much suspiciously akin to the concept of independence, which, as we have seen, is an element of sovereignty.

Shaw focuses instead on the Montevideo Convention, particularly the phrase "capacity to enter into relations with other States. For Shaw the

> essence of such capacity is independence. This is crucial to Statehood and amounts to a conclusion of law in the light of particular circumstances. It is a formal statement that the State is subject to no other sovereignty and is unaffected either

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10 Ian Brownlie, *Principles of Public International Law* 293 (5th ed., 1998).

11 *Id.* at 294.

12 Gerhard Von Glahn, *Law Among Nations* 53 (7th ed., 1996).

> by factual dependence upon other States or submission to the rules of international law.[13]

This is seconded by Harris:

> When the Montevideo Convention refers to 'capacity to enter into relations with other States' as a requirement of statehood it is referring to independence.[14]

This refers to "factual, as well as legal, independence from other States."[15]

Nevertheless, Shaw makes one important point:

> The capacity to enter into relations with other States is an aspect of the existence of the entity in question as well as an indication of the importance attached to recognition by other countries. It is capacity not limited to sovereign nations, since both international organizations and non-independent States can enter into legal relations with other entities under the rules of international law. But it is essential for a sovereign State to be able to create such legal relations with other units as it sees fit. Where this is not present, the entity cannot be an independent State.[16]

From this statement alone, one can see that capacity to enter into relations, independence, and sovereignty are three distinct concepts.

Now Brownlie approaches the discussion in another way:

> Another perspective is provided by the notion of sovereignty as discretionary power within areas delimited by law x x x. Yet in all these cases the exercise of the power is conditioned by the law.[17]

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[13] Malcolm N. Shaw, *International Law* 143 (4th ed., 1999).

[14] DJ Harris, *Cases and Materials on International Law* 106 (5th ed., 1998).

[15] *Id*. at 109.

[16] Shaw, *supra* note 13, at 142.

[17] Brownlie, *supra* note 10, at 290 (citing Fisheries case).

> In application of rules or in case of an absence of rules, the presumption is that States have legal competence or is one of incompetence. In the Lotus case, the Court decided the issue of jurisdiction on the basis that 'restrictions upon the independence of States cannot be presumed'. However, there is no general rule, and in judicial practice issues are approached empirically.[18]

Nevertheless, again, this seems to blur distinctions between independence and sovereignty and, this time around, talking as he does of "discretionary power within areas delimited by law," jurisdiction. He does interestingly point out that "in all these cases the exercise of the power is conditioned by the law." The point here is that, whether he was actually talking of jurisdiction or of sovereignty, the implications are large, more so if he was indeed talking of the latter, talking as he does of the supremacy of international law (which is unacceptable in the domestic sphere.)

This blurring between sovereignty and jurisdiction can also be seen in the following:

> Sovereignty is also used to describe the legal competence which states have in general, to refer to a particular function of this competence, or to provide a rationale for a particular aspect of the competence. Thus, jurisdiction, including legislative competence over national territory, may be referred in the terms 'sovereignty' or sovereign rights.'[19]
>
> Jurisdiction refers to particular aspects of the general legal competence of States often referred to as 'sovereignty'. Jurisdiction is an aspect of sovereignty and refers to judicial, legislative, and administrative competence.[20]

Finally, you have John H. Jackson, who is, presumably from his writings, not that big a fan of sovereignty. For him,

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[18] *Id.* at 291.

[19] *Id.*

[20] *Id.* at 301.

sovereignty is essentially a question of "power allocation," although he does mention a legal commentator who calls it "organized hypocrisy." In any event, he cites in one article the following types of sovereignty:

> Domestic sovereignty [is the] organization of public authority within a State and to the level of effective control exercised by those holding authority; interdependent sovereignty [refers to the] ability of public authorities to control transborder movement; international legal sovereignty [is the] mutual recognition of States or other entities; Westphalian sovereignty [is the] exclusion of external actors from domestic authority configurations.[21]

However, Jackson does make a crucial point which is in a way a peripheral theme of this lecture and that is there seems to be no inherent or definite understanding of what sovereignty is and that the same seems to be dependent on custom and on the practice of each individual State.

If that were so, then the concept of sovereignty as understood here, is as good as any and thus it is to this concept, whatever it is, that we return.

III. Sovereignty, *Tañada v. Angara*, and the WTO

Tañada v. Angara was filed in 1994, heard in 1996, and in 1997—or three years after the case was filed and two years after the WTO came into being—it was finally decided.

We will not discuss the details of the case and instead focus on the matters relevant to this lecture. Relevant therefore is the contention by the Petitioners that our entry into the WTO violates Article II, Section 19 of the Constitution, which reads:

> The State shall develop a self-reliant and independent national economy effectively controlled by Filipinos.

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[21] John H. Jackson, *Sovereignty, Subsidiarity, and Separation of Powers in* The Political Economy of International Trade Law 16 (2002).

Also Article XII:

> **Sec. 10**. x x x The Congress shall enact measures that will encourage the formation and operation of enterprises whose capital is wholly owned by Filipinos.
>
> In the grant of rights, privileges, and concessions covering the national economy and patrimony, the State shall give preference to qualified Filipinos.
>
> **Sec. 12.** The State shall promote the preferential use of Filipino labor, domestic materials and locally produced goods, and adopt measures that help make them competitive.

I am surprised they did not make reference to Section 13:

> The State shall pursue a trade policy that serves the general welfare and utilizes all forms and arrangements of exchange on the basis of equality and reciprocity.

While the petitioners did not refer to Article III.1 of the GATT,[22] which I think was relevant, they did make reference to the trade-related investment measures (TRIMS):

> **Art. 2 – *National Treatment and Quantitative Restrictions***
>
> 1. Without prejudice to other rights and obligations under GATT 1994, no Member shall apply any TRIM that is inconsistent with the provisions of Article III or Article XI of GATT 1994.
> 2. An illustrative list of TRIMs that are inconsistent with the obligation of national treatment provided for in paragraph 4 of Article III of GATT 1994 and the obligation of general elimination of quantitative restrictions provided for in paragraph 1 of Article XI of GATT 1994 is contained in the Annex to this Agreement.

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[22] "The contracting parties recognize that internal taxes and other internal charges, and laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products, and internal quantitative regulations, requiring the mixture, processing or use of products in specified amounts or proportions, should not be applied to imported or domestic products so as to afford protection to domestic production."

Most crucially, the petitioners made reference to Article XVI.4 of the Marrakesh Agreement Establishing the World Trade Organization:

> Each Member shall ensure the conformity of its laws, regulations and administrative procedures with its obligations as provided in the annexed Agreements.

Thus, in *Tañada*:

> It is petitioners' position that the foregoing 'national treatment' and 'parity provisions' of the WTO Agreement 'place nationals and products of member countries on the same footing as Filipinos and local products,' in contravention of the 'Filipino First' policy of the Constitution.

The Supreme Court, nevertheless, ruled against the petitioner:

> x x x while sovereignty has traditionally been deemed absolute and all-encompassing on the domestic level, it is however subject to restrictions and limitations voluntarily agreed to by the Philippines, expressly or impliedly, as a member of the family of nations. Unquestionably, the Constitution did not envision a hermit-type isolation of the country from the rest of the world.
>
> By their inherent nature, treaties really limit or restrict the absoluteness of sovereignty. By their voluntary act, nations may surrender some aspects of their State power in exchange for greater benefits granted by or derived from a convention or pact. After all, States, like individuals, live with coequals, and in pursuit of mutually covenanted objectives and benefits, they also commonly agree to limit the exercise of their otherwise absolute rights.
>
> [As illustrated by numerous existing treaties of which the Philippines is a party to], the Philippines has effectively agreed to limit the exercise of its sovereign powers of taxation, eminent domain and police power. The underlying consideration in this partial surrender of sovereignty is the reciprocal commitment of the other contracting States in granting the same privilege and immunities to the Philippines, its officials and its citizens.

This ruling is not without logic and its reasoning in fact is supported by international law literature. Thus, Brownlie states that:

> The institutional aspects of organizations of States result in an actual, as opposed to a formal, qualification of the principle of sovereign equality. x x x Of course it can be said that on joining the organization each member consented in advance to the institutional aspects, and thus in a formal way the principle that obligations can only arise from the consent of States and the principle of sovereign equality are satisfied.[23]

Furthermore, international trade law commentators Trebilcock and Howse indeed agree that:

> All international treaties, whether relating to nuclear disarmament, human rights, the environment, the law of the sea, or trade, constrain domestic political sovereignty through the assumption of external obligations x x x. x x x trade treaties that structure relations by reference to durable, well-defined substantive norms and objective dispute resolution procedures reduce the risks of larger countries exploiting raw economic power to bully smaller countries, by subjecting power relations to some form of legal ordering. In addition, smaller countries typically stand to gain disproportionately from trade liberalization.[24]

The Catholic Church's doctrine, enunciated in Number 435 of the Compendium of the Social Doctrine of the Church, seems to be in agreement with the reasoning in *Tañada v. Angara*:

> National sovereignty is not, however, absolute. Nations can freely renounce the exercise of some of their rights in view of a common goal, in the awareness that they form a 'family of nations' where mutual trust, support and respect must prevail.[25]

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[23] Brownlie, *supra* note 10 at 292.

[24] Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade* 14–15 (2nd ed., 1999)

[25] "434. x x x

The international community is a juridical community founded on the sovereignty of each member State, without bonds of

In terms of logic and reasoning, there is indeed nothing much one can say with which the Supreme Court met the concerns of the petitioners, at least those which we pointed out and leaving others to another time. However, it is the philosophical implications of the Supreme Court's ruling that is of interest to us here and bears further examination.

Essentially, what the Supreme Court laid bare in the case of *Tañada* is a concept of "sovereignty" that is seemingly in keeping with the concept as apparently understood by international law commentators, not precisely that of national practice, albeit with its ambiguities, that at the same time is seemingly different from the concept of an absolute, indivisible, inalienable sovereignty, a sovereignty that is supreme and uncontrollable.

In his annotation to the *Tañada* case in the *Supreme Court Reports Annotated* (SCRA), Jorge Coquia stated that:

> It is obvious that the term 'sovereignty' has now lost the meaning attributed to it in the past centuries. States may still be described as 'sovereign States' but their sovereignty is under the law to which they have bound themselves by the UN Charter. It is sovereignty in the fields of national law or domestic jurisdiction that lie outside the newer areas controlled by international law.[26]

This reading of the concept of sovereignty obviously jives with the reading of sovereignty by the Supreme Court. Inasmuch

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subordination that deny or limit its independence. Understanding the international community in this way does not in any way mean relativizing or destroying the different and distinctive characteristics of each people, but encourages their expression."

"435. The Magisterium recognizes the importance of national sovereignty, understood above all as an expression of the freedom that must govern relations between States. Sovereignty represents the subjectivity of a nation, in the political, economic, social and even cultural sense. x x x"

[26] Jorge Coquia annotating *Tañada v. Angara,* 272 SCRA 18, 94.

as the judiciary and apparently the greater body of the legal academe is in agreement with this present understanding of sovereignty, the question that remains is whether perhaps such understanding is shared by the greater Philippine community.

IV. Conclusion

> The erosion of the concept of 'sovereignty' in international affairs has been much commented on. Perhaps in no context more than international economic affairs has this erosion actually occurred.[27]

Thus so says John Jackson, thus so says the Philippine Supreme Court. Having said that, a cursory survey of the statements and declarations of other members of the body politic, from politicians and trade activists, NGOs and members of the general academe, the concept of sovereignty is still invoked with passion and resolute reliance.

The reason is the undeniable ambiguity that the concept of sovereignty has. Whether it is ambiguity in the Philippine context or in the greater realm of international law study, sovereignty is still—in a workable, practicable, categorical sense—undefined.

This concern is furthered by the fact that there is a seeming acceptance, even favor, to this continued ambiguity. For bureaucrats because of the available policy space it creates, to activists and legal practitioners because of the wide parameters within which to shape advocacies, to politicians because its vagueness lends itself easily to rhetoric.

So what are the implications for the situation that we are currently in? For the WTO, the implication is a continued danger for the multilateral trading system. Member countries will continue to pull and tug at the provisions and the rulings of the Dispute Settlement Board (DSB) in a manner that may eventually derail the WTO both as a negotiating forum and as a venue for

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[27] John H. Jackson, *The World Trading System* 79 (2nd ed., 1999).

justiciable disputes. The probability has been forwarded that the WTO as a negotiating forum could be rendered naught but its DSB still in full form. This I believe needs to be further examined because if the WTO as a negotiating forum is rendered meaningless, the lack of new trade rules that will reflect present trade realities will eventually render the WTO dispute settlement system futile. Now, some suggested remedies for this admittedly dire (perhaps) scenario are

a. for the realm of public international law to find a solution to this definitional conundrum of sovereignty,

b. for the WTO Members to come to an agreement that will circumvent this conundrum, or

c. for the WTO Members to voluntarily desist from giving in to "sovereignty arguments."

All three remedies are highly difficult to achieve, particularly the last two for the reasons stated above.

For the Philippines, the implication would be the continuation of the status quo, which is both a bane and a boon. Taking the positive side first, the ambiguity allows the Philippines a wide policy space within which to interpret the economic provisions of the Constitution and at the same time within which to formulate trade policy. On the minus side, the ruling in *Tañada* does paint the Philippines in a legal corner. For having conceded to a mitigated power of sovereignty and a narrower scope of sovereignty (to mere domestic jurisdiction —which it must be remembered is narrowly getting construed by international law), then the Philippines may have just given itself a weaker legal justification for an aggressive trade policy if it so decides in the future. On a wider view, the lack of a determined compass within which to guide ambiguities in our trade future would certainly have to be engaged sooner or later.

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*Interwar Period: 1918–1939**

Ms. Cristina M. Bautista

"In all the long history of money the decade of the 1920s—
extended by a few years to the consequences—
is perhaps the most instructive."[1]
— John Kenneth Galbraith

This paper will trace the historical events that precipitated the 1944 Bretton Woods agreement—an agreement that would determine a postwar international monetary and trade order. The interwar period, 1918–1939, draws three lessons. First, it is a story of nations struggling to attain internal stability and external stability. In some cases, it required a trade-off between the two. Second, it is also a story of international cooperation, and lack of it. Third, it is a story of conflicting views on what is just and unjust.

The Gold Standard and the World Economy before 1914

Just before the First World War of 1914–1918, Western Europe and North America dominated the world economy. In 1913, Europe accounted for 58.4 percent of world trade, while the United States (US) and Canada together had 14.1 percent share.[2] There was financial liberalism, and private bankers and central bankers had a considerable influence on the monetary order.

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* Delivered at the *Seminar-Workshop on Law and Economic Development Issues for the Philippine Judiciary* held on March 27–28, 2007, at the Quezon City Sports Club, Quezon City.

1 John Kenneth Galbraith, *Money: Whence It Came, Where It Went* (London: André Deutsch Limited, 1975), 147.

2 Rondo Cameron, *A Concise Economic History of the World* (Oxford: Oxford University Press, 1993), 340.

The financial system was based on the gold standard. In Britain, the gold standard had been in place legally since 1819, through the Resumption Act of the British Parliament.[3] Towards the end of the 19th century, other major countries followed.

Economic historian Rondo Cameron explains that "the high degree of integration achieved in the world economy in the late nineteenth century depended critically on general adherence to the international gold standard x x x that integration depended primarily on the central role of Great Britain, and of London, its financial as well as political capital, in the world economy."[4]

What is the gold standard? In Britain then, it meant that "(1) the Royal Mint was obliged to buy and sell unlimited quantities of gold at a fixed price; (2) the Bank of England—and by extension, all other banks—was obliged to exchange its monetary liabilities (banknotes, deposits) into gold on demand; and (3) no restrictions could be imposed on the import or export of gold."[5] In the gold standard system, "the primary responsibility of a central bank was to preserve the official parity between its currency and gold; to maintain this price, the central bank needed stock of gold reserves."[6]

The gold standard is supposed to provide automatic external and internal balance to the economy. External balance implies that there will just be adequate amount of gold, i.e., "the central bank was neither gaining gold from abroad nor (more important) losing gold to foreigners at too rapid a rate."[7] This implies that

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3 Paul R. Krugman and Maurice Obstfeld, *International Economics* (Massachusetts: Addison-Wesley Publishing Co., 2000), 538.

4 Cameron, *supra* note 2, 284.

5 *Id.* at 285.

6 Krugman and Obstfeld, *supra* note 3, at 538.

7 *Id.* at 539.

in the country's balance of payments, there will be no excessive current account surplus, nor excessive current account deficit.[8]

Theoretically, the gold standard should also ensure internal balance. Internal balance is achieved when there is price stability and low unemployment. Since central banks maintain a parity rate between their currency and gold, this puts a limit to the growth of money supply, which in turn puts a limit to the growth in prices.

However, there are some drawbacks.[9] First, historical experience shows mixed results on price stability, primarily because the relative price of gold with respect to other goods also changes.[10] Second, achieving internal balance was also made difficult by the inflexibility of monetary policy under the gold standard as a tool to fight unemployment. Third, even when there is economic growth, central banks' holdings of international gold reserves will still be ultimately limited by new gold discoveries. Fourth, countries with large gold production will have more ability to influence world macroeconomic conditions.

During the war, the belligerent countries one by one abandoned the gold standard so that "no major country now allowed the free export of gold x x x and since gold could not leave, its loss could not reduce bank reserves, reduce bank deposits, reduce note circulation x x x [so that] Each of the industrial nations, in other words, was now free to pursue internal economic policies that reflected its preference or necessity."[11]

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[8] The balance of payments (BOP) record of a central bank has two major components, the current account and the capital account. The current account records the value of trade in goods and services. The capital account is the financing component for the current account such as loans and investments.

[9] Krugman and Obstfeld, *supra* note 3, at 515–516.

[10] *Id.* at 541.

[11] Galbraith, *supra* note 1, at 147.

The 1918 Armistice and the 1919 Paris Peace Conference

The entry of the United States into the war, albeit only in April 1917, ensured the Allied victory over Germany. This was after Germany's unrestricted use of submarine warfare. The arrival of US troops in Europe turned the tide against Germany, and in November 1918, Germany asked for an armistice. Earlier that year, in January, US President Woodrow Wilson spoke before the US Congress about his 14-point declaration for a just and lasting peace. It was on this basis that the Germans preferred to communicate with the US their intention for a truce, for Wilson was thought to be a man of moral authority.

What terms did Germany get? There were 34 terms in all which included Germany's evacuation of territories it held—most of Belgium and Luxembourg, and a sixth of France—plus Alsace and Lorraine, the provinces it had annexed from the beaten France after the war of 1870–1871, the movement of Allied forces into Germany, the surrender of German fleet, freight cars, locomotives, trucks, bombers, fighter planes and various artillery, save for the German soldiers' own rifles.[12] While the ceasefire brought celebrations in cities of the Allied nations, the crippling terms stunned the Germans and in silence brewed vindictive emotions.

In January 1919, 32 nations led by the major Allied nations of Britain, France, US, Italy and Japan gathered for a peace conference in Paris to formally draw a postwar settlement with Germany. Their general interests were for Germany to be disarmed, to give up certain territories which included agricultural and mineral-rich lands, to pay reparations to cover war damages, and to accept the verdict of war guilt—later incorporated in the treaty as Article 231—which was the most humiliating of all for the Germans.

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[12] Robert T. Elson, et al., *Prelude to War* (Canada: Time-Life Books, Inc., 1977), 19.

Although the core group was composed of two representatives each from the five Allied nations, crucial decisions were actually made by the so-called Big Four: Georges Clemenceau of France, who served as the chairman; Britain's Prime Minister David Lloyd George; Premier Vittorio Orlando of Italy, and US President Wilson.[13] Wilson, in particular, was interested in establishing the League of Nations to maintain peace in a new postwar order.

By itself, the reparations issue was the most difficult to decide on—and for this reason, a Reparations Commission was formed—with the final agreement inadvertently contributing to an international monetary disorder in the years that followed.

In May 1919, the Treaty of Versailles that came out of the Paris Peace Conference was presented to a German delegation. The Germans saw the terms as unjust and out of proportion. So out of line from Wilson's 14-point declaration, it was a punitive peace treaty and the Germans felt betrayed. They filed 443 pages of objections, but yielded nonetheless after slight mitigation of terms.

Even British economist John Maynard Keynes, who had earlier seen an initial copy of the treaty, resigned from being an adviser to the delegation for he saw it as a "rotten peace."[14] He then wrote *The Economic Consequences of the Peace*, predicting "the dire consequences, not only for Germany but for all Europe, unless the reparations clauses were revised."[15] According to Cameron, the peace treaty exacerbated the economic problems instead of solving them and this was because the peacemakers failed to consider the growing economic nationalism as well as the monetary and financial problems brought by the war.[16]

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[13] *Id.* at 24.

[14] *Id*. at 28.

[15] Cameron, *supra* note 2, at 351.

[16] *Id.* at 350.

The Treaty of Versailles was signed by Germany and the Allied representatives on June 28, 1919.[17] But this did not really bring genuine peace and reconciliation. It only prolonged the armistice and led to 20 more years of recurring crises culminating in World War II. The US Senate did not ratify the treaty even as President Wilson, whose health had weakened by then, toured the country to appeal this to his countrymen. Among the reasons was "a distrust of the provisions of the Covenant of the League of Nations," perceived to threaten America's sovereignty.[18] In 1921, US signed a separate treaty with Germany.

Economic Consequences of World War I[19]

The war cost the belligerent nations dearly. There was the direct monetary cost of the war for military operations. Military and civilian casualties numbered about 60 million killed, wounded, dead from disease and starvation. Property damage included housing, industrial plants and equipment, mines, livestock and farm equipment, transportation and communication facilities contributing to industrial losses. Foreign trade and economic relations were disrupted due to, among others, British-German retaliatory actions, border disputes, and US protectionist tariffs. Belligerent countries, like France and Germany, lost significant foreign investments as well as foreign markets. Agricultural markets were upset by shortages in some areas and overproduction in others. Agricultural protection followed. European financial and commercial services lost incomes. The major countries abandoned the gold standard and much of the war was financed by heavy borrowings and printing of paper money, contributing to widespread inflation in Europe.

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17 Separate treaties with Austria, Hungary, Bulgaria and Turkey were to follow. Elson, *supra* note 12, at 30.

18 Elson, *supra* note 12, at 31.

19 Cameron, *supra* note 2, at 347–350.

The world's economic structure changed as Europe weakened, a new Soviet Union rose, US became a net creditor, and Japan's economic power grew.

The Reparations Tangle

The reparations tangle—a complex problem involving the reparations and the inter-Allied war debts—resulted from the peace treaty. It was at the heart of the monetary and financial disorders during the interwar period.

Until 1917, Britain was the chief financier of the Allied war effort. By the end of the war, the US became the chief financier lending a total of about $10 billion, with Britain also advancing $7.5 billion and France, $2.5 billion.[20] At the same time, both Britain and France were also indebted to the US.

France and Britain demanded reparations from Germany. But the US made no demand, and instead insisted on debt collection for it regarded the loans as commercial propositions. Although the US later agreed to reduce interests and lengthen repayment period, it still insisted on the full payment of the principal.

Germany had, all the while, been paying in cash and in kind (such as coal) even before the total bill was known. These payments were to be credited later. By April 1921, the Reparations Commission informed Germany that the total bill would be 132 billion gold marks, roughly $33 billion—more than twice the German national income.[21] But the economic restrictions made it impossible for Germany to generate that much money. Due to reparations pressures, coupled with speculators' activities, the value of the German mark began to fall in 1922 until Germany had to cease payments. This prompted France and Britain to occupy Germany's industrial heartland, the Ruhr coalmines. Germany then printed so much paper money, triggering a runaway inflation.

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[20] *Id.* at 352.

[21] *Id.* at 353.

The external and internal value of the German mark fell. In 1919, the exchange rate was 14 paper marks to $1. By November 1923, it was already 4.2 trillion paper marks to $1. Germany then demonetized and it created the rentenmark, equivalent to one trillion of the old paper mark.[22] In 1919 also, Germany's price index was 262. By 1923, it was already 126 trillion.[23]

THE BANKERS' INITIATIVES: RETURN TO GOLD STANDARD AND FINANCIAL LIBERALISM

In the 1920s, private and central bankers—particularly those from New York and London—worked to restore financial liberalism through various initiatives. During monetary conferences in 1920 in Brussels and in 1922 in Genoa, Italy, "these bankers called for a return to balanced budgets, independent central banks, free capital movements, and above all, the international gold standard. x x x Working closely together, they offered large loans to governments willing to adopt these policy changes."[24] US banker Charles Dawes led an international commission that recommended the reparations relief, reorganization of the German central bank, and capital inflow, mostly in the form of US loans, for Germany's recovery. With these, the hyperinflation ended, and Germany was able to resume reparations payment and return to the gold standard in 1924.

The bankers succeeded to some extent as major countries, one after another, returned to the gold standard and private international lending resumed. However, this victory was cut short by the rapid deterioration of confidence as a result of the

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22 *Id.* at 353–354.

23 Krugman and Obstfeld, *supra* note 3, at 543.

24 Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (New York: Cornell University, 1994), 26.

1929 US stock market crash, worldwide depression, continuing reparations tangle, and large payments imbalances.[25]

Britain's Woes, Europe's General Normalcy

Economist John Kenneth Galbraith would later refer to Britain's economic difficulties in the 1920s as "self-inflicted wounds."[26] As a financial center, London bankers naturally wanted to go back to the gold standard as soon as possible. By the mid-1920s, the Bank of England had adequate gold. The British Chancellor of the Exchequer Winston Churchill resolved to return Britain to the gold standard to the prewar pound price of gold. However, this was no longer realistic because it "would place British industry at a competitive disadvantage with respect to the United States and to other countries."[27] At that time, Britain still had higher inflation rate than the US. Even then Churchill argued "any deviation from the prewar price would undermine world confidence in the stability of Britain's financial institutions."[28]

To be competitive, British industries had to reduce prices, which consequently required wage reduction. This contributed to labor unrest and class divisions. Meanwhile, the government had been resorting to a dole system as unemployment relief, but this put pressure on its budget. It was forced to cut spending, further slowing down economic recovery and modernization.

For the European mainland, the most part of the continent had recovered and returned to normalcy from 1924 to 1929. Major countries like Germany and France regained prosperity, yet it was said that "the basis of this prosperity was fragile,

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[25] *Id.* at 27.

[26] Galbraith, *supra* note 1, at 164.

[27] Cameron, *supra* note 2, at 356.

[28] Krugman and Obstfeld, *supra* note 3, at 543.

depending on the continued voluntary flow of funds from America to Germany."[29]

The Great Depression

An economy can experience ups and downs—that is, fluctuations in production and consequently in employment. These are referred to as business cycles. When the economy continually contracts, it is experiencing a recession. Unemployment rises and incomes fall. When the situation becomes severe, it is a depression.

In economic history, 1929 is known usually as the start of the so-called great depression. It was great in terms of severity, of geographic impact, and of duration.

It was on October 24, 1929, when the New York stock market experienced a wave of panic selling, which caused the stock prices to drastically fall. That day was to be known as the "Black Thursday." This stock market crash per se did not cause the depression, but it was a clear signal.

As to what caused it, there appears to be no single one. It was more of the convergence of several economic and political factors. Some of the major factors are cited below.

One was the British stagnation in the 1920s which pulled down London as a financial center. This weakened the confidence in the stability of the gold standard. At that time, "many countries held international reserves in the form of pound deposits in London [but] Britain's gold reserves were limited, however, and the country's persistent stagnation did little to inspire confidence in its ability to meet foreign obligations."[30]

Another was the speculative boom experienced in the New York stock market in 1928, which caused bankers and investors "to cut down their purchases of German and other foreign bonds

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[29] Cameron, *supra* note 2, at 356.

[30] Krugman and Obtsfeld, *supra* note 3, at 544.

in order to invest their funds in the New York stock market x x x. By the late summer of 1929, Europe was already feeling the strain of the cessation of American investments."[31]

So there was a spectacular rise followed by a dramatic fall in stock prices. It can be noted that such fluctuations are partly due to psychological factors, including what Keynes would refer to as "animal spirits" of investors—swings of optimism and pessimism.

Recent literature point to the gold standard as a major factor.[32] Many countries had already returned to the gold standard by 1929. At that time also, US and France were doing very well and this led to fears of overheating economy and inflation. They were actually accumulating so much gold through trade and capital inflows, as other countries tried to conserve theirs. More gold in the US, for instance, meant more money, and more money meant more demand, and consequently higher prices. So to arrest inflation, monetary contraction was pursued.

This was followed by waves of bank failures around the world, which was another major factor. Galbraith wrote that "in 1929, 659 banks failed x x x. In 1930, 1,352 went under and in 1931, 2,294 x x x. When a bank failed, the depositors no longer had their money to spend. So their spending was reduced. And loans and deposits were no longer created on behalf of the borrowers. So their investment and further spending fell x x x. Both bank failures and the fear of bank failures thus had the same effect. Both were forces of compelling power to induce deflation—to contract consumer spending, investment spending and therewith sales, output, employment and prices."[33]

As many governments tried hard to stay on the gold standard, it prevented them from providing liquidity to the

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[31] Cameron, *supra* note 2, at 357.

[32] Krugman and Obtsfeld, *supra* note 3, at 545.

[33] Galbraith, *supra* note 1, at 190–191.

banks which could have helped these banks stay in business. They possibly feared that cash injected into the banks would increase private claims to the government's gold holdings. Apparently, those countries which left the gold standard relatively early during the depression, such as Britain in 1931, experienced milder declines. France, which stuck to the gold standard until 1936, had more severe contractions.[34]

Another element to consider is business confidence. There were views that 'bankers and businessmen had to be respected even when they were wrong x x x for if actions were taken in opposition to these views, business confidence would be impaired. Impaired confidence would mean reduced investments."[35]

On the fiscal policy side, an exacerbating factor was US President Herbert Hoover's preoccupation with balancing the budget. This meant reducing government spending and raising taxes. With private spending—consumption and investment—already falling, reducing government spending further reduced aggregate demand, which definitely did not help stimulate production.

Keynes indeed argued in the years that followed that total expenditures or demand in the economy stimulate economic growth. Thus, contraction in spending will also contract the economy. So if the situation demands that the government spends, in spite of its deficit, it should do so to reverse the economic slowdown and stabilize the situation.

On the external policy side, as domestic economies were feeling the contraction, the governments started raising trade barriers to discourage imports and keep the money within their countries. For instance, "the Smoot-Hawley tariff imposed by the United States in 1930 had a damaging effect on employment abroad. The foreign response involved retaliatory trade restrictions and preferential trading agreements among groups

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[34] Krugman and Obstfeld, *supra* note 3, at 545–546.

[35] Galbraith, *supra* note 1, at 187.

of countries."[36] These were beggar-thy-neighbor policies—those that improve one country's welfare at the expense of other countries.

There were a few other factors cited in the literature on the great depression, but for whatever the precise cause or causes, there appears to be general agreement that British and US positions and policies were central to the problem.[37] Before the first world war, Britain was the economic leader promoting free trade policies and foreign investments. After it weakened, no one was able to fill in the leadership vacuum. Although US had begun to dominate the world economy, its policies were not so receptive to this role—as shown by its protectionist position, among others.

Recovery, the Second World War, and the Bretton Woods

The recovery of the US pretty much followed the Keynesian advice pertaining to government intervention, particularly through more government spending. A new administration took over in 1933 led by President Franklin Roosevelt. He called for a "New Deal" to pursue economic recovery and social reforms. Among others, the new government provided farm subsidies, engaged in public works, and addressed unfair competition in business. Except for a slight recession in 1937, the strategy generally worked to move the economy forward. The Second World War, however, diverted the economic energy towards war-goods production and fighting for world stability.

Even before the war finally ended in 1945, the major countries started preparing for a postwar international economic order that would provide avenues for more cooperation in reconstruction, trade and monetary system. Thus, the meeting in Bretton Woods, New Hampshire in 1944 was arranged, where American and British delegates played key roles.

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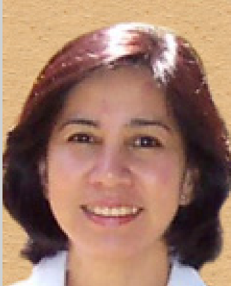
[36] Krugman and Obtsfeld, *supra* note 3, at 544.

[37] Cameron, *supra* note 2, at 360.



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Bretton Woods*

Mr. Raphael B. Madarang

At the end of the Second World War, and with devastation having befallen the major economies of the world, it was the United States which held the financial capital and technological resources necessary to resuscitate the international economy. Apart from being left relatively unscathed from the war, the US also had in its coffers a quarter of the world's gold.[1] The US therefore thus took upon a central and strategic role in the Bretton Woods system as a global economic hegemon tasked to bring about and maintain stability in the post-war financial system. Given the conditions prevailing at that time, a global financier of the effort to establish a stable global economic order that would clear away the threat of another world war, was deemed necessary. The International Monetary Fund (IMF), for one, would have immediately run out of funds to assuage balance of payment crises had the US not provided the necessary support.

To avert competitive devaluations which caused hyperinflation and the depression of economies which was believed to have led to the international unrest which triggered the Second World War, an "adjustable peg" regime was adopted at Bretton Woods. The maintenance of this peg and the prevention of competitive devaluation however required that a sufficient supply of monetary reserves be kept. At that time, and as the US pledged, the only currency convertible into gold was the US dollar, thus rendering it the status as a paper currency

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[1] Robert Gilpin, *Global Political Economy: Understanding the International Economic Order* (New Jersey: Princeton University Press, 2001), 236.

that was as good as gold. The Bretton Woods system therefore essentially hinged on the stability of the US economy and the confidence of the international community on the US dollar.

The US on the other hand was all too willing to assume that responsibility.[2] It had the production machinery, and the capital to infuse through the newly organized Bretton Woods institutions, and needed international markets to sell its goods and services. Moreover, it had control over the dollar which, apart from initially having the confidence of the international community, also was pegged to gold as US$35 per ounce.[3] It therefore undertook its hegemonic function in three ways. First, it strove to keep international markets open for the free flow of goods and services. Second, it provided loans and grants to Europe and other war-damaged economies through the Marshall Plan for the reconstruction of their economic and industrial infrastructure. Last, it served as a lender of last resort, shelling out short-term funds to deficit countries in order to alleviate potential crises.

Apart from fulfilling its post-war economic objectives, the above setup also served the US' political motives at that time which dealt heavily with an international campaign to arrest the spread of Communism from the Soviet bloc. To pursue this, the US had to ensure the rapid economic recovery of its allies (Western Europe, Japan), set up a sizable military presence in various locations in the world and, in the case of Vietnam and Korea, wage full-scale military campaigns miles away from the mainland. All of this required financial resources, and since the US had control over the issuance of what was deemed to be the "world's currency" it could practically print all the dollars it wanted to suit its political and economic objectives without any external payment constraints. As expected, the US exploited this tendency to doing away with fiscal discipline to meet its ends, eventually undermining international confidence

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2 Benjamin Cohen, Bretton Woods System, 4 available at <http://www.polsci.ucsb.edu/faculty/cohen/inpress/bretton.html>.

3 Gilpin, *supra* note 1, at 237.

in the value of its currency—which would later on spell the demise of the Bretton Woods system.

A noted economist, Robert Triffin in 1960 published a book[4] which pointed out the fundamental flaw in the Bretton Woods system that depended on the convertibility of the US dollar to gold. The US was printing so many dollars and incurring a deficit so large that the viability of its $35-to-an-ounce price was already doubted, fueling speculation and aggravating the further outflow of gold. Known as the "Triffin dilemma," it asserted that in order for confidence in the US dollar to be kept, the US would have to trim down its deficits. However, curtailing its deficit spending would stymie international liquidity.

An attempt to keep the Triffin dilemma in check and maintain liquidity without aggravating dollar deficits was the creation of Special Drawing Rights (SDRs) as an alternative source of reserves. However this was not adequate to prevent the increasing loss of confidence and continued speculation on the US dollar. The Triffin dilemma climaxed in the emergence of a dollar glut or a disequilibrium in the amount of dollars outside and within the US.

The glut of dollars, compounded with the overheating of the US economy, caused inflation to spread globally as countries struggled to preserve their peg by purchasing the growing excess of US dollars. Black markets for gold began to set shop around the world trading gold for prices lower than US$35 per ounce which resulted in a further outflow of gold from the US. Blame was exchanged between the deficit countries (mainly the US) and surplus countries (Japan, Europe). The confusion and uncertainty were pounced upon by speculators who bet on the possible devaluation of the US dollar and the appreciation of European and Japanese currencies.

Pressure and a lack of confidence in the US economy continued to mount, culminating in President Richard Nixon's

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[4] Robert Triffin, *Gold and the Dollar Crisis: The Future of Convertibility* (New Haven: Yale University Press, 1960).

decision to suspend the convertibility of the US dollar to gold.[5] Dubbed as the "Nixon shock," this suspension caused the US dollar to devalue and other currencies to revalue according to the dictates of the currency markets. This effectively nullified the fixed exchange rate system and sealed the fate of the Bretton Woods system.

Further Reading

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[5] J. Orlin Grabbe, The Rise and Fall of Bretton Woods, 30 available at <http://www.orlingrabbe.com/bretton_woods.html>.

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Challenges in Implementing the WTO Obligations in the Philippines[*]

Atty. Jeremy I. Gatdula

The topic presented to me was "Challenges of Implementation of WTO Obligations in the Philippines." I must say that I found the same quite a challenge itself. By implementation, would such refer to implementation per se, or would it refer to the effects or economic costs of implementing the WTO Agreements? With regard to the latter, the same would presently be out of the grasp of my commentators on the so-called effects that implementing the WTO Agreements have had on the Philippines in the past seven years. One need only read the papers of today and see a sufficient helping of debates regarding the pros and cons of WTO membership.

With regard to the former, again it is something that I would not completely be able to respond full-square. As legal counsel for the government on WTO matters, I generally got the impression that—for the Philippines—implementing its WTO obligations was not really a problem. I say this because the Philippines has been, seemingly, very conscious of its obligations in the multilateral trading arena and has sought to keep up with its commitments to the fullest. I believe that I can say with the utmost confidence that the Philippines has earned a well deserved reputation in Geneva for being a conscientious and quite proper member of the World Trade Organization (comments regarding compliance with our intellectual property obligations being set aside for this discussion). If one reads the

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local papers, one would see that the related commentaries therein are quite concentrated on Philippine compliance with its WTO obligations (with some writers actually ruing the fact that the Philippines sometimes commits itself even beyond what the WTO actually requires!).

The challenges, as I see it and as framed by the foregoing, are not implementation. The challenges, as far as Philippine membership to the WTO is concerned, are rather how to utilize the various provisions of the WTO Agreements for the benefit of the country and its citizens, trade on a "level playing field" if you will. I will not go into the discussion on whether the implementation of the WTO Agreements by itself would render benefits for the country. That is something for the economists to dwell upon with their numbers, which I find are quite beyond me sometimes. Rather, I would like to focus on the ability of the Philippines to deliberate on the WTO Agreements and determine—pinpoint if you will—therein the areas where the country can benefit and, not less significantly, the methods by which to get those benefits.

It is here where the challenges lie. Thus, it is the Philippines' ability to read the WTO Agreements and seek for benefits rather than obligations that is determinative of the present debate regarding Philippine membership in the WTO. The Agreements on SPS, on Textiles, TRIMS, GATT, TRIPS, TBT, and CATS have all featured prominently in trade news involving the Philippines and they have presented similarities in the sense of a struggle to grapple with the intricacies of what is contained therein rather than shifting the discussion to what the provision actually provides.

The root of this challenge, though I hope this will not be taken as mere excuse-giving, is a matter of resources, be it human or material. In a trading system where a trade remedy lawyer is called a specialist, we have practitioners who work on the entire range of WTO Agreements called by such name. That is but one example of the problem and it is simply not tenable in the long run while causing concern in the short run. Indeed, while considerable analysis can be made regarding our

commitments, about recent developments, etc., such will be of short shrift for Philippine purposes unless there is a conscious effort to develop knowledge, expertise, and experience by and this has to be emphasized—by the private sector with a view towards industry focus.

Not that the government needs no improvement. There is simply too much for too few. There are of course experts in several government agencies and they can found in the DFA, DA, NEDA, PIDS, TC, etc. to name a few. Nevertheless, to illustrate the problem, by history and by practice, let us look at the Bureau of International Trade Relations (BITR) in the Department of Trade and Industry, which has borne the heavy brunt of the work relating to the WTO.

The BITR, as it is called, has personnel numbering (if you count the non-technical and support staff) around 30 in number. Perhaps a good enough number but not so if you consider the fact that apart from WTO work, the BITR has to deal in regional trade work such as APEC, ASEAN, AFTA, etc. The BITR also deals in bilateral trading arrangements. If that were not enough, the BITR also supports the other agencies within and without the DTI for any matter that deals in international trade, particularly if it involves matters relating to the WTO.

The problem with such a heavy burden of work is of course obvious. Perhaps it would be better understood if one is to consider that other countries (Thailand comes to mind) in the single field of trade remedies, for example, would have an office to deal for matters where it is the complainant in such cases and have all entirely separate office for cases where it is the defendant. Trade remedy cases here, by law, are run through the offices of the Bureau of Import Services of the DTI (or its equivalent at the DA, depending on the nature of the products subject of the application) and the Tariff Commission. However, particularly for the former office, certain analyses of cases for those filed in the Philippines are contributed to by the BITR. Also, with regard to cases that are filed against Philippine Companies, the BITR again would take a hand in reading and analyzing the details of such.

The circumstances of the BITR that I have discussed here serve merely to demonstrate the challenge that the Philippines faces; and this is a problem that in one way or another is present in the broad spectrum of institutions that deal with WTO matters. However, this problem, it must be said, is compounded by the speed in which developments take place. Agreements and rules change at quite an impressive pace. The present WTO Agreements and rules change at quite an impressive pace. The present WTO Agreements had just been completed seven years ago and now the so called Doha Development Round seemingly would take those rules to a different form. Extraneous developments add to the difficulties as well. The increase of bilateral and regional agreements, the E.C.'s Common Agricultural Policy, the US Farm Bill, the free trade areas in the Asian region, etc., at such quickness and numbers all constitute an intricate web of trade deals and rules that have to be dealt with by such limited number of government personnel already struggling with their present load.

This concern would point to the issue of the dynamics of time and intellectual resources that reveal the lack of proper and intensive debate whether by an individual by himself or within the group. This is without going to the concerns that a practice which, by force of circumstances, would necessarily make the workers therein to be generalists (relatively speaking) in the field of WTO. This is not to say that more agencies would be needed to address the foregoing concerns. At this point, what would be needed, at least as far as government is concerned, are individuals rather than offices or additional agencies. Although the matter could indeed be examined more closely, the proliferation of individuals with singular and necessary knowledge in the field of international trade would be rendered naught if the institutions by which such individual are to operate are inadequate for the overall objectives that they were hired to meet. However, perhaps the better perspective to consider is whether a re-examination of such institutions would be appropriate at a juncture when precisely there is a need for more individuals who could positively contribute to such an examination.

The "fewness" problem however, as I had indicated beforehand, is of course not limited to the government. However, it is this fact that the government suffers from that should spur the private sector to act within the sphere that it has greater control: its own businesses or organizations. Obviously, the private sector needs to get a better and deeper understanding of the workings of international trade. Again the "fewness" problem (and you must pardon me for inventing such a word) deals with the intellectual and material resources on hand for the private sector. As counsel for the government on WTO, I have had a share in conferences, consultations, or workshops with the private sector and each time has been quite illuminating, albeit not for the reasons that one would anticipate.

There are simply the same faces that deal in the matter. One venue and one place would contain names that would be present in another. Without dwelling on the quality of the debate involving such people, nevertheless, one would have to (although perhaps I would invite examination of such an imperative) question the consistency of the quality. There is also the factor of perspective. With government personnel, one has to deal in balance of opposing and asymmetrical interests. This is not so in the case of the private sector and this is understandable and by its nature quite rightly so. However, one would easily see the problem if continuously one would be considering the same views viewed from the same set of interests debating within a pattern that always contains on the opposite side another set of recurring interests. Thus, what should set the tone for determining the needs of the country become merely repetitive and somewhat cyclical should experience have any bearing, and one comes bringing home nothing of further value than what one had already borne.

The rationale to improve this state of affairs is certainly not lacking. One of these is the fact that the international trade rules have a significant effect on how national policy and legislation is framed. The days whereby domestic law could be safely read on its own and interpreted on its own is surely gone

(at least as far as the realm of trade is concerned). To give one illustration, in the area of trade remedies, an understanding of the interplay between the provisions of Republic Act Nos. 8751, 8752, and 8800 and the provisions of the Agreements on Countervailing, Anti-Dumping, and Safeguards measures (aside from a certain familiarity with national practice from other jurisdictions) would be utterly helpful in determining the actual merits of cases filed here in the Philippines. The fact is, there have been instances when petitioners would file applications for trade remedy measures purely on the basis of their understanding of local or domestic legislation. This of course has not proven well for their cause, especially in the ultimate determination of such cases if such reaches the WTO dispute settlement system. As an aside, a closer understanding of international trade rules should also provide appreciation for the various fields that could positively contribute in a trade remedy case. There is the misconception, since the WTO is moving towards a rule-based regime, that legal interpretations are of singular and paramount importance. This is not so. The economic basis or merit of a trade remedy case should be properly questioned before such is actually endeavored and this surely is something beyond the normal grasp of most lawyers (with due apologies to those in my profession). What one is after therefore is a complementarity of expertise and that, after all, is what the nature of the multilateral trading system appeals for.

Another point would be with regard to legislation and national policy. Definitely, a private sector that would dialogue properly with government, on a sober basis and on the same intellectual plane, would definitely be contributory to achieving the benefits sought for under the present trading system. By providing information and insight based on an independent and reasoned understanding of the trading system, the private sector would become a valuable partner in law and policy making. Debate, constructive and critical, and not mere listening to the next steps of government would be the result. Had this been the case, issues raised against the legislation and

implementation of our intellectual property laws, for example or trade remedy laws would be better grasped.

The value, therefore here for the private sector is obvious. From the point of legislation that would reflect actual interests that would be in complement (not merely conform) to international trading rules, to the filing of measures or actions that would protect those rights; there would not be a methodical and reasoned value determination and not a mere blind grasp of measures that are desirable only because they look such on the surface.

Of course, it can be said that the private sector, particularly industry associations, have been very vocal about their rights or opinions with regard to the trade policy of the government. Such expressions of opinion are all well and good but such would be actually positive and contributory to government efforts if these are grounded on solid capabilities, both intellectual and material, on the part of the private sector. Otherwise, what would happen is the continuation of the present state, whereby the private sector either passively waits for information from the government or otherwise voices its opinion but in a manner not in tune with or does not factor in the realities, which we must say are different from that of the private sector's, that our government faces.

This can be done by shifting the focus from reacting to the developments in the multilateral trading arena to actually taking the initiative in the movements happening therein. This is easier said than done of course and I do not claim originality for this position. However, clichés become clichés because of the truth, the constant truth, found in such. In any event, as I've said earlier, it is easier said than done but it nevertheless can be done.

The private sector, particularly that of business, must come to a recognition and respect for the fact that (and my saying this would have been humorous were it not for the fact that, although it is quite obvious, not much has been done in this regard) in the present intertwined and linked global trading

system, developments do happen and happen quickly that can have an effect on the way you do business. This, it must be emphasized, affects not merely governments, not merely countries, but rather your business, your employees, your livelihood. Witness the financial crises of 1997 which swept through the Southeast Asian region; witness the demise of an American accounting firm that had considerable consequences for people here in Makati.

Thus, the midterm elections in the US which could perhaps precipitate change in the way the US shapes its economic policy, China's desire to link up with ASEAN, the expansion of the EU, the US Farm Bill, etc. should have been contemplated, studied, and examined for possible consequences, with priorities formulated immediately to respond to possible outcomes. This is not being done now on a sufficient level by the private sector. To illustrate, China had been applying to be a member of the world multilateral trading system even before there was a WTO. However, it was only when China became a member of the WTO officially in 2002 (though admitted in November of 2001), that one sees a mass of discussion and forum groups, analysis and papers, on the matter. This is not a situation that can be labeled as desirable and now we find various sectors scrambling to examine the consequences of China's liberalization program. However, the speed with which our competition reacts, not to mention the speed by which developments occur, would add problems to how we properly analyze policy towards China. To provide a further example, most of the analysis done is on China's 1.2 billion people but rare is the question that has been raised on what actually constitutes a viable market there for the Philippines and whether it is indeed economically better for us to focus on China (looking at 10 years from now) rather than, say, aggressively promoting bilateral deals with our neighbors, or perhaps re-shift our focus towards the WTO. These are not mere academic queries but such that would actually determine the actions that a business here might take to compete actively, i.e., either by manufacturing abroad or by exporting.

Of course, these comments apply to government initiative obviously as well but I would rather focus encouragement for the moment at the private sector. The reason is that the private sector (and I refer here not merely to business but also to schools, non-government institutions, consumer groups, etc.) is the one with the actual resources and capabilities to effect a change in how our country navigates through the multilateral trading system. It is the one with the capacity, not the government (cash-strapped as it is, going by the newspapers) to train personnel and to build up its facility for materials and data gathering. Granted that there is a dearth of people willing to devote their time to work on WTO matters, this, however, can be remedied if companies simply recognize the relevance of this subject. Having done this, people will see the value of working on such matters. Thus, companies could either train their people with regard to the WTO or demand for specialist assistance or not settle for that of generalists in this regard. Schools could educate more economists, lawyers, or managers to recognize the value of WTO or international trade literacy. Definitely, our companies and schools should exert more in acquiring materials, whether it be software, books, training manuals, etc. regarding the world trading system.

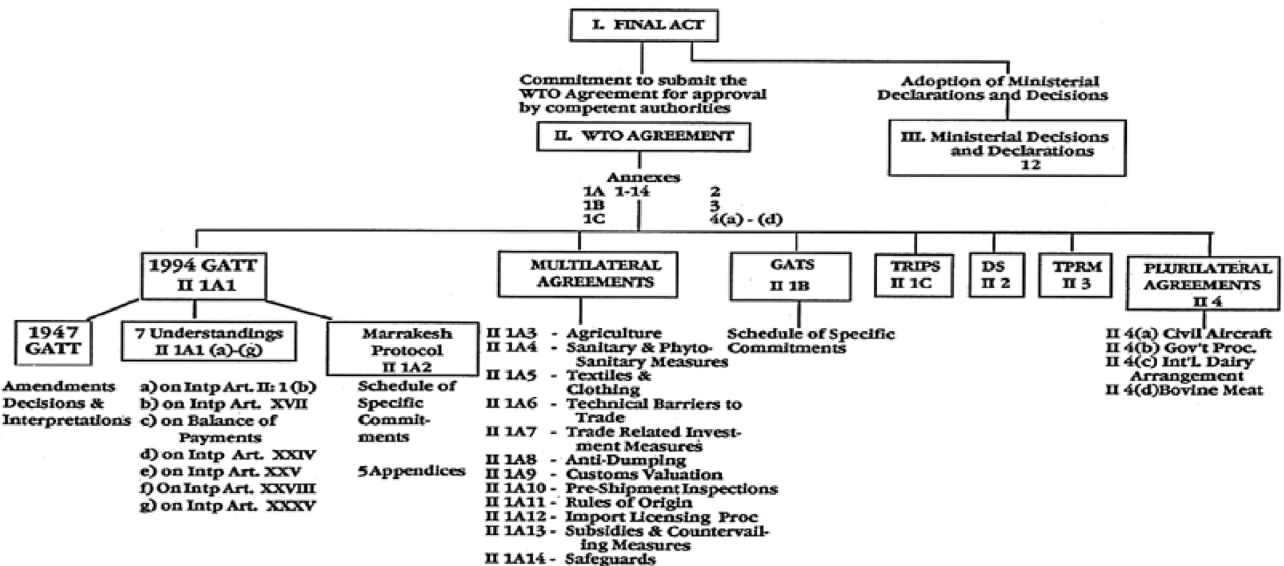
Another aspect is the respect for business practice. The multilateral trading rules emphasize rules and transparency, doubtless to encourage trade amongst different countries, which would otherwise be difficult if there were instability or insecurity or secrecy within each individual country's business environment. However, the rules and transparency espoused and required by the multilateral trading system (including certain domestic laws that have international implications such as the US Foreign Corrupt Practices Act) should serve as an inducement or impetus for businesses here to adopt good corporate practice, keeping due regard of rules, and dealing with the government in as open and transparent way as possible. The private sector has the full capability and control to make these changes on its own should it decide to do so. There have been complaints aired regarding corruption in government.

Now, with the present trading environment, business has the opportunity to effect changes in this regard, not merely for ideal or ethical reasons (though by itself that should have been enough) but for pragmatic reasons as well: first, because the multilateral trading system demands it, and second, no less significantly, because the global business environment has changed in such a way that there is actual and greater value for money for the private sector to do business or deal with the government in a transparent basis as possible.

Doubtless, this would take time and constitute a huge investment in several levels but it is something that should have been done before and has to be started now. The global trading system, in whatever form, is here to stay and should be responded to in the manner that it demands. Perhaps the government may provide assistance but truly it is the private sector, with their peculiar focus, specific training, and unique but varying interests that would have the capability to initiate reforms in the way we deal with our commitments and opportunities. It is as it should be; after all, the private sectors' business as it is their business that is on the line.

Annex A

STRUCTURE OF THE RESULTS OF THE URUGUAY ROUND MULTILATERAL TRADE NEGOTIATIONS



*Do Trade Remedies Really Remedy?**

Dr. Marissa Maricosa A. Paderon

I. What Trade Liberalization is About

In a liberal economic system, government does not intervene with private parties in their attempts to enter voluntary transactions. Moreover, taxes are stable, predictable, and non-prohibitive. Simply put, trade liberalization refers to a reduction in trade restrictions (i.e., removal of quantitative import restrictions, import licensing; export restrictions and export taxes). As such, tariff will be the only commercial policy instrument set in place. The aim is to make the extent of protection clear and to make competition possible. It thus eliminates whatever rent-seeking behavior there might be among the firms.[1]

Trade liberalization increases efficiency in three ways: First, through the exploitation of increasing returns to scale in a larger market. With liberalization, country A can have market access of its partners, countries B and C, and buy more inputs at lower duties and thus increase output. Second, through specialization in the production of the comparative advantage good, results to better resource allocation. For example, the reduction in tariffs via the tariff reform program in the Philippines within and across sectors is meant to reallocate the resources to the country's comparative advantage like semiconductors and some agricultural products like banana, mango, and pineapple. Finally, the intense competition brought about by the lowering of trade

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[1] For example, a firm seeking tariff protection may bribe or spend for lawyers to obtain a good concession rather than spending the money and effort on improving product quality.

barriers encourages innovation and breaks down institutional obstacles to change. For example, when trade reform was introduced in the Philippines, the local industries are forced to innovate and increase efficiency to survive foreign competition.

There are three ways to liberalize trade: first is by unilateral action. The country on its own initiative liberalizes its market. Second is by bilateral or regional action. Here, the country liberalizes because it is in consonance with its bilateral agreement with a trading partner country or perhaps as part of a regional trading bloc like the Association of Southeast Asian Nations (ASEAN) or European Union (EU). Last is by way of multilateralism or its multilateral trade negotiations like that of the General Agreement on Tariffs and Trade-World Trade Organization (or the GATT-WTO).

II. Fair Trade versus Liberal Trade

"Trade is liberal when the individuals and companies can freely make contracts with foreigners as they desire."[2] Less restrictions or regulations allow the firms to enter into business transactions. When a partner country will be trading unfairly, putting the domestic industry at a disadvantage, the government should step in. Such a case is fair trade implying that "the state is expected to alter the conditions of exchange (or even ban exchange) in the interest of unsuccessful competitors."[3] But such action has to be justified by empirical evidence.

In a world of trading environment, there are instances when countries will be trading unfairly. These are cases of dumping and imposition of subsidy (domestic or export). To remedy these unfair trade practices, the GATT-WTO provides for remedy measures such as anti-dumping duty, countervailing duty, and safeguards measure.

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2 Martin Wolf, *The Uruguay Round: A Handbook on the Multilateral Trade Negotiations "Why trade liberalization is a good idea?"* (J. Michael Finger and Andrzej Olechowski, Eds) Washington: The World Bank, 1987, 14.

3 *Id.*

III. What is Dumping?

Article VI of the GATT indicates that dumping occurs when foreign producers sell their products to another country at a price below their cost of production or 'normal value'. By doing so, it threatens or causes injury to the domestic industry of the importing country.

The 'normal value' is the comparable price or the price of the product in the exporter's home market. In the absence of such domestic price, it is the highest comparable price in a third market or country, or the estimated cost of production in the exporting country plus a mark-up for selling cost and profit. The difference between the export price and the normal value is the dumping margin. For example, the ex-factory price of terry towel in China is $100 per unit but exports it to the Philippines at a price, say $50, which is lower than its home market price ($100/unit). Such is the case of dumping, since China sells it at $50/unit lower than its home market price of $100/unit or a dumping margin of $50.

To the economist, dumping is price discrimination. A foreign firm sells its product at a lower price in the export market than in the home country market. Thus, dumping is unfair and constitutes a threat or cause of injury to domestic industry of the importing country. This unfair trade practice caused by dumping can be remedied by giving protection through tariff to the affected industry. Hence, protection through tariff; that is, an anti-dumping duty is justified. The cheaper terry towel sold by China to the Philippines is an example of price discrimination and may threaten or cause injury to the local manufacturer of terry towel in the Philippines. Assuming that the dumping of Chinese terry towel causes a threat or injury to the local Philippine industry, protection through tariff is called for.

The Philippine Anti-Dumping law is embodied in Section 301 of the Philippine Tariff and Customs Code, as amended by Republic Act (RA) No. 8752, effective September 3, 1999. It is based and harmonized with the WTO Agreement on anti-dumping.

IV. What are the Types of Dumping?

- *Persistent dumping*. It is selling a good continually at a lower price to the importing country than in the home country. "The import good is simply sold in different markets at different prices under profit-maximizing conditions."[4] Hence, it is price discrimination. Note that "this behavior could not persist in the long run under the selling-below-cost definition because the producer will incur more losses, unless the government provides a subsidy."[5] For example, home market price of onions in country A is about $0.50 per kilogram. Persistent dumping exists if country A continually sells onions in different countries, say country B, C, and D at different prices, say $0.25, $0.30 and $0.20 per kilogram, respectively, all export prices below its home market price of $0.50/kilogram.

- *Predatory dumping*. This is the case when a foreign dominant supplier embarks on a strategy to deliberately "sell at a low price until home producers are driven out of the markets";[6] then the price is raised above cost and losses incurred during the period of undercutting are recuperated. Simply put, this means that a monopoly position has been established. Unlike in persistent dumping, protection in predatory dumping is justified because of waste of resources. For example, if country A's normal price of onions is $0.50 per kilogram but sells it at $0.25 to country B with the intention of driving away local onion producers selling local onions at $0.45, protection is justified once it is proven that dumping has threatened or has caused injury to the local industry.

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4 Dennis Appleyard et al., *International Economics* (New York: McGrawHill/Irwin, 2006), 321.

5 *Id.*

6 *Id.*

- *Sporadic dumping*. "This occurs when a foreign producer, (or government) with a temporary surplus of a good, exports the excess for whatever price it will command outside its country."[7] This type of dumping may have temporary adverse effects on competing home industries. For example, country A experiences a temporary surplus of rice and sells the excess to any country, say country B and C, at any price it can command just to eliminate its surplus production.

V. Arguments for Anti-dumping Measures[8]

- *Dumping is 'unfair' competition*. A firm sells a proportion of output below cost when the market is depressed. This is a business practice done by companies to recover some of their fixed costs but adversely affects the domestic industry of the importing country. This may refer to the case mentioned in the sporadic dumping.
- *Countries differ in cost structures; some countries have greater propensity to dump*. Proponents for anti-dumping measures argue that nations differ in cost structures because of fixed costs that account for a greater proportion of total costs, or due to government policy. Hence, some countries tend to dump their output more than other countries to recover their fixed costs. For example, country A regularly receives an agricultural subsidy from its government. This encourages the local producers to produce and sell their products relatively cheaper than other countries. The cheaper foreign good sold then in country B is unfair as it discriminates the local counterpart.
- *Anti-dumping measures are needed to reduce employment variation*. Frequent changes in domestic output and

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7 *Id.* at 321.

8 This section draws heavily from Grimwade, Nigel, *International Trade Policy: A Contemporary Analysis* (New York: Rouledge, 1996), 96–104.

employment impose considerable adjustment costs on the importing country, so the argument goes. For example, a local industry will request the government to impose an anti-dumping duty as a form of protection against foreign competition. Otherwise, the local firm will threaten to close shop if not given protection through anti-dumping duty.

- *Existence of transitional dumping*. The exporter needs to price below marginal cost to maximize sales and expand market share, because it is a new entrant or it is a high-technology industry where new products/processes are continually being developed. There might be considerable savings in early stages of production, or 'learning-by-doing.' Anti-dumping duty is therefore needed to counter such transitional dumping. For example, a manufacturer of computers and electronics in country A continually sells its goods below its costs to country B because it simply wants to expand its market base. Country B argues that an anti-dumping duty is justifiable since the foreign computers and electronics sold in its country is transitional dumping and anti-dumping measure is called for.

- *Protection for local industries*. Anti-dumping measures are needed to ensure the national producers that same products receive protection. This is rather a case of the 'theory of the second-best solution' where government intervention (which usually leads to distortions in the price or factor markets) can actually increase welfare through the use of trade policy. In this example, trade policy calls for an application of anti-dumping duty. For example, ceramic tiles manufacturers in country A are seriously affected by the dumping of same product from country B. Hence, anti-dumping measure is needed to protect the local ceramic manufacturers in country A.

VI. What Economists Say about Anti-Dumping Policy

- The economic rationale is rather weak. Economists agree that an anti-dumping duty is justifiable in the case of predatory dumping. However, this kind of dumping is relatively rare in practice. One approach is to consider export prices below the marginal costs of production. Even then, it may not be predatory intent. Other criteria should therefore be considered like "exporter's share of the market, the existence of entry barriers and effects on competition, etc."[9]
- Governments can tackle the problem of dumping through competition policy, rather than trade policy. They can determine whether or not dumping will likely result in reduced competition and higher prices to consumers in the long run. The aim is to ensure that anti-dumping measures will not be used for protectionist purposes. For example, an efficient and sole supplier of gasoline in country A may file a case of dumping against a foreign firm in country B to get protection against foreign competition. However, after investigation of the government in country A, there is no prima facie case of evidence of dumping. In this case, trade policy is not the answer to the problem of the local firm in country A but rather competition policy by deregulating the oil industry.
- Governments can also address the problem at its root. This simply means that if the real problem is inefficiency of domestic industry, then one can use domestic policy (production subsidy, financial incentives, fiscal incentives, infrastructure improvement, etc.) to address the situation and not trade policy. As discussed above, the government must discern carefully the root of the problem. As in the example of sole supplier of gasoline in country A, domestic policy in the form of fiscal incentives may perhaps alleviate its problem rather than resort to trade policy.

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[9] *Id.* at 104.

- Governments can strengthen the role of consumer protection. In most developed countries, consumers associations are organized. The consumers can play a proactive role in monitoring local or foreign firms' anti-competitive behavior. Examples of well-organized consumer groups include those of the United States or the EU which monitor anti-competitive behavior of both local or foreign firms.

VII. Subsidies and Countervailing Measures

A *countervailing duty* (CVD) is a trade counter measure to offset any bounty or subsidy bestowed directly or directly upon the manufacture, production or export of any merchandise. A subsidy (whether production or export subsidy) is said to be 'unfair' if it causes or threatens material injury to producers in the importing country.

A *domestic subsidy* is an incentive given by the government to a producer on output produced whether for export or for the home market. This may be in the form of financial aid, total or partial tax exemption, remission of tax, credit provision, preferential treatment in provision of public infrastructure, etc. In contrast, an *export subsidy* is a payment by the government to a producer per unit of the good produced for export market. Export subsidy allows an exporter to sell the good in a foreign market at a lower price (or even below its costs of production) than at home. Export subsidy may be in the form of export credit subsidies. For example, the United States and the EU grant export subsidies on their agricultural products like cotton, and wheat.

The WTO-Uruguay Round Agreement on Subsidies and Countervailing Measures (SCM) of 1986 indicates that countries may impose countervailing duties on such imports that were granted subsidy, "provided that the rate of duty does not exceed the element of subsidy."[10] The SCM is embodied in Section 302

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[10] *Id*. at 128.

of the Philippine Tariff and Customs Code, as amended by the Countervailing Duty Act or RA No. 8751 that took effect on August 31, 1999.

VIII. Arguments for Subsidy

Some firms or industries will argue that a subsidy is justifiable because the social return on capital exceeds the private return. For instance, a firm is a new entrant such that initially it will incur costs. Over time, it will learn how to produce efficiently and will be profitable only in the long run, such that it will need a protection by way of a subsidy.[11]

Another instance could be a case of giving a subsidy to an industry with possible external economies of scale. By external economies of scale, it means that the industry expands as its cost per unit decreases but the cost reduction depends on the size of the industry and not on the firm level. Thus, the government argues that a subsidy is justified because there will be net positive benefits to other firms resulting from the efficiency of a larger firm. For example, government in country A may argue that it grants domestic subsidy to its local car parts manufacturers thinking that it will spill over to the car assemblers. Hence, subsidy is justifiable in this case.

Finally, some will argue that subsidy is justified particularly if the government subsidizes a potential industry to create knowledge or develop high-technology products. In all cases, social return exceeds whatever will be the financial costs. An example is that of the Japanese integrated circuits and computers. Japan gave extensive research and development support to its 'knowledge-intensive industries' like the integrated circuits and computers in the 1970s, expecting greater social returns out of its subsidy.

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[11] Such is a classic case of an 'infant industry argument' which argues that temporary protection is justified because the firm will earn profits in the long run.

IX. Safeguards Measure

Article XIX of GATT 1994, otherwise known as “safeguard clause,” specifies that temporary restrictions may be imposed or previous trade concessions withdrawn if imports are causing or are threatening to cause serious injury to domestic industries. The safeguards measure is embodied in Section 402 of the Philippine Tariff and Customs Code, as amended by the Safeguards Act or RA No. 8800, effective August 9, 2000.

Safeguards measure may only be applied after a proper investigation by the importing country where all interested parties should give evidence. The safeguards provisions as embodied in the WTO-Uruguay Round Agreement contrasts ‘serious injury’ and ‘threat of injury’. Serious injury refers to the “significant overall impairment of the position of a domestic industry. Criteria include the rate and amount of the increase in imports of product in absolute and relative terms, share of imports to total domestic market, changes in the level of sales, production, productivity, capacity utilization, profits and losses, and employment.[12] On the contrary, threat of injury must be serious injury that is clearly imminent and must be based on facts and not merely allegation, conjecture or remote possibility.

Important features of the WTO Agreement on safeguards are as follows. The restrictions on the intensity of any safeguard measure should be only applied as needed to prevent or remedy serious injury and facilitate adjustment. Any safeguards measure must be applied irrespective of the source; and that safeguard measures should be applied at a maximum of four years. Safeguards measure may be extended for another four years if necessary to prevent or remedy serious injury. The WTO Safeguards Agreement also contains provisions for consultation on trade compensation and retaliation when consultations between the countries in interest have been unsuccessful.

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[12] Grimwade, *supra* note 8, at 89.

For developing countries, safeguard measures are not to be applied against products coming to or from them as long as the share of imports coming from developing country does not exceed 3 percent, and that developing countries collectively account for no more than 9 percent of total imports. They may extend the duration of safeguard measures for a period of up to two years beyond the maximum.

All grey-area measures[13] shall be phased out or brought into conformity with the WTO Agreement with a period of not exceeding four years. Exception can be made for one specific measure per importing country where phase-out date is December 31, 1999. In case of EU, exception is to be the voluntary export restrains (VER) governing imports of cars from Japan. The Agreement requires countries to notify the Committee on Safeguards of any investigation to be initiated, finding of serious injury or decision to impose a safeguard measure. The Committee on Safeguards is assigned the task of monitoring and surveillance role to ensure that provisions of the Agreement are applied.

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[13] These are voluntary export restraints, orderly marketing arrangements (OMA), export moderation schemes, price monitoring systems, export/import surveillance,etc.

*Anti-Dumping under International and Philippine Trade Law**

Atty. Jeremy I. Gatdula

The issue of anti-dumping has come into prominence in recent times. The Philippines, as narrated by the local media, constantly appears to be either on the verge of employing or being subjected to anti-dumping measures. Thus, cement, floor coverings, resins, etc. have become the focus of intended anti-dumping measures. This development is not peculiar to the Philippines. Among the so-called trilogy of trade remedy regimes—i.e., countervailing, safeguards, and anti-dumping measures, it is the last that has been considered the most "popular."[1]

Anti-dumping actions have been initiated in a number of countries, with one study showing no less than 19 countries initiating 160 anti-dumping actions. The European Union (considered as one country under the General Agreement on Tariffs and Trade 1994 or "GATT 1994") was the leading initiator, followed by the United States. Brazil and Mexico also initiated a substantial number of actions.[2]

Following developments in international trade law, An Act Providing Rules for the Imposition of an Anti-Dumping Duty, Amending for the Purpose Section 301, Part 2, Title II, Book I of the Tariff and Customs Code of the Philippines, as Amended by Republic Act No. 7843, and for Other Purposes (Republic Act No. 8752, otherwise known as "Anti-Dumping Act") was passed.

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[1] Michael J. Trebilcock and Robert Howse, *The Regulation of International Trade* 166 (2nd ed., 1999).

[2] WTO Focus Newsletter, December 7, 1995, at 10.

By virtue of this Act, an inter-agency committee was created composed of their respective Secretaries: the Department of Trade and Industry; Department of Agriculture; the Department of Finance; Bureau of Customs; and the Tariff Commission. Together, they subsequently issued the Implementing Rules and Regulations Governing the Imposition of an Anti-Dumping Duty under Republic Act No. 8752 (Joint Administrative Order No. 01, Series of 2000).

The foregoing, along with the enactment of Republic Act No. 8800 (the Safeguard Measures Act) and Republic Act No. 8751 (the Countervailing Duties and Subsidies Act), and the creation of the WTO/AFTA Advisory Commission[3] and the Economic Coordinating Council,[4] highlight government sentiment of a "compelling need to take advantage of the requirements and opportunities arising from globalization and from borderless competition."[5]

The prime engine of international trade law and globalization is undoubtedly the World Trade Organization (WTO), whose membership has now risen to 150 as of January 2007 with the most recent accession of Vietnam. With the entry of China (and the conditions on trade remedies attached thereto), the international trade arena has become both more competitive and complex. Anti-dumping, as an available remedy in international trade, is therefore a significant and certainly relevant issue.

I. Background

Having felt the necessity of expanding the coverage of the multilateral trading system in both developed and developing countries, the Uruguay Round of Multilateral Trade Negotiations

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[3] Executive Order No. 193 (1994), *amended by* Executive Order No. 322.

[4] Executive Order No. 193 (2000).

[5] *Id.*, First Whereas Clause.

was launched in September of 1986. This resulted in a set of agreements (consisting of 492 pages of legal texts"[6] and around 22,000 pages of tariff bindings) covering goods, services, and intellectual property rights. More importantly, an organization overseeing the conduct of international trade was created—the World Trade Organization (or "WTO")—and a system for managing disputes (the Dispute Settlement Understanding) was agreed upon. The countries and custom territories that are part of the WTO are called "Members" (participants to GATT 1947 were called "Contracting Parties").

In the area of goods, a series of agreements was entered into. Among them was the Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade of 1994 (more popularly known as the "Anti-Dumping Agreement"), which involves detailed provisions as to the identification of and remedies against dumping. Though it may be said that the Anti-Dumping Agreement is general and comprehensive (and also quite complex), nevertheless, the provisions of Article VI of GATT 1994 which are consistent with the Anti-Dumping Agreement remain in effect.

Accordingly, WTO Members are required to undertake anti-dumping actions only in accordance with the Anti-Dumping Agreement. Unlike in actions involving subsidies and countervailing duties, anti-dumping measures are taken against business enterprises and not against the Members themselves. Thus, business enterprises found to be dumping their goods on a member country (and such is said to be causing injury to the domestic industry of that importing Member) can rightfully be made a party to an action.

Dumping is popularly considered as an unfair trade practice. However, the reason for this is not entirely defined and clear. In instances where there seems to be harm to a domestic industry that produces goods similar to that being dumped, it is

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[6] The World Trade Organization, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* (1999 reprint).

undeniable that the effect of low prices which is normally associated with dumping certainly redound to the benefit of consumers and end-users of such products.[7]

Dumping has also been linked to the idea of predatory behavior. But then again, the extent—and even the existence—of the benefits assumed to go to the "predator" have been questioned. Economists doubt the chances for success of predation, citing the tendency of those so engaged to collude in raising prices after their competitors have been eased out of the market. This would then result in the difficulty of keeping out new competitors due to the raised prices.[8] Anti-dumping laws have also been defended by referring to the so-called "intermittent dumping." According to Jacob Viner, intermittent dumping is a systematic form of dumping lasting for several months or years at a time. Presumably, this form is objectionable because it injures domestic producers without providing consumers a constant supply of goods.[9] Consensus however as to a categorical determination of the ill effects of intermittent dumping remains to be seen.[10] Assertions have also been made as to the desirability of sales below costs. However, whether prices are lowered due to the increase in production experience or due to the need to increase market share, it has been demonstrated that over-all welfare is actually improved by below cost sales (which again raises doubts as to the justifiability of anti-dumping actions).[11]

Arguments for the propriety of anti-dumping measures are also raised on grounds other than economic reasons. Of the so-called non-efficiency rationale, the most effectively propagated is the idea of "unfairness." Politicians and policy makers justify

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7 Bhagirath Lal Das, *The World Trade Organization* 205 (1999).

8 John H. Jackson, *The World Trading System* 254 (2nd ed., 1999).

9 Trebilcock and Howse, *supra* note 1, at 184.

10 *Id*. at 185.

11 Jackson, *supra* note 8.

anti-dumping legislation by emphasizing the perceived "unfairness" brought about by cheaper imported products. These rationale, however, are disputable due to the inability of those invoking it to differentiate the effects between losses caused by non-predatory dumping and that caused by non-dumped low priced imports.[12]

In any event, as consumer groups tend not to be as well organized and as funded as business enterprises (the latter oftentimes, having the support of labor unions), the losses suffered by the latter are generally given more consideration by governments than the benefits which should have been enjoyed by the former.[13]

Dumping has long been a concern in domestic and international trade. During the negotiations leading to GATT 1947, careful attention was given to dumping. This led to the Article VI provisions mentioned above. Changes were promptly made however as some of the Contracting Parties felt that several of them were applying anti-dumping actions as a barrier to trade.

In the Kennedy and Tokyo Rounds, some modifications to the then anti-dumping rules were formulated. The changes later brought by the Uruguay Round reflect the differing interests of the developed countries (notably the United States and the European Union, which as mentioned above initiated a substantial proportion of the anti-dumping cases) and the developing countries which (rather ironically) are usually the defendants in such cases.[14]

It must be emphasized however that dumping *per se* is not disallowed under international trade law. Though Art. VI, Section I of GATT 1994 does state that dumping is to be condemned, nevertheless it is to be adjudged as such only if it causes or

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[12] Trebilcock and Howse, *supra* note 1, at 186.

[13] Lal Das, *supra* note 7.

[14] *Id.* at 257.

threatens material injury to an established industry in the territory of a contracting party, or if it materially retards the establishment of a domestic industry.

It must be considered that the WTO agreements are international treaties that bind nations entering into it and not private individuals (which, as mentioned above, are the actual respondents in an anti-dumping case). The WTO agreements do not even bind Members to refrain from dumping or to compel Members to restrain domestic private firms from engaging in dumping.[15]

There is some opinion to the effect that anti-dumping rules should include provisions on "social" or "exchange rate." Social dumping occurs when import prices are low because the exporting country has relatively lower wages and less strict environmental or work safety rules. Exchange rate dumping refers to instances when import prices decline because of shifts in the exchange rates.[16] However, to date, these ideas have not gained widespread acceptance.

There have also been questions as to whether the provisions of the Anti-Dumping Agreement and Article VI of GATT 1994 should cover "downstream dumping." This occurs whenever a company acquires parts or components at below cost prices thus enabling that company to sell the finished product at much lower prices. Prevalent views do not include downstream dumping to be part of existing international trade law though there has been an attempt in the United States Congress to explicitly include it in its domestic legislation.[17]

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[15] Jackson, *supra* note 8, at 257.

[16] John H. Jackson, William J. Davey, Alan 0. Sykes, Jr., *Legal Problems of International Economic Relations* 683 (3rd ed., 1995).

[17] *Id.* at 686.

II. Concepts in Anti-Dumping

Dumping is said to occur whenever any product, commodity, or article of commerce imported into the Philippines at an export price less than its normal value in the ordinary course of trade for the like product, commodity, or article destined for consumption in the exporting country is causing or is threatening to cause material injury to a domestic industry or materially retarding the establishment of a domestic industry producing the like product.[18]

Stated briefly, there is dumping if a country exports a product to another country at a price lower than the price of the like product in the exporting country. The important terms that must be considered are "export price," "normal value," "like product," "domestic industry," "material injury or threat of material injury," and "causal linkage."

It must be noted however that the shipment or consignment of imported products to government agencies which are not organized for profit and particularly designated by law or proper authorities to import, directly or through awardees, such products as would stabilize or supplement temporary shortages, and conditionally duty-free importation allowable under Section 105 of the Tariff and Customs Code of the Philippines, as amended, shall not be the subject to an anti-dumping action.[19]

"Export price" refers to the ex-factory price at the point of sale for export, or as the freight on board price at the point of shipment. In cases where the latter cannot be used, then the export price may be constructed based on such reasonable basis

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18 An Act Providing the Rules for the Imposition of an Anti-Dumping Duty, amending for the purpose Section 301, Part 2, Title II, Book I of the Tariff and Customs Code of the Philippines, as amended by Republic Act No. 7843, and for other purposes [Anti-Dumping Act of 1999] Republic Act No. 8752, § 3.

19 Implementing Rules and Regulations (IRR) of Republic Act No. 8752, Anti-Dumping Act of 1999, § 1.

as the Secretary of the Department of Trade and Industry, Secretary of the Department of Agriculture, or the Tariff Commission may determine.[20] However, the foregoing definition of export price may not be appropriate in instances where the exporter and importer are in collusion, the export price being basically the price shown in the books of the exporter. Note that the Anti-Dumping Agreement provides for a "constructed export price," which is the price in which the imported product is first sold to an independent buyer (one which neither controls nor is controlled by the seller, or where the buyer and seller is not controlled by a third person).[21]

In cases where the products are not imported directly from the country of origin but are exported to the Philippines from an intermediate country, the price in which the products are sold from the country of export to the Philippines shall normally be compared with the comparable price in the country of export. However, comparison may be made with the price in the country of origin if, for example, the products are merely transshipped through the country of export, or if there is no comparable price for them in the country of export.[22]

The "country of origin" is the country where the allegedly dumped product either was wholly obtained or where the last substantial transformation took place. The country of origin and the country of export may be the same but not in all instances. In the case of transshipment where a product is shipped from a third country, that is, not the country where the product was manufactured or processed, the country of origin will be different from the country of export.[23]

The "normal value" refers to a comparable price at the date of sale of the like product, commodity or article in the ordinary course of trade when destined for consumption in the country

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[20] *Id.*

[21] Lal Das, *supra* note 7, at 207–208.

[22] Anti-Dumping Act of 1999.

[23] IRR of the Anti-Dumping Act of 1999, § 2(h).

of export.[24] The term "ordinary course of trade" has been negatively defined as to exclude transactions where the exporter and importer are related or where the product is made for a specific purpose in accordance with particular specifications.[25]

Generally speaking, therefore, there is dumping when the export value of an exported product is less than its normal value. The resulting difference is called the "margin of dumping" and the anti-dumping duty imposed is usually equal to the margin. However, a lesser duty may be applied if such lesser duty will be adequate to remove the injury to the domestic industry.[26]

For an anti-dumping duty to be warranted, however, the *de minimis* provisions of the Anti-Dumping Agreement must be complied with. Thus, no anti-dumping duty shall be applied if the margin of dumping is less than 2 percent of the export price. Furthermore, if the volume of dumping is less than 3 percent of the imports of the like product in the importing country, or if imports from individual enterprises be less than 3 percent each and less than 7 percent collectively, no anti-dumping measures can be taken.[27]

"Like product" refers to a product that is identical or alike in all respects to the product under consideration, or in the absence of such a product, another product which, although not alike in all respects, has characteristics closely resembling those of the product under consideration.[28] In the *US-Wine and Grape Products Case,* the Panel concluded that wine and grapes were not like products and found that the two products had different physical characteristics. Furthermore, the production

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[24] *Id.*

[25] A similar provision can be found in the Anti-Dumping Act of 1999.

[26] The Anti-Dumping Act of 1999.

[27] A similar provision can be found in the Anti-Dumping Act of 1999.

[28] Anti-Dumping Act of 1999.

of wine and grapes are two separate industries in the United States.[29]

The determination of whether a product is a like product is also important with respect to the determination whether the several producers of a product constitute a "domestic industry" (to be discussed later). The concept of like product in the Anti-Dumping Agreement is somewhat different from that of Articles I and III of GATT 1994. Like product in Article I seemingly refers to classification (e.g. tariff classification). In Article III, on the other hand, like product apparently refers to competitive conditions and, unlike the concept as understood in the Anti-Dumping Agreement, would also refer to products of similar qualities.[30]

A "domestic industry" refers to the domestic producers as a whole of the like product or to those of them whose collective output of the product constitutes a major proportion of the total domestic production of that product, except when producers are related to the exporters or importers or are themselves importers of the allegedly dumped product, the term domestic industry may be interpreted as referring to the rest of the producers.[31]

It must be emphasized that the above definition, which is almost a repetition of the definition found in Article 4.1(i) of the Anti-Dumping Agreement, is related to determinations of injury and should be differentiated from the concept of domestic industry for purposes of applications for the initiation of anti-dumping actions. Thus, an application shall be considered to have been made by or on behalf of the domestic industry if it is supported by those domestic producers whose collective output constitutes more than 50 percent of the total production of the like product produced by that portion of the domestic industry expressing either support for or opposition to the

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[29] BISD 39S/436, 446–447.

[30] Lal Das, *supra* note 7, at 34.

[31] *Id.*

application. In cases involving an exceptionally large number of producers, the degree of support and opposition may be determined by using a statistically valid sampling technique or by consulting their representative organizations. However, no investigation shall be initiated when domestic producers expressly supporting the application account for less than 25 percent of the total production of the like product produced by the domestic industry.[32]

With respect to the concept of domestic industry in relation to the determination of injury, note the use of the phrase "major proportion." While no definition of the term yet exists under local laws, nevertheless, there is opinion under international trade law practice to the effect that even somewhat lower proportions may be accepted as a major proportion. Emphasis must also be placed on the concept of "related producers." This is a situation whereby the producers are related to exporters or importers because one of them directly or indirectly controls the other; or both of them are directly or indirectly controlled by a third person; or together they directly or indirectly control a third person (one shall be deemed to control another when the former is legally or operationally in a position to exercise restraint or direction over the latter[33]).

In determining the makeup of the domestic industry, therefore, related producers would normally be excluded. This is so provided that there are grounds for believing or suspecting that the effect of the aforementioned relationships is to cause the producer concerned to behave differently from non-related producers.[34] Otherwise, the concept of "arm's length transactions" would be applicable. These are transactions where the price is not affected by any relationship between the buyer and the seller, or if there is no compensation, reimbursement, benefit or other consideration given in respect of price.[35]

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[32] The Anti-Dumping Act of 1999.

[33] The Anti-Dumping Act of 1999, § 2(1).

[34] Anti-Dumping Agreement, Footnote 11.

[35] The Anti-Dumping Act of 1999, § 2(c).

The concept of "material injury" (and of threat of material injury) is significant because it is the presence of such which would permit the imposition of anti-dumping measures. However, what constitutes material injury is not precisely defined under current practice. Reference is usually made to the concept of "serious injury" provided for in the Agreement on Safeguards and in the escape clauses. Serious injury usually refers to a "*significant overall impairment in the position of a domestic industry*"[36] and is understood to mean a higher degree of injury than that of material injury.

The point sought to be reached is that the dumping must show an impact harmful to the whole industry and not to a particular firm. If the industry is thriving despite substantial losses being suffered by some firms then the application of anti-dumping measures is unwarranted.[37] Under RA No. 8752, the presence and extent of material injury shall be determined on the basis of positive evidence and shall require an objective examination of the rate of increase and amount of imports, the effect of dumping on the price in the domestic market for like products, and the effect of dumping on domestic producers.

In the *New Zealand-Electrical Transformers* case, it was stated by the panel that determination of material injury is not the exclusive prerogative of the importing Member's government and thus could be challenged before a panel.[38]

"Threat of material injury" is such material injury that is clearly foreseen and imminent. A determination thereof should be based on facts and not merely on allegation, conjecture, or remote possibility. Any change in circumstances, which will create a situation in which the dumping will cause injury, must clearly be imminent and unforeseeable.[39] An example is when

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[36] Art. 4, Section 1(a) of the Agreement on Safeguards.

[37] Jackson, *supra* note 8 at 266.

[38] BISD 32S/55,67–68.

[39] Anti-Dumping Agreement, Art. 3.7.

there is convincing reason to believe that that there will be in the near future substantially increased importation of the product at dumped prices.[40]

Finally, there is the concept of "causal linkage" (also referred to as "causal relationship" or "causality"). It is necessary that there be established a relationship between the allegedly dumped product and the material injury or threat of material injury to the affected domestic industry or material retardation of the establishment of a domestic industry.[41] Under the 1967 Anti-Dumping Code, it was required that the dumping be the "principal" cause of the material injury. The present rule seems to be that there is no requirement of determining the most important cause. Other causes of injury will not preclude the imposition of anti-dumping duties provided, of course, those other causes will not in actuality be the sole cause of the injury suffered.[42] Republic Act No. 8752 also points out that any known factors other than the dumped imports which at the same time are injuring the domestic industry shall also be examined and the injuries caused by these factors must not be attributed to the dumped imports. The implementing rules of RA No. 8752 state that causal link refers "to a finding that the material injury suffered by the domestic industry is the direct result of the importation of the dumped product."[43]

A definite finding of dumping shall result in the imposition of anti-dumping duties, which is a special duty imposed on the product dumped into the Philippines. As mentioned above, the anti-dumping duty would usually be equivalent to the difference between the export price and the normal value of the product or the so-called margin of dumping. As a general rule, the imposition of an anti-dumping duty shall remain in force only as long as and to the extent necessary to counteract

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[40] Anti-Dumping Agreement, Footnote 10.

[41] The Anti-Dumping Act of 1999.

[42] Jackson, Davey, and Sykes, Jr., *supra* note 16, at 688, 718.

[43] IRR of the Anti-Dumping Act of 1999, § 2(d).

dumping which is causing or threatening to cause material injury to the domestic industry or material retardation of the establishment of the same.[44]

III. Procedure

Republic Act No. 8752 along with its implementing rules lays down the procedure (described below) for the imposition of anti-dumping duties. Its provisions practically duplicate the provisions of the Anti-Dumping Agreement and were obviously enacted as part of the Philippines' moves to make its laws conform to present international trade law.

Article XVI, Section 4 of the Marrakesh Agreement establishing the WTO states that each member shall ensure conformity of its laws, regulations, and administrative procedures with its obligations as provided for in the various WTO agreements (reiterated in Article 18.4 of the Anti-Dumping Agreement). Article 1 of the Anti-Dumping Agreement declares that anti-dumping measures shall be applied only under the circumstances provided for in Article VI of GATT 1994 and pursuant to the investigations initiated and conducted in accordance with the provisions of the said Agreement.

An anti-dumping investigation is initiated upon receipt of a written application from any person (natural or juridical) representing a domestic industry. The application shall include evidence of dumping, injury, and a causal link between the dumped imports and the alleged injury. Simple general assertions are insufficient. The application shall contain, as is reasonably available to the applicant, information such as identity of the applicant, description of the volume and value of the domestic production of the like product of the applicant, description of the alleged dumped product, the name of the country of origin, the identity of each known exporter or foreign producer and a list of known persons importing the product under consideration, the normal value of the product under

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[44] *Id.*

consideration in the country of origin or export, the evolution of the volume of the alleged dumped imports, the effect of these imports on the price of the like product in the domestic market, and the consequent impact of the imports on the domestic industry.

The application shall be filed with the Secretary of Trade and Industry in the case of non-agricultural products or with the Secretary of Agriculture in the case of agricultural products. "Agricultural products" refer to products classified under Chapters 1 to 24 of the Tariff and Customs Code, including those listed under Annex A of the implementing rules. "Non-agricultural products" refer to those classified under Chapters 25 to 97 of the Tariff and Customs Code.[45] The appropriate Secretary shall thereafter require the petitioner to post a surety bond in such reasonable amount as to answer for any and all damages which the importer may sustain by reason of the filing of a frivolous petition. He shall immediately release the surety bond upon making an affirmative preliminary determination.

Within five working days from receipt of a properly documented application, the Secretary shall examine the accuracy and adequacy of the petition to determine whether there is sufficient evidence to justify the initiation of an investigation. In order to verify the information contained in the application or to obtain further details, the Secretary may conduct visits or ocular inspections of the facilities of the domestic producers and importers. The Secretary may also visit other domestic producers and importers that have not provided submissions during the investigation.[46] Upon receipt of the application, the Secretary shall send notices to the Secretary of Finance, the government of the exporting member country, and thereafter to all the interested parties. If there is no sufficient evidence to justify initiation, the Secretary shall dismiss the petition and properly notify the Secretary of Finance, the Commissioner of Customs, and other parties concerned regarding such dismissal.

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[45] *Id.*, § 2(a)(p).

[46] *Id.* § 6(h).

All in all, the Secretary or the Commission shall give public notices through two newspapers of general circulation in no less than five instances: upon initiation of the investigation, conclusion or suspension of an investigation, upon making the preliminary or final determination, upon making a decision to accept or terminate an undertaking, and upon terminating a definitive anti-dumping duty.

The respondent shall then be given 30 days from receipt of notice within which to present his answer and evidence to prove that he is not involved in dumping. If the respondent fails to submit his answer the latter shall be declared in default. In any event, the Secretary shall make such preliminary determination of the case on the basis of the information available. The preliminary determination shall essentially determine the price difference between the export price and the normal value of the article in question in the country of export or origin, the presence and extent of material injury or threat of material injury to the domestic industry producing the like product or the material retardation of the establishment of a domestic industry, and the causal relationship between the allegedly dumped product and the material injury or threat of material injury to the affected domestic industry or material retardation of the establishment of the domestic industry.

In case the preliminary finding of the Secretary is in the affirmative, the latter shall immediately issue, through the Secretary of Finance, written instructions to the Commissioner of Customs to impose within three days from receipt of instructions a cash bond equal to the provisionally estimated anti-dumping duty but not greater than the provisionally estimated margin of dumping. This is in addition to any other duties, taxes, and charges imposed by law on like products. The cash bond shall be deposited with the government depository bank and shall be held in trust for the respondent. The Secretary may suspend the imposition of the provisional anti-dumping duty, taking into consideration whether the imposition of the provisional duty will result in political or economic crisis, or if

such imposition will cause a severe shortage of the like product in the domestic market.[47]

Within three days from making his preliminary findings, the Secretary shall transmit the same along with the records of the case to the Tariff Commission. Within three days from receipt of the records, the Commission shall start the formal investigation and shall accordingly notify in writing all parties on record and give public notice through two newspapers of general circulation of the details regarding the formal investigation. In the formal investigation, the Commission shall make determinations regarding the margin of dumping, the presence of material injury or threat thereof, the causal linkage, the anti-dumping duty to be imposed, and the duration of the anti-dumping duty.

The formal investigation shall be conducted in a summary manner. No dilatory tactics or unnecessary or unjustified delays shall be allowed and the technical rules of evidence used in regular proceedings shall not be applied. The Commission shall take into account the effects of the seasonality of products, whenever applicable, in the final determination of whether or not the elements for the imposition of an anti-dumping duty exist.[48] The Commission shall, after due notification, conduct a public consultation to give all parties directly affected and such other interested parties that in the judgment of the Commission are entitled to attend an opportunity to be heard and to present evidence bearing on the subject matter.[49] The Commission can require any interested party to allow it access to or otherwise provide necessary information to enable the Commission to expedite the investigation. The Commission may conduct on-site investigations of the domestic producers, importers, foreign exporters or producers concerned, including ocular inspections of their facilities, to verify information provided or obtain

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[47] IRR of The Anti-Dumping Act of 1999, § 8(a).

[48] *Id.*, § 10(d).

[49] *Id.*, § 10(e).

further details.[50] The Commission shall complete the formal investigation and submit a report of its findings to the Secretary within 120 days from receipt of the records of the case.

The Secretary shall, within 10 days from receipt of an affirmative final determination of the Commission, issue a Department Order imposing an anti-dumping duty on the imported product. An anti-dumping duty shall be imposed only from the date of determination thereof except however in certain circumstances wherein the duty may be applied retroactively. In case a cash bond has been filed, the same shall be applied to the anti-dumping duty assessed. Curiously enough and despite the fact that dumping is not considered illegal under international trade law, our domestic legislation seem particularly harsh on those found engaging in dumping. Thus, importers and businesses found guilty of dumping shall have their licenses and charters, respectively, revoked. Furthermore, its officers shall be disqualified from holding official positions in corporations of other business entities in the Philippines. A fine equal to twice the definitive anti-dumping duty shall likewise be imposed.

In case of a negative finding by the Commission, the Secretary shall issue, after the lapse of the period to appeal to the Court of Tax Appeals, through the Secretary of Finance, an order for the Commissioner of Customs for the immediate release of the cash bond to the importer. In addition, all the parties concerned shall be properly notified of the dismissal of the case.

A motion for reconsideration may be filed with the Secretary within 15 days from receipt of the Department Order imposing the definitive anti-dumping duty.[51] However, no motion for reconsideration shall be allowed for provisional orders issued pursuant to the implementing rules or for provisional duties

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[50] *Id.*, § 10(g).

[51] *Id.*, § 20(b).

imposed by the Secretary[52] and no second motion for reconsideration shall be allowed.[53]

Anti-dumping duties shall be imposed only on a temporary basis and the need for its continued imposition shall be reviewed by the Commission *motu proprio*, upon the direction of the Secretary, or upon the petition of any interested party. The duration of a definitive anti-dumping duty shall not exceed five years.

Any interested party adversely affected by a final determination to impose an anti-dumping duty may thereafter file with the Court of Tax Appeals a petition for the review of such finding within 30 days from receipt of notice thereof. The filings of the petition for review shall not in any way stop, suspend, or otherwise hold the imposition or collection of the anti-dumping duty on the imported product. The rules of procedure of the court regarding a petition for review filed with the Court of Tax Appeals shall be applied.

An anti-dumping investigation may be suspended or terminated without imposition of provisional measures or anti-dumping duties upon receipt by the Commission of a satisfactory voluntary price undertaking executed by the exporter or foreign producer under oath, that he will increase his price or will cease exporting to the Philippines at a dumped price, thereby eliminating the material injury to the domestic industry producing the like product. This undertaking must be accepted by the affected industry. Price increases under such undertakings shall not be higher than necessary to eliminate the margin of dumping.

A price undertaking shall be accepted only after a preliminary affirmative determination of dumping and injury caused by such dumping has been made. No price undertaking shall take effect unless the Secretary approves it after a recommendation by the Commission.

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52 IRR of The Anti-Dumping Act of 1999, § 20(a).

53 *Id.*, § 20(f).

With respect to actions on behalf of a third country, the authorities of the third country requesting it shall make applications for anti-dumping measures. This refers to instances when the domestic industry of such third country is being prejudiced due to the dumping practices of an exporting country to an importing country, the third country being also an exporter to the importing country. Such an application shall be supported by price information to show that the imports are being dumped and by detailed information to show that the alleged dumping is causing injury to the domestic injury concerned in the third country. The government of the third country shall afford all assistance to the authorities of the importing country to obtain any further information that the latter may require. In considering such application, the authorities of the importing country shall consider the effects of the alleged dumping on the industry concerned as a whole in the third country; that is to say, the injury shall not be assessed in relation only to the effect of the alleged dumping on the industry's exports to the importing country or even on the industry's total exports. The decision whether or not to proceed with a case shall rest with the importing country. If the importing country decides that it is prepared to take action, the initiation of the approach to the Council for Trade in Goods seeking its approval for such action shall rest with the importing country.[54]

The provisions of the Dispute Settlement Understanding (DSU) are basically applicable to dumping cases. Thus, Article 17 of the Anti-Dumping Agreement states that the DSU is applicable to consultations and the settlement of disputes relating to the Anti-Dumping Agreement.

If any Member considers that any benefit accruing to it, directly or indirectly, under the Anti-Dumping Agreement is being nullified or impaired, or that the achievement of any objective is being impeded, by another Member or Members, it may, with a view to reaching a mutually satisfactory resolution

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[54] Anti-Dumping Agreement, Art. 14.

of the matter, request in writing consultations with the Member or Members in question.[55]

If the Member that requested consultations considers that the consultations have failed to achieve a mutually agreed solution; and if final action has been taken by the administering authorities of the importing Member to levy definitive anti-dumping duties or to accept price undertakings, it may refer the matter to the Dispute Settlement Body (DSB). When a provisional measure has a significant impact and the Member that requested consultations considers that the measure was taken contrary to the provisions of Article 7, paragraph 1 of the Anti-Dumping Agreement, that Member may also refer such matter to the DSB.[56]

The DSB shall, at the request of the complaining Member, establish a panel to examine the matter.[57] The panel shall thereafter determine whether the establishment of the facts by the authorities was proper and whether their evaluation of those facts was unbiased and objective. If such is the case, even though the panel might have reached a different conclusion the evaluation shall not be overturned.[58]

Unlike the Agreement on Safeguards and the Agreement on Subsidies and Countervailing Measures, practically no provision can be found in the Anti-Dumping Agreement giving special treatment to developing countries (of which the Philippines, of course, is a member). Nevertheless, Article 15 of the Anti-Dumping Agreement gives recognition that special regard must be given by developed country Members to the special situation of developing country Members when considering the application of anti-dumping measures under

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[55] *Id.*, Art. 17.3.

[56] *Id.*, Art. 17.4.

[57] *Id.*, Art. 17.5.

[58] *Id.*, Art. 17.6.

the Agreement. Possibilities of constructive remedies provided for by the Anti-Dumping Agreement should be explored before applying anti-dumping duties where they would affect the essential interests of developing country Members.

Trade Remedies: Some Definitional Issues[*]

Atty. Jeremy I. Gatdula

Below is a discussion on certain definitional issues relating to trade remedy rules of the Philippines in the context of the relevant World Trade Organization agreements:

I. Anti-Dumping and Safeguards: Substantial Differences

Anti-dumping (Republic Act [RA] No. 8752) and safeguards (RA No. 8800) measures are often confused with one another, sometimes understandably so as they both deal with imposing measures against foreign imports, usually outside the regular tariff protection system. Public discussions sometimes use these two terms interchangeably and there have been cases in the past when an anti-dumping application has been withdrawn and re-filed as a safeguards petition. However, there are significant differences between these two trade remedies and they must be carefully noted for the procedure chosen will have a substantial impact on the outcome of the applications, as well as on the consequences of the imposed measures.

Some of the differences are basic in nature. Thus, anti-dumping measures are employed when foreign goods are said to be "dumped" into the importing country (i.e., if the export price is less than the normal value of that product in the exporting country). "Dumping" *per se* however is not illegal (at least from the viewpoint of the WTO); rather it only becomes

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actionable if it causes "material injury" to the domestic industry in the importing country. Material injury has not been defined categorically, although the factors to be examined to determine the presence of such are enumerated in RA No. 8752.

Safeguards measures, on the other hand, are imposed in response to surge of imports. The increase may be in absolute terms or merely relative to domestic production. Again, however, import price is particularly relevant because the increase in imports will not automatically result in the imposition of safeguards measures unless such increase results in "serious injury" to domestic producers of a like product. Serious injury, like material injury, has not been categorically defined (although general definitions can be found in legislations: "significant overall impairment in the position of a domestic industry"). Nevertheless, it has been understood that serious injury connotes a higher standard or level of injury than material injury.

One of the rationales for the difference in injury standards actually points to another difference between the two trade remedies. Dumping is considered to be an unfair trade practice while the importations for which safeguards measures are applied are not. Safeguards measures are imposed simply because the quantity of imports is harming the local industry. Thus, as opposed to anti-dumping, the application of safeguards measures is viewed by some commentators as actually an acknowledgment by the applicant of the higher level of efficiency of the foreign competitors.

Another difference between anti-dumping and safeguards measures is their application. Anti-dumping measures tend to be specific, in the sense that they are imposed against only those countries whose companies are exporting to the Philippines at "dumping" prices. Countries whose companies are not engaged in dumping are not affected by anti-dumping measures. Under safeguards, however, such measures are applied to all countries that export to the Philippines (save for those countries falling under the *de minimis* provisions).

Safeguards measures, viewed in that light, are therefore encompassing in nature.

Finally and most importantly, safeguards measures (unlike anti-dumping) require the country imposing it to give compensation to the countries against whom the measures are applied. Thus, if the Philippines were to impose safeguards measures against countries x, y, and z it would be necessary to give these three countries compensation in the form of tariff reductions on certain products exported by the latter to the Philippines. If the Philippines fails to give such compensation, then countries x, y, and z (under certain conditions) would have the right to withdraw substantially equivalent concessions that they give to the Philippines.

II. Domestic Industries

Another significant issue regarding our anti-dumping rules (and the same could perhaps be said for another trade remedy, i.e., countervailing measures) is the concept of "domestic industries."

"Domestic industries" has been defined in Republic Act No. 8752 (and in its Implementing Rules) as referring to "the domestic producers as a whole of the like product or to those of them whose collective output of the product constitutes a major proportion of the total domestic production of that product except when producers are related to the exporters or importers or are themselves importers of the allegedly dumped product, the term domestic industry may be interpreted as referring to the rest of the producers." This definition has been copied practically from Article 4.1 of the WTO Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (or the "Anti-Dumping Agreement").

What has to be realized is that the term "domestic industries" is used in two contexts. The above definition is made in reference to determining whether or not "material injury" exists. Note that in order for anti-dumping measures to be

imposed, it is necessary that three elements are present: that dumping of a like product be established, that material injury is caused to the domestic industry, and that there is "causality" between the dumping and the material injury caused. The concepts of "like product" have been discussed elsewhere. "Causality" is another concept seemingly simple (one may be tempted to relate it to our own concepts of causality in determining the presence of a cause of action for domestic civil suits) but again bring certain difficulties in practice and should be appropriately discussed in another article. In any event, Footnote No. 9 of the Anti-Dumping Agreement states that the term "material injury" shall be taken to mean "injury to a domestic industry, threat of material injury to a domestic industry or material retardation of the establishment of such an industry."

Thus, to determine generally whether indeed material injury exists one has to look upon the impact of the alleged dumping upon a group of producers of a like product constituting "a major proportion of the total domestic production of that product." It is to be noted that the term "major proportion" have not specifically been defined by the Anti-Dumping Agreement nor by RA No. 8752 (and its Implementing Rules). There is some opinion that it should mean "50 percent plus one" but practice in other jurisdictions apparently employs lower proportions. This, in any event, would undoubtedly be threshed out through further interpretations in succeeding anti-dumping cases.

It is to be noted further that the Anti-Dumping Agreement also considers as "domestic industry"—for purposes of determining injury—producers within a market if the territory of a WTO Member may be properly divided into two or more competitive markets (see Article 4.l.ii).

The other context for the term "domestic industry" is in the initiation of anti-dumping proceedings. Thus, an application shall be considered to have been made by a domestic industry (or on its behalf) if "it is supported by those domestic producers whose collective output constitutes more than 50 percent of

the total production of the like product produced by that portion of the domestic industry expressing either support for or opposition to the application. x x x However, no investigation shall be initiated when domestic producers expressly supporting the application account for less than 25 percent total production of the like product produced by the domestic industry." The foregoing is quoted from Section 301(a) of the Tariff and Customs Code, as amended by RA No. 8752. It has been practically lifted from Article 5.4 of the Anti-Dumping Agreement.

From the foregoing, one sees different concepts and standards between that required for determining the presence of "material injury" and for determining if indeed proper application has been made for initiating anti-dumping proceedings.

To reiterate, with regard to "material injury," one should be mindful on whether such has been incurred by producers constituting a "major proportion of the total domestic production" of the like product.

However, for purposes of determining whether an application has indeed been made by a domestic industry (or on its behalf), one must establish the amount of support and opposition to the application among domestic producers of a like product. The application is said to have been made by or on behalf of the domestic industry if those favoring the application account for a collective output of more than 50 percent of the total production of the like product of those both supporting and opposing the application. It must be noted that what is required here is not the number of producers but rather the level or amount of production of the like product.

The foregoing requirement comes with the further condition that the domestic producers expressly supporting the application should account for not less than 25 percent of the total production of the like product produced by the domestic industry. This requirement of 50 percent is obviously different from the requirement of "major proportion" and one must

consider that perhaps a lower figure is contemplated for purposes of a proper application due to the second condition that the domestic producers applying be not less than 25 percent total production of the like product produced by the domestic industry.

III. Like Products

The concept of "like products" has been one of the more challenging concepts related to trade remedies. It has so far eluded proper definition and this has led to certain problems, particularly with regard to the application for trade remedies and its imposition. It is a concern that affects all parties to a trade remedy case (e.g., safeguards, anti-dumping, or countervailing). The narrowness or broadness of a definition would have material (not to mention commercial) consequences upon both the applicants and the "targets" of trade remedies, as well as upon government's ability to maintain a balance between the interests of the conflicting parties. The concept of "like products" is vital in determining the presence of a "domestic industry" (for purposes of evaluating a trade remedy application) and also in determining the existence of injury. Though the temptation may be strong to either veer towards an overly broad or narrow definition, both would have negative implications that affect both sides of a trade remedy case. To illustrate, while a narrow interpretation would exclude a greater number of products in an investigation, such should prove easier in establishing injury. A broad interpretation, however, may enable one to include a greater number of products but with the concomitant increase in difficulty in proving injury.

The phrase appears in our three Trade Remedy laws: RA Nos. 8751, 8752, and 8800. These in turn were legislated in response to certain WTO Agreements: the agreement on Subsidies and Countervailing Measures, the Agreement Implementing Article VI of the General Agreement on Tariffs and Trade 1994, and the Agreement on Safeguards. "Like product" is defined in RA No. 8800 (and almost similarly in RA

Nos. 8751 and 8752), albeit in obviously general terms, as a "domestic product which is identical, i.e., alike in all respects to the imported product under consideration, or in the absence of such a product, another domestic product which, although not alike in all respects, has characteristics closely resembling those of the imported product under consideration."

The foregoing definition is almost similar to that found in the Agreement on Subsidies and Countervailing Measures (footnote 46). That same definition however could not be found in the Agreement on Safeguards (which ironically is the "source" of RA No. 8800). The latter makes reference instead to "like or directly competitive products." No specific definition has been given with regard to the latter half of that phrase and it has been the belief that such (as is the case with "like products") can only be determined on a case-to-case basis.

Confusion stems from the fact that the phrase "like products" also appears in Articles I, II, III, IX, XI, and XIII of the General Agreement on Tariffs and Trade 1994. It must be noted that the Agreement on Subsidies and Countervailing Measures had its origins in Articles VI and XVI of GATT 1994, the Agreement on Safeguards from Article XIX, and the Anti-Dumping Agreement from Article VI. However, though "like products" does make an appearance in at least eight different Articles within the same Agreement, it does not necessarily follow that they hold the same meanings and the consensus among international trade experts is, in fact, the opposite.

In Article I of GATT 1994, known as the MFN or "most favored nation" clause, "like products"—though not specifically defined—is understood to have a meaning more nearly in accord with tariff classifications. Accordingly, to consider two products as like products under Article I, consideration has been made as to how the said products have been listed in a particular tariff schedule, the applicable duties, production process, content, etc.

The phrase "like products" similarly has not been defined in Article III of GATT 1994, the so-called "national treatment" clause. It has been understood to have a meaning, however,

slightly different than that accepted for "like products" in Article I. Thus, "like products" in Article III is taken to include products of similar qualities (not limited merely to identical products), relating more to competitive conditions (as opposed to mere reliance on tariff classification), and with due consideration for the nature, qualities, and end use of the products in question. The phrase "directly competitive or substitutable products," incidentally, appears in Ad Article III.2.

The foregoing definitions, it must be emphasized, are meant to apply to Articles I and III and GATT 1994. Nothing in the WTO Agreements however indicates with certainty if such are to be applicable to the Agreements relating to trade remedies. As mentioned above, it has been accepted that different provisions are accorded different interpretations of "like products." The problem of identifying each definition for each provision is obviously substantial. In practice, however, credibility in the foregoing belief has been strained. One trade author discussed "like products" in the context of safeguard measures by simply referring to both the MFN and national treatment provisions of GATT 1994. It is to be reiterated that RA No. 8800 makes use of a definition that is practically lifted from the Agreement on Subsidies and Countervailing Measures. What is compounding this definitional issue is the addition of the phrase "directly competitive products" in the Agreement on Safeguards (as well as our own RA No. 8800). That phrase, as mentioned above, is also undefined but nevertheless has been accepted to have a meaning different to that of "like products." More will be discussed about this later.

Our very own Safeguards Law however tried to be helpful on the matter, albeit unsuccessfully. Thus, "like product", to reiterate, refers to a "domestic product which is identical, i.e., alike in all respects to the imported product under consideration, or in the absence of such a product, another domestic product which, although not alike in all respects, has characteristics closely resembling those of the imported product under consideration." "Directly competitive products," on the other hand, "shall mean domestically-produced substitutable products."

A case-to-case study of the determinations of the Department of Trade and Industry or the Department of Agriculture (with respect to preliminary determinations), and of the Tariff Commission (with respect to final determinations) would not give definitive guidance on the matter (at least as far as Philippine interpretation of "like products" is concerned) due to the scarcity of cases so far filed and decided. Developments in the international scene have also failed to give a conclusive definition for "like products" although some instructive ideas have been rendered which may serve as a foundation for eventual guidance on the matter.

With regard to safeguards, the Agreement on Safeguards and (its precursor) GATT Article XIX require that a surge of imports, whether relative or absolute, be of such level as to injure domestic producers of "like or directly competitive products." The phrase "directly competitive products" is unique to safeguards. The WTO panel in the Japanese Liquor Taxes II (which, it must be noted, is a case involving Article III provisions) made an interesting comment:

> In the view of the Panel, like products should be viewed as a subset of directly competitive or substitutable products. The wording ("like products" as opposed to "directly competitive or substitutable products") confirmed this point, in the sense that all like products are, by definition, directly competitive or substitutable products, whereas all directly competitive or substitutable products are not necessarily like products.

"Directly competitive products" is therefore seemingly broader in application than "like products." Certain local jurisdictions have adopted this interpretation. The United States International Trade Commission ("ITC") for one interprets the phrase "directly competitive products" to mean "substantially equivalent for commercial purposes," or "adapted to the same uses" and "essentially interchangeable." Interestingly enough, US interpretation seems to cover products at different stages of processing, an altogether important consideration which one expert theorizes as allowing the ITC to consider as one "industry" a number of otherwise unrelated producers.

As regards "like products," the ITC traditionally looks to whether the products have interchangeable uses, similar physical appearances, common manufacturing and distribution, similar prices, and similar customer perceptions. The Canadian Special Import Measures Act defines "like goods" as goods which are identical in all respects to the foreign manufactured goods imported into the Canada, or in the absence of such goods, goods that closely resemble the foreign goods and share the same uses and characteristics.

To partially solve the definitional dilemma, some experts point to the fact that Articles I and III are anti-discrimination provisions, whereas the trade remedy provisions merely establish contrary or exception rules. The point for these experts is that interpretations of "like products" for the latter should be narrower than those for anti-discrimination provisions. One however finds difficulty in following such logic because the rationale for both the anti-discrimination and trade remedy provisions are to provide corrections to uncompetitive conditions.

It is this perceived purpose of correcting uncompetitive conditions however that may give impetus to finally resolving this definitional question. The Appellate Body, on review, made the following remarks on the abovementioned Japan Liquor Taxes case:

> x x x the Panel emphasized the need to look not only at such matters as physical characteristics, common end uses, and tariff classifications, but also at the "market place." This seems appropriate. The GATT 1994 is a commercial agreement, and the WTO is concerned, after all, with markets.

According to one expert, the effect of the Liquor Taxes case is to emphasize the importance of competition, which necessarily includes taking into consideration the consumer's perspective, in defining "like" or "directly competitive or substitutable products." The logic in this argument is attractive. If one does accept that the WTO is indeed concerned with markets," then the interpretation placed by the Panel and Appellate Body for Japanese Liquor Taxes (though for an Article

III matter) should consequently apply to trade remedies as well, the latter after all deals in the correction of injurious situations to the market.

In any event, the definitional issue regarding “like products” is obviously far from resolved, and both domestic producers and importers are faced with significant problems that would affect their ability to thrive under the multilateral trading system. A definite standard is certainly necessary so as to avoid uncertainty to the rights of parties but it simply would not do to limit the debate on the merits of a narrow or broad definition. The eventual formulation of a definition that would balance the interests of producers, importers, consumers, and the government is the most prudent and therefore the best course.

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The Fog of Trade[*]

Atty. Jeremy I. Gatdula

The topics I have been asked to comment on are on anti-dumping, regional trade agreements, and trade facilitation. It is notable, however, that even in the narrow technical confines of these three areas, one could not but sense the direction of increasing skepticism and—more to the point—caution in the multilateral trading system in general. This and the suggested steps to face such direction shall serve as the general theme of my comments.

Anti-Dumping

The Negotiating Group on Rules had the mandate of clarifying and improving the rules on anti-dumping. A lot of the issues with regard to this focused on initiation, dumping margin calculations, non-market economies, injury and causality determinations, price undertakings, lesser duty rule, and sunset reviews.

In Cancun, these negotiations were led by two groups: the users, for which India, US, EC, Argentina, South Africa are counted; and those asking for stricter disciplines: Japan, Korea, Chile, Thailand, and Norway. Incidentally, the most "popular" targets for anti-dumping investigations are: China, EC, Korea, US, Chinese Taipei.

By Hong Kong, the talks would further narrow into the manner in which the negotiations are conducted. Nevertheless,

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the range of topics covered would still expand into on-site investigations, fair comparisons, like product definitions, accrual of interests in computing dumping margins, public interest rule, material retardation, currency conversion, conditions of competition, cumulation, and definitions of domestic industry and causation.[1]

There have been a huge number of proposals tabled—141 by some counts—but no consensus reached moving forward. A group of countries, called the Friends of Anti-Dumping Negotiations (FANS) have tabled a lot of the proposals, asking for greater disciplines. Interestingly, the US seemingly has become a little more subtle in its position regarding anti-dumping, recognizing (ominously for others) the importance of anti-dumping actions as a protection for "unfair" trade and—at the same time—calling for certain amendments to the anti-dumping rules. The HK Ministerial text merely recognized the status of the discussion so far.

Seemingly, it would appear that the most beneficial position for the Philippines indeed is to maintain generally the present procedures for anti-dumping investigations. This would allow for greater familiarity as to the effects and implications of the provisions as they stand, provide a notable period in which a certain degree of discretion can still be exercised by the authorities imposing anti-dumping measures, and to allow the Appellate Body the space within which to flesh out jurisprudence on anti-dumping.

RTAs

So far, there apparently has been no substantial strides with regard to the discussions on Regional Trade Agreements (RTAs)

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[1] The Appellate Body, in US-Anti-Dumping Measures on Oil Country Tubular Goods from Mexico, ruled that it is not necessary to establish the causal link between likely dumping and likely injury in a sunset review of anti-dumping duties pursuant to Article 11.3 of the ADD.

and the implications for this currently adds more uncertainty to the question involving the same.

While not commenting on the direction of the RTA negotiations and focusing instead on RTAs itself, it must be stated that for all their supposed benefits, they are simply tricky propositions. Getting concrete interpretations alone of Article XXIV of GATT 1994 (which provides for the creation of FTAs and customs unions) is quite difficult. However, even assuming that the Doha Round could produce less ambiguous rules on RTAs, the very existence and potential number of the same provides an increasingly complex international trading system. Considering that there have been concerns raised regarding the capacity of the Philippines to keep up with its multilateral trading commitments, this obviously would be multiplied in view of the proliferation of RTAs because not only would the Philippines need to keep track of its own membership commitments but also, for purposes of keeping Philippine competitiveness, keep track of the arrangements of which the Philippines is not a part of but has been entered into by other countries.

Also, by relying on the benefits of RTAs, certain rules would be needed and these are inevitably complex. Most significant among these rules would be those pertaining to the rules of origin, the overlapping jurisdictions by the different dispute settlement systems in place between the multilateral trading system and the different RTAs, the non-tariff subjects (such as customs procedures, sanitary and phytosanitary measures, technical barriers to trade, and—perhaps—the issue of smuggling).

Finally, it is to be noted that if various Philippine stakeholders are disturbed by the complexity of the subjects involved in multilateral negotiations, these subjects (such as the Singapore issues, agriculture, non-agricultural market access, etc.) will be no less complex in bilateral and regional discussions. If these stakeholders are lamenting the muscular negotiating tactics of developed countries, these tactics will be no less demanding and aggressive in bilateral or regional talks.

It must be emphasized that the safety mechanisms that multilateralism brings (i.e., the comfort of numbers, transparency, and an established dispute settlement system) are not present to the same degree in bilateral or regional negotiations.

This is not to say that RTAs are destructive. Benefits certainly there may be and there is no dearth of economists who would point to such expected benefits. The point simply is that with regard to formulating a policy or view with regard to RTAs, there is always the need for greater information regarding the environment that surrounds them. For the moment, a certain degree of caution would perhaps be justifiable under the circumstances when even exploring the idea of possible bilateral or regional trading arrangements precisely because there are no categorical indications regarding the direction, benefits, and risks that are concomitant with RTAs.

Trade Facilitation

With regard to trade facilitation, much of the work has focused on improvements to GATT 1994, such as Article V (freedom of transit), Article VIII (fees and formalities), and Article X (transparency and notification). Various proposals have been given, most notably in the area of post-entry audit.

In Cancun, the Philippines had then acknowledged the desirability of trade facilitation measures and with good reason. This was the correct approach. The question was with regard to the issue of resources. Considering the innately technical nature of trade facilitation issues, introducing new rules to presently existing ones (like the Agreement on Customs Valuation) would definitely lead to certain difficulties.

Trade facilitation was lumped together with three other subjects: competition policy, investments, and government procurement, the so-called Singapore Issues. Of these four, trade facilitation was the least contentious and the possibility remained that, if no multilateral rules could be established, at least something in the nature of a soft law could be made.

By the time of the Hong Kong Ministerial, trade facilitation was recognized as a negotiating topic. Meetings for its negotiating group started in November 2004, although some reports indicate that substantial discussions on the matter only occurred in 2005. By now, the discussions had taken into consideration the issues of internet publications, notifications, time periods for such publications, advance rulings, appeal procedures, disciplines for fees, data documentation requirements, uniform customs code, single windows, elimination of pre-shipment inspection, risk management analysis, clearance times, post-entry audit, and, most significantly, S&D treatment for developing countries.

Definitely, trade facilitation is helpful. They are also highly technical affairs. With an eye towards the resources available to the Philippines to devote to trade facilitation, the best recourse is to simply not have a solid written agreement that would bind the Philippines to further obligations. Unilateral improvement of trade facilitation, without the pressure of a binding commitment, would be the safest course. Nevertheless, commitments from developed countries to assist developing countries in upgrading customs capabilities should be had.

State of Play

When the Uruguay Round of negotiations were contemplating the need for an international trade organization to oversee the various trade agreements being considered, a negotiation was specifically set aside to discuss the "functioning of the GATT system" and was given the acronym "FOGS." Out of this the WTO was created. Unfortunately, more than 10 years later, what was deliberated under FOGS is still under a fog.

Two noticeable things that one can notice is the lack of certainty as to the future of the multilateral trading system. The other is a subtle creeping shift from an absolutist belief among supporters of trade liberalization to a more cautious and conditional stance. Thus:

> The countries that have succeeded in raising living standards rapidly, over long periods, have followed many varieties of economic policy and have lived under many different forms of government x x x Not fully, or even nearly so x x x They adopted liberal trade partially, selectively and mostly gradually. But the important thing was that they adopted it. (Liberty's Great Advance, June 28, 2003; underscoring supplied.)

> It is true that the poorest countries often face the biggest obstacles to reaping the gains from trade and that economists' models often assume these obstacles away. Many rely on tariffs as a source of government revenue. Weak infrastructure and underdeveloped credit markets can make economic restructuring difficult. These problems underline why trade liberalisation is no substitute for either more domestic reform or foreign aid. They also suggest that some of the poorest countries need more time to open their markets than others. (Weighed in the Balance, December 8, 2005; underscoring supplied.)

Interestingly, while there has indeed been comment that poor infrastructure can result in the non-effectiveness or mitigation of the benefits of trade, this recent statement from an article in the Wall Street Journal was intriguing:

> Many believe globalization will create a firebreak against inflation, but trade barriers have been in a steady descent for more than 70 years with no consistent bearing on U.S. inflation rates. (A Hard Landing, AWSJ, 3 Feb. 2006, p. 13)[2]

So there it is, a country as sophisticated and as developed as the US and still with an infrastructure not good enough for

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[2] Another interesting article is that from the New York Times: "Put simply, the Philippines got taken. A charter member of the World Trade Organization in 1995, the former American colony dutifully embraced globalization's free-market gospel over the last decade, opening its economy to foreign trade and investment. Despite widespread worries about their ability to compete, Filipinos bought the theory that their farmers' lack of good transportation and high technology would be balanced out by their cheap labor. The government predicted that access to world markets would create a net gain of a half-million farming jobs a year, and improve the country's trade balance. It didn't happen." (The Rigged Trade Game, July 20, 2003).

trade liberalization to substantively affect its inflation rate. If the US has been found wanting, then what country would not? Is trade liberalization indeed that powerful a force that could benefit countries and their peoples? There now seems to be a creeping doubt that it is.

Finally, there is also the refusal of the developed countries to practice what they preach. For but the most recent examples, witness the national furor that erupted when a foreign company signaled its intention to purchase a European manufacturing company, a similar national outrage when a foreigner bought a local European football club, when the lifestyle of a country's farmers are given greater consideration than the lives of starving farmers in less developed countries.

All of these do not bring much confidence in the world trading system. Thus, if we could not find that confidence elsewhere, we should ensure that we instead develop that confidence in ourselves.

Suggestions

Here, then, are some suggestions:

a. First is the review of our trade-related legislation, particularly seeking to remove any ambiguities in them and ensure that they serve national interest. Among such laws suggested to be reviewed are: RA No. 8752 (the anti-dumping law), RA No. 8800 (the safeguards law), Section 304 of the TCCP, Sections 401/402 of the TCCP, and RA No. 9135 (the customs valuation law).

b. Second is the institutionalization of private sector participation in the formulation of positions and the conduct of negotiations. The appointment of a Special Envoy for Trade Negotiations, the expanded inclusion of private sector parties into the trade delegation to the Hong Kong Ministerial, and the establishment of the Universal Access to Competitiveness and Trade

(UACT) initiative (with its appreciably defined objectives) are good first steps in this direction.

c. Third is the institutionalization of hearings and proceedings that would lead to greater transparency and accountability in the conduct of trade negotiations. Among such would be the conduct of periodic and regular hearings in Congress to determine the state of our trade activities.

   Included with this suggestion is the refinement of our rules to remove any ambiguity as to the need for our elected representatives to have a say in our entry into any trade agreement. This is especially with regard to the ongoing confusion regarding the classification of trade agreements into "treaties" (which need Senate concurrence) and "executive agreements" (which do not). Thus, new rules could be issued clarifying this matter so that any substantive agreement (and most trade agreements are substantive) will have to be submitted to the Senate for its concurrence. This is but right as our elected representatives need to have a say as to whatever trade commitment the Philippines is entering into.

   Another is for the government to lay down publicly, in writing, a detailed draft of what our trade policy actually is. Not only would it result in informing the public as to where the government intends to bring us in terms of trade, it would also give the most affected stakeholders (which is us, the private citizens) the opportunity to speak out on the wisdom of such policy.

d. Fourth is the creation of the office of the Republic of the Philippines Trade Representative's Office (RPTR). This should not necessarily be a huge bureaucratic creation, at least at the outset. When the USTR was created in 1962, its legal counsel's office was composed only of two men (one of whom happened to be Robert Hudec, one of the acknowledged fathers of international

economic law). Incidentally, when the USTR was created, the reasoning of the US Congress that created it in 1962 was that trade policy should not be entrusted to the State Department (which it said looked out for the interests of foreigners or broad foreign policy goals) or the Commerce Department (which always looked out for narrow domestic political interests) but rather to have an office that would take the middle and have trade as its only mission. For the RPTR, it is ideal that the same be peopled with professionals of diverse backgrounds: diplomacy, law, economics, finance, etc. Such an office would have the function of taking the lead in dealing in matters involving Philippine engagement in the WTO, AFTA, APEC, and UNCTAD, as well as dealing with issues brought about by prospective or probable bilateral or regional trading arrangements. It has to be the primary source of information on matters dealing with international trade and, at least with regard to issues arising principally from trade negotiations, be responsible directly to the President.

e. Finally, there is the need for the enactment of an effective competition policy law. Competition policy, in its simplest form, primarily deals with the state of competition internally, that is, with regard to the state of competition within a country's borders and seeks to rid of harmful monopolies, cartels, and other anti-competitive practices. Furthermore, in a country where it is commonly acknowledged that the nation's wealth is concentrated only in the hands of a very few, a robust competition policy would be one way of ensuring a more equitable distribution of wealth and, perhaps, a more meritocratic society. Competition policy can help in ensuring greater competition, efficient market conditions, more adaptable industries, promote the easier and more effective entry of new players in the market, greater quality goods entering that market, and price stability.

In fine, DTI Secretary Peter Favila's message which essentially is that we are all in this together and with the same goal for the national good, is well said. Considering, however, the present state of the multilateral trading system, it is suggested that we prioritize in employing our called-for united energies and efforts towards reorganizing and making our house in order. This is not a call for us to be isolationists or protectionists. Rather, it is so that we can develop a strong and deliberate base within which to move out and confidently engage our trading partners.

The Road Ahead: Responding to Uncertainties in the Multilateral Trading System[*]

Atty. Jeremy I. Gatdula and Mr. Raphael B. Madarang

I. Introduction

The Doha Round of Negotiations, which was aimed at addressing the international economic needs of developing and less developed countries, has reached a critical point. While much optimism enveloped the outcome of the Sixth Ministerial Conference at Hong Kong last December 2005, with general commitments made and renewed towards what many observers described as the right direction, pre-agreed guideposts and deadlines in the course of the whole negotiating efforts have now begun to lapse. Many trade practitioners pinpoint divergent negotiating positions and the intransigence displayed by the different member country blocs as the main reason behind the laggard pace at which the negotiations have proceeded. At this particular juncture, several factors have arisen threatening to derail the negotiations.

Presently, any potential outcome to the negotiations could be anyone's guess, as developed, developing, and less developed countries tender positions practically diametrically opposed to each other. The infinite number of permutations and possibilities as to what compromises will be reached, and how these would be of consequence to the economies of the participating member countries are similarly difficult to define. Adding a complication herein is the surprising lack of confidence by trade commentators as to whether the negotiating positions purveyed by countries are indeed reflective of the interests of

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[*] Delivered at the *Seminar-Workshop on Law and Economic Development Issues for the Philippine Judiciary* held on March 27–28, 2007, at the Quezon City Sports Club, Quezon City.

the industries the government negotiators are tasked to represent.

What is of prime importance, of course, is the assessment of what possible outcome would positively affect the bottom line of all this—which is the economic welfare of Filipinos. If there is any word that would best characterize the direction of the talks and the possibility for the country to gain tangible economic benefits by liberalizing further, that would be "uncertainty." If a solution could be proposed that would enable the Philippines to optimize the benefits of its participation in the multilateral trading system, it would most likely be linked to domestic reform for more transparent governance and an effective competition policy.

This paper will provide updates and an analysis on the present state of play at the Doha Round considering the outcome of the latest WTO negotiations, present geo-political conditions, and the seeming FTA initiative within the Asian region. It will be shown that in order for the Philippines to respond well to any uncertainty in the direction that the multilateral talks may take and what tangible benefits the economy would derive, it would have to refine its policy making process by reviewing its trade policy legislation, institutionalizing private sector participation in the formulation of positions and conduct of negotiations, institutionalizing public hearings for transparency (such as clarifying "treaties" and "executive agreements"), creating an Office of the Republic of the Philippines Trade Representative (RPTR), and the enactment of an effective competition policy.

As to how the said benefits from our greater participation in the multilateral system can be obtained, the same is not dependent on how open the economy is, but rather can only be driven by how effectively we are able to refine our domestic policies and institutions to make the country more competitive. Notably, despite the rapid pace at which we have opened our economy, the Philippines remains uncompetitive and unattractive to foreign investments relative to its neighbors. Thus, attaining the benefits of globalization is no longer a matter

of opening up the economy but by improving local institutions and governance structures, making them friendly and accommodating to international business.

Verily, an examination of international trade's present state does not bring much confidence in the world trading system. The point, therefore, of this paper is that such confidence cannot be found in the system at present, therefore we should instead ensure that we develop our understanding and capacities vis-à-vis the multilateral trading system and confidence in ourselves by improving governance, refining our laws and processes, and strengthening our institutions.

II. International Trade's State of Play

This section will consist of updates on four areas of the present negotiations that are critical to the interests of the Philippines —that of non-agricultural market access (NAMA), Agriculture, Services and Trade Related Aspects of Intellectual Property Rights (TRIPS). It would also provide quick updates on the FTAs in which the Philippines is currently party or may become a party to. It will be shown herein that issue after issue, a potential stalemate and only an uncertain outcome can be foreseen for the Philippines.

In a nutshell, ambiguity still grips the direction of the negotiations due to the divergent interests and negotiating positions propounded by different country members of the WTO. Developed countries have called for movements in Agriculture negotiations only if conditioned on movement in NAMA and Services.[1] Developing countries, such as the Philippines on the other hand, are calling for flexibilities in NAMA and services, whilst pushing for the prioritization of agriculture. Corollary to the uncertainty as to the most likely outcome of this hodgepodge of negotiating positions is an even deeper irresolution as to whether the Philippines could gain

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1 Available at <http://www.europa.eu.int/comm/trade/issues/newround/doha_da/pr281005_en.htm>.

more from liberalizing further and deepening its involvement in the current world trading system.

A. NAMA

The current main concern on market access issues relating to non-agricultural products revolve around how much of a cut or ceiling should be imposed on tariffs on industrial products, and whether certain products would be afforded exemption from such cuts.

Developed economies such as the US and the European Communities (EC) hold strong comparative advantage in the production of a myriad of highly specialized and high-value industrial products. It is not surprising therefore that developed countries are the primary advocates for the enforcement of the most substantial tariff cuts on industrial products so as to allow them wider market access for their products in foreign markets, among which are developing and less developed countries (LDCs).

Developing countries such as the Philippines, on the other hand, have taken a strong position to maintain a wider range of flexibility in adjusting their industrial tariffs to shelter selected domestic industries from an influx of importations, in line with their development objectives. It has to be noted that for some developing countries, this position was taken not necessarily due to a perceived threat from the US or the EC, but rather from other developing countries such as China. According to the Report by the International Development Committee of the UK House of Commons: "We were told by the Department for International Development (DFID) that the reason that India was so reluctant to lower its industrial tariffs was not because of the EU but because of Chinese industrial exports."[2]

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[2] The House of Commons International Development Committee, 1 The WTO Hong Kong Ministerial and the Doha Development Agenda, Third Report of Session at 21 (2005–2006).

1. Negotiations on the Formula

The designated method of tariff reduction for market access is by way of a mathematical formula. At Hong Kong, it was already agreed, as stated in the Hong Kong Ministerial Declaration—that a Swiss formula[3] be used as the basis for determining the extent of tariff disciplines for non-agricultural goods. The said formula makes use of a coefficient that will determine the new set of maximum tariff rates. A modified Swiss formula is also on the negotiating table which allows for more than one coefficient.[4] Argentina, Brazil, and India have proposed a modified Swiss formula that would consider a country's average tariff rate and have the same multiplied with the set coefficient(s). The value of the coefficient(s), however, as well as the question as to whether more than one coefficient should be used, remains to be resolved at the negotiations.

Even prior to Hong Kong, the Philippines and many other developing countries were already agreeable to the use of the Swiss-type formula saying that the same "was equitable and had flexibility, meeting the principles of SDT [special and

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[3] The principle behind the Swiss formula as opposed to a linear formula is that the former imposes "the highest cuts on the highest tariffs," whereas the linear formula will effect a uniform cut across all tariff lines.

The Swiss Formula is expressed algebraically as follows: Z = AX/(A+X) where: X = initial tariff rate, A = coefficient and maximum tariff rate, Z = resulting lower tariff rate (end of period) (cited at <http://www.wto.org>).

[4] This alternative formula is expressed as follows:

> T1= (BxX)xT/(BxX)+T, where T1 is the final tariff rate, T is the initial tariff rate, B and X are coefficients. The difference between the modified Swiss formula and the Swiss formula is the presence of the additional coefficient X.

(*See* Ranjan Pranhash, *Choosing the Appropriate Tariff Reduction Formula in NAMA*, Economic and Political Weekly, April 22, 2006).

differential treatment] and less than full reciprocity."[5] This, however, will still be driven by the value of the coefficients to be agreed upon.

Developing countries are inclined to negotiate for a higher coefficient or multiple coefficients for themselves as this would produce shallower cuts on their industrial tariffs (which on the average are higher than those of developed countries). Conversely, developing countries have also taken the position for developed countries to adopt a lower coefficient which will effect a much higher cut on their tariffs and thus allow greater access for industrial exports from developing countries.

Some developing countries have proposed a coefficient of at least 30. Developed countries, such as the US, however, are insisting on a coefficient of 10, with a maximum of 15 for developing countries. Another group of developing countries on the other hand, called the NAMA-11[6] (of which the Philippines is part) argued that even with a coefficient of 40 for developing countries and a coefficient of 10 for developed countries, developing countries will make a 41.57 percent reduction in their bound tariffs as opposed to only a 25.77 percent reduction for developed countries.[7] Furthermore, while some proposals have suggested that the formula be used on the present applied tariffs instead of the maximum tariffs allowed in the commitments schedules (bound rates), the NAMA-11 maintain that the tariffs be reduced from the bound rates.[8]

Due to the sheer number and complexity of the proposals that have been raised for the coefficients alone, the outcome of the negotiations, as well as the accuracy of conjectures

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[5] Available at <http://www.twnside.org.sg/title2/twninfo208.htm>.

[6] Along with Argentina, Brazil, Egypt, India, Indonesia, Namibia, South Africa, and Venezuela.

[7] Available at <http://www.twnside.org.sg/title2/twninfo376.htm>.

[8] *Id.*

identifying which countries would benefit the most from such an outcome, remains hazy at best.

2. Different Interpretations of Paragraph 8 Flexibilities

Paragraph 8 of Annex B of the July 2004 Package[9] provides for flexibilities in tariff cuts for developing countries. The said paragraph is quoted as follows:

> We agree that developing-country participants shall have longer implementation periods for tariff reductions. In addition, they shall be given the following flexibility:
>
> a) applying less than formula cuts up to [10] percent of the tariff lines provided that the cuts are no less than half the formula cuts and that these tariff lines do not exceed [10] percent of the total value of a Member's imports; or
>
> b) keeping, as an exception, tariff lines unbound, or not applying formula cuts for up to [5] percent of tariff lines provided they do not exceed [5] percent of the total value of a Member's imports.
>
> We furthermore agree that this flexibility could not be used to exclude entire HS Chapters.

Foremost, it has to be considered that despite it having already been written down in Paragraph 8(b) of Annex B of the July Package, developed countries continue to express their objection to allowing developing countries to exempt 5 percent of their NAMA tariff lines from cuts.

Whilst practically all of the phrases in the aforementioned paragraph affords for greater discussion and debate, one of the strongest points of contention before, during, and after the Hong Kong meeting was whether the abovequoted paragraph should be treated as a "stand-alone" provision, or should be traded off or linked with the tariff cuts to be implemented according to the agreed Swiss formula coefficient.

The developed countries such as the US and the EC are of the position that there should be a trade-off between the

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[9] Or the WTO General Council Decision adopted in August 1, 2004.

flexibilities provided in paragraph 8 of Annex B and the coefficient of the formula. This would mean "that the deeper the tariff cuts undertaken, the greater the flexibilities that would be available. In other words, according to some members, the percentage thresholds of paragraph 8 are not final and could be revised downwards depending on the level of the coefficient of the formula."[10]

Developing country members, on the other hand, including the NAMA, reject this position, asserting that paragraph 8 is a stand-alone provision in the agreed NAMA framework, and that any move to link it, or use it as a trade-off with the tariff reduction formula will create unnecessary difficulties in the negotiations.[11] The said group adds that "the two issues are separate and should be treated as such."[12]

The Philippines for its part issued a pronouncement to the same effect that Paragraph 8 is "a stand-alone provision that cannot and ought not to result in any enhanced or separate coefficient for certain developing countries as a result of their use or non-use of paragraph 8 flexibilities."[13] It added further that, "to allow, at this late stage of the negotiations, a special coefficient for a certain group of countries would lead to other groups of countries to also seek special coefficients, including those countries with low unbound and applied duties."[14] With the wide rifts in the positions between developed and developing countries, the proposals of the Philippines, and of the NAMA-11, for that matter, may give way to further amendment and concessions—the permutations and final effects of which may lead to different conclusions as to how it would affect developing countries.

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10 South Centre, *NAMA State of Play: Countries Negotiating Positions*, Geneva, Switzerland, May 2006.

11 Available at <http://www.twnside.org.sg/title2/twninfo376.htm>.

12 *Id.*

13 Available at <http://www.twnside.org.sg/title2/twninfo381.htm>.

14 *Id.*

3. Divergent Views on the Treatment of Unbound Tariffs

Paragraph 17 of the Hong Kong Declaration provides for the use of a non-linear mark-up approach to determine the base rates on currently unbound tariffs for the negotiations. Research has suggested that this paragraph was not present in previous drafts of the Hong Kong Declaration and was only inserted at the last minute.[15] Nevertheless, this is considered as a major concession on the part of developing countries since it has long been a position of developing countries to retain a certain percentage of their tariff lines unbound, with bound tariff rates pegged at relatively high rates in order to provide developing countries more latitude in setting tariff policy.[16] Following this rule, applied rates—including those of unbound tariff lines—will be increased by a markup value still to be determined, after which the formula will be applied. The resulting rates will then constitute the new bound rates. Regarding the value of the markup, a range of 5–30 absolute percentage points has already been broached at the negotiations, although no agreement has yet been reached.[17]

Developed countries, primarily the US and the EC, fully support this as it would subject all industrial tariff lines of their potential markets to disciplines. Developing countries on the other hand have expressed strong reservations as to how Paragraph 17 would impact on their unbound tariff lines. The NAMA-11 countries for one, as mentioned earlier, maintain the position that any reductions to tariffs should start not from applied rates but from bound rates.

It must be considered that, even prior to Hong Kong, the Philippines had already articulated its opposition to applying

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15 Available at <http://www.fao.org/docs/nems/trade/33541/TWN.doc>.

16 Available at <http://www.focusweb.org/content/index2.php?option=com_content&do_pdf=1&id=866>.

17 South Centre, *NAMA State of Play: Countries Negotiating Positions*, Geneva, Switzerland, May 2006.

the formula to unbound tariff lines. Moreover, even during meetings in the run-up to Hong Kong, the Philippines was of the position that the “India-Brazil-Argentina [another term for the modified Swiss formula] formula (to be used for unbound tariffs) was only suitable for countries with high unbound tariff rates and not for countries with low applied and unbound rates.”[18] The Philippines also supported a proposal brought forth by Malaysia in 2004 that duties be bound at a target average of 25 percent with a ceiling of 40 percent for all newly bound duties.[19]

With regard to NAMA, various proposals and suggestions reflective of each country’s interests have been placed on the negotiating table regarding this issue. The current inability of the negotiating body to arrive at a compromise as to a) which formula to adopt, b) what interpretation of paragraph 8 to accept, and c) how unbound tariff lines would be treated only casts further uncertainty as to how the WTO talks would turn out.

It may also be uncertain whether the current negotiating positions taken by the Philippines are indeed reflective of and responsive to the interests of Philippine business. Setting aside such relevant questions regarding the sufficiency of manpower and other such resources, there is also a question as to whether the analysis and research regarding NAMA was unnecessarily focused on industrial tariffs. Considering the interlinkages of the negotiations between NAMA, agriculture, and services, and the conditionalities prevailing among them, the current approach may have to be refined to reflect such fact of interlinkages. There is also the question of proper and effective consultation with the private sector for purposes of developing the positions on NAMA.

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18 Available at <http://www.twnside.org.sg/title2/twninfo208.htm>.

19 South Centre, *NAMA State of Play: Countries Negotiating Positions*, Geneva, Switzerland, May 2006.

B. Agriculture

Agriculture has been the subject of controversy and contention since the onset of multilateral trade negotiations. Generally, the insistence of developing countries to prioritize discussions on a new Agreement on Agriculture and the dogged determination of developed countries to divert discussions elsewhere (such as the effort to push for Singapore Issues[20] ahead of agriculture at the Fifth Ministerial Conference at Cancun) has left many aspects of and proposals for agriculture trade unresolved.

Developing countries have taken the position that negotiations in market access, domestic support, and export subsidies should be interlinked since any progress in one or two areas will be negated and will be of no bearing to developing country trade interests if a single one is not addressed. Each is discussed in the subsequent portions of this section.

1. Export subsidies

On this subject, divergent positions were taken by two of the largest blocs among the developed countries. On one hand, the US proposed that all export subsidies be eliminated by 2010. The EC proposal, on the other hand, called for an elimination of export subsidies by 2015. Developing countries batted for the soonest end date for the elimination of these subsidies and threw support for the soonest deadline (or even before 2010) for the elimination.

At the conclusion of the Hong Kong talks, a milestone was claimed to have been attained when a compromise was reached for the elimination of all trade export subsidies by 2013, except for those on cotton which was marked for earlier elimination within 2006. Nonetheless, this constitutes an agreement on a deadline for only one of the pillars of the negotiations.

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[20] Investment, Government Procurement, Competition Policy and Trade Facilitation.

Furthermore, according to observers, the elimination of export subsidies may not create much of an impact since "the US does not use export subsidies extensively and x x x comprise only 3.6 percent of overall CAP [common agricultural policy] support of the EC."[21]

2. Domestic Support

For domestic support, the only agreement arrived at so far is the classification of countries into three bands depending on the amount of support they provide with the highest band subject to the steepest linear cuts. The topmost band will be composed of the WTO member giving the highest level of domestic support while the second band will hold the two members paying the second and third highest amount of domestic support. All the rest, including developing countries, will be categorized under the lowest band. Interestingly, while NAMA tariffs are to be cut according to a non-linear approach across all countries (meaning the steepest cuts for the highest tariffs), domestic support will only be reduced on a linear basis albeit dependent on which band a country belongs. It is worth noting in this regard that the domestic support provided by developing countries is utterly insignificant as compared to those granted by developed countries.

The US proposed to cut its financial support to farmers by 60 percent. This was rejected by developing countries and non-government groups, such as Oxfam, saying that the bottomline of such a proposal would be limited to the US government reducing its spending on agriculture by only 2 percent once the implementation period of the Doha Round ends.[22] The EC, on the other hand, again took a contingent stand, offering to cut its payments to farmers by 70 percent provided that other countries providing heavy subsidies likewise undertook

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21 The House of Commons International Development Committee, 1 The WTO Hong Kong Ministerial and the Doha Development Agenda, Third Report of Session at 19 (2005–2006).

22 *Id.* at 21.

proportionate actions. It also offered to reduce its present *de minimis* allowance by at least 65 percent.[23]

3. Market Access

It is in market access negotiations where various proposals are currently being debated. As early as October last year, the US and the EC stated their respective offers in agriculture.

Unlike in the case of NAMA in which a formula for tariff reductions has already been adopted, no such means has yet been agreed upon for market access for agricultural products. Instead, on the table are unilateral proposals from various member countries as to how they would be willing to effect disciplines in their tariff rates and extend special and differential treatment to poorer countries. Nonetheless, in the Hong Kong Declaration, all members agreed to establish four bands for the structuring of tariff reductions—although the thresholds are still to be deliberated on.

In its offer, the US proposed to reduce its tariffs on farm products by a range of 55 and 90 percent, and provide duty-free access on LDC exports for at least 97 percent of all tariff lines. The remaining tariff lines would be reserved for products the US would choose to protect such as sugar.[24]

The EC for its part proposed an average cut of 46 percent on all tariff lines (60 percent on the highest and 35 percent on the lowest tariffs), imposing a maximum agricultural tariff of 100 percent, a reduction in the number of designated sensitive products to 8 percent, wider tariff rate quotas (TRQs), a 70 percent reduction in trade distorting agricultural subsidies and tighter disciplines on Blue Box spending, and more special and differential treatment for developing countries.[25] The EC still

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[23] *Id.* at 9.

[24] Available at <http://www.card.iastate.edu/iowa_ag_review/winter_06/article3.aspx>.

[25] Available at <http://ec.europa.eu/comm/trade/issues/newround/doha_da/pr281005_en.htm>.

made it clear, however, that their proposal was still conditioned on further movement in other sectors.

Developing countries on the other hand led by the G20 demanded the EC to slash its agricultural tariffs by 54–75 percent. The US, notably in line with the G20 position, called for an even steeper cut of 90 percent. Also, developing countries dismissed the EC proposal to designate as much as 8 percent of its tariff lines as sensitive arguing that such should be limited to 1 percent. A World Bank Report has been cited which states that "if even 2 percent of products in developed countries, (and 4 percent for developing countries) are deemed special or sensitive products this virtually eliminates the poverty impacts of a Doha agreement."[26] Up to the present, this remains a hotly contested aspect of the negotiations.

Also on market access, the Philippines has taken a vocal position on the designation of certain tariff lines as Special Products to be given flexibilities in the imposition of tariff cuts. Paragraph 7 of the Hong Kong Declaration states that:

> Developing Countries will have the flexibility to self-designate an appropriate number of tariff lines as Special Products guided by indicators based on the criteria of food security, livelihood security and rural development.

In this connection, the Philippines, which aligns itself with the G-33 position, has issued a proposal allowing developing countries to designate, at the very least, 20 percent of their agricultural tariff lines as Special Products. The Philippines in its submission acknowledges that some countries may consider the said proposal as ambitious. It, however, cites a study attesting that Special Products are "essential to lessening the diverse impact of the Doha Round cuts on developing countries," and that "little losses would result, in any event, to Members

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[26] The House of Commons International Development Committee, 1 The WTO Hong Kong Ministerial and the Doha Development Agenda, Third Report of Session at 20 (2005–2006).

with offensive interests, even if full flexibilities for SPs and SSM were granted to developing countries."[27]

To note, negotiations on Agriculture have been ongoing for several decades already. Unlike in NAMA, however, an agreement on a negotiating component as rudimentary as the formula to be used in the tariff cuts, has remained elusive. Divergent interests are likely to lead to a further distilling of positions and a seeking of compromises whose extent and consequences to the Philippines and developing country economies cannot yet be ascertained. Again, for the Philippines, agriculture negotiations seemingly are approached without a practical level of consideration of its linkage to NAMA and services negotiations. It must be emphasized that either of the three areas of the negotiations could be used or treated by other countries as negotiating levers for compromises in the other remaining areas.

C. Services

The Services negotiations have moved at a relatively sluggish pace since the beginning of the Doha Round. Many attribute this to the cumbersome bilateral request-offer approach adopted in the previous discussions. Different positions and varying degrees of ambition taken by countries on different modes have taken their toll on the speed of the talks, which have particularly concerned developed countries—principally the EC. To address this, a plurilateral method was agreed upon, with no prejudice to the bilateral approach favored by developing countries. However, the need for members of one common interest group to agree among themselves prior to the arrival at a formal offer for each sector under the said approach, as well the high level of ambition contained therein, have presented additional challenges in determining how the negotiations would proceed.

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[27] Statement by the Delegation of the Philippines on Special Products Informal Open-ended Consultations, April 27, 2006 [JOB(06)/131].

1. The Plurilateral Approach

In order to expedite the progress of negotiations, a more inclusive plurilateral approach was adopted, as agreed in Paragraph 7 of Annex C of the Hong Kong Declaration which states that:

> In addition to bilateral negotiations, we agree that the request-offer negotiations should also be pursued on a plurilateral basis in accordance with the principles of the GATS and the Guidelines and Procedures for the Negotiations on Trade in Services. The results of such negotiations shall be extended on an MFN basis.

The incorporation of the plurilateral approach into the Hong Kong Declaration is said to have been an outcome favorable to developed countries intent on fast-tracking the liberalization process in key sub sectors of services in foreign markets. Among these sectors are banking, transport and communications—where the EC claims that investments are necessary for fragile economies to grow.[28] The EC was even pushing for a benchmarking approach wherein all member countries will be required to make a specified number of offers. This offer was rejected, and interestingly beamed upon by the UK as a positive outcome for developing countries.[29]

Unlike in bilateral negotiations wherein a requesting country can ask for far-reaching commitments from other countries in areas of interest to them, plurilateral negotiations would require requestors to first agree amongst themselves before they can tender an official request to a target country.[30]

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[28] Available at <http://trade.ec.europa.eu/doclib/docs/2006/january/tradoc_125708.pdf>.

[29] The House of Commons International Development Committee, 1 The WTO Hong Kong Ministerial and the Doha Development Agenda, Third Report of Session at 22 (2005–2006).

[30] Alexandra Strickner and Carin Smaller, *Geneva Update, Heading Towards an Iceberg: Is It Too Late to Steer the Ship?* Institute for Agriculture and Trade Policy, Trade Observatory, Geneva, February 24, 2006.

The EC has been fully supportive of this move, although the US appeared more inclined to giving preference for the bilateral request approach.[31]

Developing countries on the other hand have been relatively cautious in liberalizing certain sectors for reasons of national interest. Following this reasoning, the Philippines is even advocating for the establishment of emergency safeguards measures in the services sector.[32]

Representatives from developing countries were not very comfortable with accepting the plurilateral method, as they were concerned that such may deprive them of leeway and flexibilities which were afforded by the bilateral approach.[33] Concerns were also raised that differences among members of a negotiating group may force the undertaking of internal compromises that may lead to a less favored "least common denominator" position. In these respects, the Philippines, along with other developing countries, was quick to reiterate during the negotiations that the plurilateral approach should not supersede the bilateral-request offer approach.[34] It was also emphasized by developing countries that their participation in making plurilateral requests was done on a purely voluntary basis and that such would not constitute any binding obligation to make any definite commitments in the sectors being discussed.[35]

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[31] Available at <http://www.globalpolicy.org/socecon/bwi-wto/wto/2006/0309mini.htm>.

[32] *See* Philippine Statement, Council for Trade in Services/Special Session, February 16, 2006.

[33] Available at <http://www.fao.org/docs/nems/trade/33541/TWN.doc>.

[34] *See* Philippine Statement, Council for Trade in Services/Special Session, February 16, 2006.

[35] Carin Smaller, *Geneva Update, Lamy Takes the Reigns of the Doha Round: When Will He Make His Mark?* Institute for Agriculture and Trade Policy, Trade Observatory, Geneva, April 20, 2006.

Once the initial sessions using the plurilateral approach were completed, many observers came out with the opinion that a reversion to the bilateral request-offer approach may be in order for the next negotiations. This possibility could be tied to the difficulty experienced by developing countries in pushing for the far-reaching commitments they sought due to certain political sensitivities.[36] During the sessions, it was also noted on a number of occasions that certain requests by some countries exceeded what they were willing to offer and/or their present state of liberalization in that sector. It is of interest to note that in those negotiations, the EC advised developing countries to consider their own request as an offer, when in fact it became evident that the EC itself was unwilling to liberalize as much as, or beyond, what they were demanding other countries to do.[37] This, according to commentators, may cast further doubt on the future of the plurilateral process and the general outcome of the negotiations. The next round of revised offers will have to be submitted by July 31, 2006 and the final draft schedules of commitments have to be turned in by October 31, 2006.

2. The Modes

Notably, most of the plurilateral requests from the demandeurs so far have focused on modal schedules—Modes 1–3 and especially in Mode 3 (commercial presence).[38] Mode 1 refers to the cross-border supply of services such as the offshore outsourcing of business processes (e.g., call centers) to the workforce of another country. Mode 2, on the other hand, covers the consumption of services by residents of one country traveling to another country (e.g., as tourists). Mode 3, or commercial presence, deals with the establishment of entities abroad by service companies (e.g., banks) to provide services for the market of the host country. Finally, Mode 4 is a category

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36 *Id*.

37 Available at <http://www.globalpolicy.org/socecon/bwi-wto/wto/2006/0309mini.htm>.

38 *Id.*

for the movement of natural persons in which residents of one country move to a host country for them to render services there (e.g., Overseas Filipino Workers).

Returning to the discussion on Modes 1 to 3, developed countries, even amongst themselves, have divergent interests on certain sensitive sectors such as Audiovisual; Maritime; Education; Air Transport; and Postal services, for which an impasse is foreseen.[39] Nevertheless, developed countries have been cohesively demanding developing countries to allow greater access for Telecommunications; Financial Services; Energy; Environmental Services; Logistics; Distribution; Construction and Computer-Related Services.[40]

Developing countries on the other hand, have been particularly outspoken in their request for increased market access through Mode 4 or the movement of natural persons. The Philippines has plenty to gain from further liberalization under Mode 4 considering the vast pool of skilled labor and knowledge workers it is capable of exporting, and the large percentage share of foreign remittances to its economy. Opening up offshore markets for foreign labor will provide better opportunities for doctors, nurses, engineers, lawyers, and other professionals from developing countries to work in developed countries to earn the much needed foreign exchange to strengthen their home economies. However, it is to be expected that the willingness of developed countries to open up their labor markets will be driven mainly by how much developing countries can offer similar concessions either in the same or other modes (such as Mode 3). Some developing countries, such as the Philippines, limit the practice of professions to nationals of their countries due to deep-rooted economic and political considerations.

Another area of importance for some developing countries, especially the Philippines and India, are Modes 1 (cross-border

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[39] *Id.*

[40] *Id.*

supply) and 2 (consumption abroad)—mainly in cognizance of their comparative advantage in business process outsourcing (BPO). India and the Philippines have recently made wide strides in proving their growing competitiveness as investment areas for call centers and other BPO activities. India is already in the process of preparing requests on Modes 1, 2 and 4, along with Argentina which is preparing requests for agricultural services.[41]

Despite its recent introduction to the multilateral negotiating agenda, approaches to the discussion of trade in the services have taken varied turns as a consequence again of diverging positions and priorities from a diversity of member country stakeholders participating in the process. The Philippine agency in charge of Services negotiations is the National Economic and Development Authority (NEDA). Again the said agency specializes exclusively on Services negotiations and may not be privy to Agriculture and NAMA technicalities where offers may be made by other countries as concessions for movements in other sectors.

D. TRIPS (Parallel Importations)

The Trade-Related Aspects of Intellectual Property Rights (TRIPS) is one discussion item in the multilateral trading system where the division of interests between the developed and developing countries may be readily perceived. Developing countries have argued for concessions to enable the affordable reproduction of patented or copyrighted products and materials or less prohibitive fees to gain access to certain patented technologies from developed countries. High costs of medicines due to intangible costs arising from exclusive distributorship arrangements has been a perennial issue particularly when alternative "parallel import" routes (as will be discussed below) are tapped by sellers to developing countries.

Parallel importations are also known as gray-market importations. These are goods that are manufactured under

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[41] *Id.*

the protection of trademarks, patents and copyrights, which are then placed into circulation in a particular market; and then the second market would import it without the authorization of the local owner of the intellectual property right. The products obtained through parallel importations are exactly the same with products authorized to be sold domestically with the only differences to be noted mostly in packaging and the absence of the original manufacturer's warranty. In the Philippines, the Philippine International Trading Corporation (PITC) has engaged in parallel importations of certain antihypertensive medication from Pakistan and India (which are cheaper) to be available domestically in exceptional circumstances to safeguard public health. Since this would potentially displace sales of the same drug (at a higher price) by the licensed distributors of the drug in the Philippines, this practice has been frowned upon by the Philippine-based entity of the same multinational company.

Nevertheless, the Philippines has been pushing for parallel importation. The PITC, in particular, has been asking the Bureau of Food and Drugs (BFAD) to start processing documents which will allow the parallel importation of certain medicines as soon as its patent expires.

One article[42] published by the PITC commented that developing countries like the Philippines that are unable to develop their own R&D would have to resort to other options like parallel importation, targeted consumer subsidies, and other programs to lower the prices of essential medicines. PITC has pushed for amendments to the intellectual property code for it to complement the governments' program on parallel importation. Developing countries have expressed the same public concern on the lack of access to affordable medicines, amid pressures from developed countries for developing countries sell only products authorized for distribution therein. It was not until after the Doha Conference in 2001 and also with

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[42] Affordable drugs, available at <http://www.pitc.gov.ph/newsletter/newsletter.htm#breaktime>.

the help of the Special declaration on Public Health that an exception was made allowing developing countries to make parallel imports in case of a public health crisis.

Pharmaceutical industries mostly based in developed countries argue that they need strong patent protection to secure revenue from their market and to make up for their costs on R&D. The world's pharmaceutical market is dominated by US, EC, and Japan. Developing countries believe that providing patent protection will increase prices of medicines and this will eventually have a significant impact on the public's access to drugs.[43] At present, developing countries with the capacity of producing drugs such as India and Brazil have liberalized or at least loosened up their patent laws to produce low-priced drugs.[44]

Some developed countries and pharmaceutical companies have sought to restrict the use by developing countries of compulsory licensing and parallel importing measures. Two examples of this are the drug companies' court case against South Africa, and the US case against Brazil in the WTO.[45] Developed nations have been aggressively pushing developing nations to provide patent protection for their medicines.[46]

While the position and intention of developing countries are clear in this issue, the willingness of the developed world to further relax their position against parallel importations is still very much uncertain.

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43 Parallel imports in Pharmaceuticals: Increase access to HIV drugs, available at <www.thailawforum.com/articles/hivdrugs1.html>.

44 Available at <www.thailawforum.com/articles/hivdrugs3.html>.

45 Patents and Medicines: The WTO Must Act Now! available at <http://www.twnside.org.sg/title/joint4.htm>.

46 Parallel imports in Pharmaceuticals: Increase access to HIV drugs, available at <www.thailawforum.com/articles/hivdrugs1.html>.

E. FTA Updates

While only a few developments have taken place at the multilateral scene, the same could not be said of the bilateral/ regional negotiating arena. Since the aftermath of the Fifth Ministerial Conference in Cancun, several countries have signified their intention and/or launched negotiations with their trading partners to establish FTAs. The Philippine experience was not an exception to this growing trend. Apart from being a member of the AFTA, the Philippines is now party to two other regional FTAs, namely the ASEAN-China FTA and the ASEAN-Korea FTA. It is currently engaged in negotiations with Japan and feasibility studies have been commissioned for a prospective Philippines-US FTA. Note that the economic and industrial impact of these FTAs, most of which were entered into through Executive Agreements, would be no less extensive and significant as those effected by multilateral agreements, which required Congressional concurrence. Also, it is important to note that FTAs now include provisions that cover a broader and deeper dimension of trade (e.g., trade in goods, dispute settlement, intellectual property, trade facilitation, services) all of which are already akin to the WTO (which required treaty concurrence). This section explores updates on FTAs to which the Philippines is currently a party.

1. AFTA

The main feature of the AFTA is its accelerated reduction of tariffs for intra-ASEAN trade. As of 2003, tariffs on all products designated in the “inclusion list” of the original members of ASEAN were lowered to a range of 0–5 percent (except for petrochemicals which was granted 7 percent exemption). Some products were designated as sensitive but a gradual phase-out of these products commenced in 2003. Presently, updates on the AFTA pertain more to administrative and implementation matters—particularly the reformulation and enforcement of new rules of origin which are used to determine whether a product is of ASEAN origin or not—as opposed to mere transshipments. A new set of rules of origin was released in 2005 allowing for cumulation of the 40 percent value-added

criteria. The impact of AFTA cuts across all industry sectors and opens a number of Philippine industries such as petrochemicals, cement, plastics, chemicals, and automobile parts to foreign competition (albeit limited to ASEAN countries).

2. ASEAN-China

The ASEAN-China FTA was initially propounded by China with a willingness to undertake unilateral tariff reductions through an "Early Harvest Program" (EHP) that would serve as a dowry to solidify its intentions. Just as many twists take place during negotiations, the unilateral offering made by China eventually evolved into a reciprocal arrangement covering all raw agricultural products formalized in 2004. The Philippines refused to participate in the EHP without the inclusion of certain processed agricultural products and some manufactured products. Concessions were reached and the Philippines finally agreed in 2006. Similarly, a Trade in Goods Agreement and a Dispute Settlement Agreement had already been signed. The most affected sector in this FTA are the vegetable growers in the Philippines who, since the inception of the EHP, have aired concerns over the influx of cheap vegetable imports from China after tariff cuts are implemented.

3. Japan-Philippines Economic Partnership Agreement (JPEPA)

The JPEPA was initially envisioned to take effect last 2005. However due to complications in the negotiations pertaining to the proposed unrestricted entry of Philippine health workers to Japan, the talks stalled momentarily. Gradually, however, inroads were made in the negotiations. In May of 2006, the Japanese government conceded not to impose any quota restrictions on Filipino health workers but maintained that strict skill standards and training requirements should be put into effect. JPEPA has been foreseen to potentially impact on the Philippine automotive industry. As a matter of fact, non-Japanese automobile firms in the Philippines initially expressed serious reservations on this proposal.

The JPEPA was finally signed last September 9, 2006, at the Asia-Europe Meeting in Helsinki, Finland. The Japanese Diet

has since given its approval of the deal and, as of this writing, is awaiting the Philippine Senate to give its concurrence to have the Agreement in effect by year's end. The Philippine Senate however late last year signaled that it "was not in a hurry" to approve the deal, amidst controversies regarding concessions in excess of the country's WTO commitments, threats of toxic waste from Japan entering the country, and the apparent secrecy in which the negotiations were conducted.

4. ASEAN-Korea

Just signed in May 2006, the ASEAN-Korea FTA is the latest preferential trading arrangement the Philippines has involved itself in along with its ASEAN neighbors. At this stage, however, the products to be covered by this FTA have yet to be determined. What is clear however is that Korea and each ASEAN country will be allowed to exclude as many as 40 tariff lines from duty cuts for an unspecified period of time. To the dismay of Thailand, however, which opted out of the deal, Korea sought to exclude rice from the FTA coverage. As the final product lists are still to be released, it is difficult to assess the general effect that this FTA would have in the Philippines. Since Korea harbors highly competitive manufacturers of chemicals (especially resins) and automobiles, then an impact would be felt by competing industries here in the Philippines.

The current FTA engagements of the Philippines are meant to bolster the pace of liberalization with its trading partners in the region, the biggest of which are China and Japan. Although this is anticipated to improve regional trade and investment, the question of whether the Philippines has the full capacity to benefit from these at the point of full optimization remains. While the Philippines has opened up and reduced its tariffs faster and to a more significant degree, its gains from liberalization would not seem to be at par with the leaps and bounds experienced by its ASEAN neighbors such as Malaysia and Thailand. Thus, a closer look may have to be taken at the Philippines' domestic, institutional, and structural readiness to further open up its markets.

III. End Game or Where To?

In view of the mounting stumbling blocks in various sectors that still remain to be hurdled in the coming months, many thinkers correctly predicted that no new substantial Agreements will be reached before the 2006 deadline expires. In July 2006, after conducting a series of meetings with key WTO members to restart the Doha Round talks, WTO Director General Pascal Lamy conceded that gaps in negotiating positions were still too wide to broker an effective compromise sufficient to break the gridlock. Spewing more pessimism and uncertainty on the prospect of having a new deal were the shifting political priorities of key players in the negotiations from an outward economic policy-making mindset towards a focus on more domestic policy issues.

As a key example of this, the US—a prime mover in the present Doha Round—recently underwent a political transition in that the Democratic Party took control of the legislature. Democrats are known historically to be more inclined to prioritize domestic political and economic concerns over international trade agreements. Furthermore, the US Trade Promotion Authority (TPA) is set to expire by the end of June 2007, and with the Democrats in control—the likelihood of this being renewed may be reduced. Thus, as Jeffrey Schott of the Institute of International Economics in Washington DC said in a speech last February 2006, "WTO negotiators must operate under the assumption that the Doha Round can be successfully concluded before the expiration of the trade promotion authority."[47] He adds that "there is no assurance that TPA would be extended—given how sharply divided Congress is on trade issues—and much evidence that extending the horizon of the talks will undermine negotiating momentum."[48] Even assuming that the TPA is even extended, the external priorities of the US

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47 Available at <http://www.usda.gov/oce/forum/2006%20Speeches/PDF%20speech %20docs/Schott_jeff.pdf>.

48 *Id.*

may still have to be subordinated to yet another significant inward-looking political event—the 2008 presidential elections.

The UK still grapples with domestic issues as reports have circulated regarding the incumbent Prime Minister announcing his plans to step down from office in 2007 to give time for his successor to settle down prior to the next UK general elections.[49] It must be considered however that the UK House of Commons released a report on how it perceived the current state of play at the Doha Round. The said report, which has been quoted a number of times in the paper, critiques some of the positions taken by the EC. It concedes that "the Commission has been inconsistent in its advice to the developing countries x x x [and that] x x x [T]he Commission's refusal to practice what it preaches in respect of liberalisation threatens the EU negotiating position."[50]

France, a highly influential member of the EC, will likewise be going to the polls this year, 2007. Notably, two of the main contenders in the elections, Nicolas Sarkozy and Segolene Royal, have taken positions not very divergent from the present policy stance of the country—both being staunch supporters of the CAP. Royal, in an appearance at Villepinte and calling for "fairer competition" in international trade made a statement that "Europe cannot just be a free-trade zone appended to Nato," adding that "Europe must not abandon itself to the sole doctrine of competition." On the same occasion, she also called for a revamp of the Common Agricultural Policy to strengthen its support of smaller farmers and protecting the environment.[51] On the other hand, according the IHT, Sarkozy said in an article published in a French newspaper that further reductions in farm

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[49] Available at <http://cnews.canoe.ca/CNEWS/World/2006/05/14/1579791-ap.html>.

[50] The House of Commons International Development Committee, 1 The WTO Hong Kong Ministerial and the Doha Development Agenda, Third Report of Session at 30 (2005–2006).

[51] Available at <http://www.theaustralian.news.com.au/story/0,20867,21210779-2703,00.html>.

subsidies were “not acceptable” and that dismantling the CAP would put “an end to Europe’s status as an agricultural power.”[52]

Germany came through a tumultuous election with Angela Merkel winning the Chancellorship following disputes on the election results. Merkel is known to be more market-inclined in terms of economic policy relative to her own party, as can be seen in her moves to reform labor laws allowing companies to have a freer hand in controlling labor costs by relaxing restrictions on firing employees and increasing the number of work hours in a week.[53] Merkel has also indicated her support for the WTO talks in her policy statements. In one, she said “Commerce and free trade are one of the major prerequisites for enabling all players to participate in equal terms. In Germany, too, many people fear that free trade could disadvantage certain parties. Yet any introduction of more freedom in Germany has generally propelled the country forward. Here, too, we must overcome our fears.”[54] Presently, the leadership of Chancellor Merkel has been well-received as shown by her high approval ratings which figured at levels unprecedented since 1949.

Japan has promised compliance with its WTO commitment to put negotiations back on track. It has disclosed its position to lower its Minimum Access commitment for rice. In addition to that, last December 2005, Japan partially re-opened its market to US beef after much pushing and almost getting banned from the US. However, last January 2006, a reversal took place when Japan again closed its market following a determination that one shipment from the US did not meet the requirements of its

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[52] Available at <http://www.iht.com/articles/2005/10/21/business/wto.php>.

[53] Available at <http://en.wikipedia.org/wiki/Angela_Merkel>.

[54] Merkel’s Speech at the World Economic Forum 2006, Davos, Switzerland, January 25, 2006.

Available at <http://www.globalmarshallplan.org/e5095/e6262/e6768/index_eng.html>.

export verification program.[55] Notably, Japan has pursued bilateral trade negotiations with a number of countries (e.g., Mexico, Philippines, Thailand, etc.) and ASEAN regions.

China, which joined the WTO only in 2001, has emerged to become the world's fastest growing economy and largest trader. However, many have observed that China has placed too much attention in boosting export growth and developing its local industries, causing it to compromise efforts to meet its commitment to market access, implementation of labor rights, and the protection on intellectual property rights. Moreover, it remains a general perception that China continues to maintain prohibitive trade barriers. These trade barriers are said to have contributed significantly to the growing US trade deficit.[56] Apart from this, non-tariff, administrative and language barriers continue to hinder trade from fully flourishing in China. Like Japan, it has also pursued bilateral trade negotiations with other countries (India, Thailand) and regions (ASEAN).

Russia has yet to become a member of the WTO. Last March 2006, Russian President Vladimir Putin complained that accession negotiations for Russia to join the WTO were being delayed by questions from the US negotiators.[57] However, just last February 2007, US Trade Representative Susan Schwab issued a comment before the Senate Finance Committee that "Russia is not moving forward with the kinds of WTO commitments it would need to become a full-fledged WTO member." On top of this all, it is worthy to note, nevertheless, that when re-elected in 2004, Putin set as one of his priorities the rebuilding of a central government to keep the autonomy

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55 Available at <www.ustr.gov/assets/Document_Library/Reports_Publications/2006/2006_NTE_Report/asset_upload_file339_9185.pdf>.

56 Available at <www.ustr.gov/assets/Document_Library/Reports_Publications/2006/asset_upload_file921_8938.pdf>.

57 Russia, available at <http://www.fas.org/sgp/crs/row/RL33407.pdf>.

of its outer regions in check—in response to the Chechen uprising. Thus, it is fair to comment that domestic issues continue to take hold in Russia.

The indicators above point at a higher likelihood for the Doha Round to miss its pre-agreed end-2006 deadline and for continuous doubts as to how the talks may turn out after. However, the lapse of 2006 should not be instantly construed as a failure of the Doha Round. It would be equally baseless to consider the Doha Round talks dead if no new set of agreements is reached. Some thinkers even consider this as a natural and normal part of the negotiation process.[58] It may be remembered that the Uruguay Round of Negotiations took eight years to complete on a range of issues far less diverse than those being tackled under the ambit of the Doha Round. It should therefore no longer come as a surprise if the five-year Doha timeline is breached.

A deadlock at Doha, the retardation of multilateral talks, and the prevailing uncertainty should however not haphazardly be taken by the Philippines, or any country for that matter, as reason to either close up or impulsively engage its trading partners bilaterally for the sake of liberalization. Now could be the time to reassess and recalibrate the country's liberalization policy as well as the readiness of its domestic institutions to accommodate deeper global engagement—in view of the ongoing debates on the limits of the benefits of liberalization. As will be discussed more in the recommendations portion, there is a subtle creeping shift from an absolutist belief among supporters of trade liberalization to a more cautious and

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[58] Charles Finny, CEO of the Wellington Regional Chamber of Commerce: "[t]he missing of a deadline does not mean that the Round is dead. Likewise, there is a long way to go this year before anyone should be taking odds that the Round will fail. WTO rounds, like the rounds of international trade negotiations that were the precursors to the WTO, frequently miss deadlines; but they are yet to fail. I think that this Round is likely to continue this record" taken from <http://www.tcsdaily.com/article.aspx?id=051006A>.

conditional stance. Thus, as one longtime advocate of free trade has put it:

> The countries that have succeeded in raising living standards rapidly, over long periods, have followed many varieties of economic policy and have lived under many different forms of government x x x Not fully or even nearly so x x x they adopted liberal trade partially, selectively and mostly gradually. But the important thing was that they adopted it.[59] (underscoring supplied)

> It is true that the poorest countries often face the biggest obstacles to reaping the gains from trade and that economists' models often assume these obstacles away. Many rely on tariffs as a source of government revenue. Weak infrastructure and underdeveloped credit markets can make economic restructuring difficult. These problems underline why trade liberalization is no substitute for either more domestic reform or foreign aid. They also suggest that some of the poorest countries need more time to open their markets than others.[60] (underscoring supplied)

As uncertainties likewise surround the debate on how much liberalization would be needed and what benefits could be had, the foreseen slowdown should be construed as an opportune breather for the country to introspect, contemplate, and reassess its capacities to compete more effectively in international trade. The convoluted uncertainties in the present state of negotiations, afford the Philippines the time and opportunity to take stock of where it is, where its strengths and weaknesses lie, and how to better manage future negotiations once they recommence. Now is the time to look the uncertainties in the eye and make for an effective way to respond positively to them.

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[59] *Liberty's Great Advance*, The Economist, June 28, 2003.

[60] *Weighed in the Balance*, The Economist, December 8, 2005.

IV. Recommendations Moving Forward

In view of the previous discussions, it is a given that the uncertainties facing the Philippines come in three forms: first is the overall direction of the multilateral talks, second is what benefits that we stand to gain from further liberalization and, third, how such benefits can be attained. The first two can be readily addressed by improving the country's monitoring, consultative and policy formulation process, making it more effective and responsive to the needs and interests of domestic businesses vis-à-vis the present state of negotiations. As for the third, such can only be determined by improving the domestic governance structure to make it more transparent, open to competition, business-friendly, and focused on domestic reforms.

A. The "How" as to the Benefits of Trade

Focusing initially on the third uncertainty, it is not a new observation that the bulk of the country's economic problems lies on its domestic policy environment and not its participation in the multilateral trading system. The inadequacy of local infrastructure (particularly farm-to-market roads), high costs of doing business, a lack of transparency, high transaction costs, perceptions of corruption, and the absence of clear competition rules has made businesses and foreign investors averse to setting foot in the Philippines. Liberalization has already done its part but its benefits can only go so far without the proper domestic response. This has been affirmed by EC Trade Commissioner Peter Mandelson during his visit to the Philippines last May when he commented that "Free trade spreads prosperity but it is not a magic wand. It does not automatically lead to greater economic growth. For this, countries need high standards of governance and to invest effectively in their productive capacity and human resources in order to benefit from trade, and to deliver a better life for people."[61] Although the Philippines has already opened up,

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[61] Delivered at the Shangri-la Makati Hotel Manila, May 15, 2006.

unless its internal ills are corrected, it risks the danger of stagnating. It has been mentioned by a representative of UNCTAD in a symposium hosted by the Philippine Council for Foreign Relations[62] that the contribution of value-added by Philippine manufacturers in its exports has declined in the past few years, despite the openness of our economy. The necessity to clean our own backyard is even made more imperative by our lackluster performance relative to our neighbors. One may ask, why is it that Thailand and Malaysia outpaced us when they did not unilaterally open up as quickly as we did?[63] Economists now are even concerned about Vietnam overtaking us if we do not shape up.

To rectify our domestic problems, the first step is to create a sound and level domestic playing field for business. The suggestions that have been made here are so commonplace as to be a cliché: transparency, reduce corruption, better governance, credible judicial system, stability of contracts and property rights, better business infrastructure, education, and improvement of the peace and order situation.

1. Competition Policy

However, one suggestion that we do make in this paper is the enactment of an effective competition policy law. Competition policy, in its simplest form, primarily deals with the state of competition internally, that is, with regard to the state of competition within a country's borders; and seeks to rid it of harmful monopolies, cartels, and other anti-competitive practices. In a country where it is commonly acknowledged that the nation's wealth is concentrated only in the hands of a very few, a robust competition policy would be one way of ensuring a more equitable distribution of wealth and, perhaps, a more

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[62] Held at the Department of Foreign Affairs, May 24, 2006.

[63] According to the World Bank, as of 2003, the average weighted tariff rates for the three countries are as follows: Philippines – 2.6 percent, Malaysia – 4.2 percent, and Thailand – 8.3 percent (Available at <http://www.heritage.org>).

meritocratic society. Competition policy can help in ensuring greater competition, efficient market conditions, more adaptable industries; promote the easier and more effective entry of new players in the market, greater goods entering that market, and price stability.[64]

2. Refine Philippine Laws on Trade

Also, Philippine trade-related legislation has to be revisited, particularly to remove any ambiguities in them and ensure that they serve national interest. Among such laws suggested to be reviewed are: RA No. 8752 (the anti-dumping law), RA No. 8800 (the safeguards law), Section 304 of the Tariff and Customs Code of the Philippines (TCCP), Sections 401/402 of the TCCP, and RA No. 9135 (the customs valuation law). These provide the legal trade-based framework on the conduct of trade, and should therefore be completely at par with international standards and clearly attuned to the need of business for transparency and consistency.

B. The Direction of Trade and Identifying Its Benefits

While domestic policies should be reformed for the benefits of globalization and liberalization to be fully realized, the process for the formulation of external trade policy and negotiating positions would likewise have to be reassessed and improved. This is to be able to have a focused approach that accurately takes the interests of local business into consideration in order to respond positively to the uncertainty gripping into the multilateral system and clearly identify the benefits that could be derived, if any. Indeed, it may be worthwhile to remember the famous New York Times editorial that said:

> Put simply, the Philippines got taken. A charter member of the World Trade Organization in 1995, the former American colony dutifully embraced globalization's free-market gospel over the last decade, opening its economy to foreign trade and investment. Despite widespread worries about their ability to

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[64] Jeremy I. Gatdula, *Competition Policy*, Businessworld, 2005.

> compete, Filipinos bought the theory that their farmers' lack of good transportation and high technology would be balanced out by their cheap labor. The government predicted that access to world markets would create a net gain of a half-million farming jobs a year, and improve the country's trade balance. It didn't happen.[65]

The following, therefore, are our recommendations with regard to meeting the first two uncertainties mentioned above, particularly providing suggestions as to determining our trade direction and the determination of any trade-related benefits.

1. Consultative Mechanism

Private sector participation in the formulation of positions and the conduct of negotiations still appear to be limited. To address the need for increased participation, hearings and proceedings would have to be institutionalized so as to lead to greater transparency and accountability in the conduct of trade negotiations. Among such would be the conduct of periodic and regular hearings in Congress to determine the state of our trade activities. This would have to involve greater private sector consultation and, as much as possible, participation during negotiations, as is practiced by many other countries. This is only fair considering that it is the very interests of the private sector which will be at stake.

The appointment of a Special Envoy for Trade Negotiations, the expanded inclusion of private sector parties into trade delegations, and getting the formal cooperation of privately established think tanks (with its appreciably defined objectives) are good first steps in this direction.

2. Congressional Review of Trade Agreements

In connection with the point above is the refinement of our rules to remove any ambiguity as to the need for our elected representatives to have a say in our entry into any trade agreement. This is especially with regard to the ongoing confusion regarding the classification of trade agreements into

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[65] *The Rigged Trade Game*, New York Times, July 20, 2003.

"treaties (which need Senate concurrence) and "executive agreements" (which do not).

The impact of trade agreements on the country can never be underestimated, with effects definitely trickling down to the smallest Filipino business. Due to the mass of details and technical information contained in such agreements, it is important that ordinary Filipinos and their elected representatives have a say regarding the matter. Unfortunately, international trade is presently a mystery to most and one interesting question still needing resolution is whether trade agreements could indeed be considered as treaties (which need Senate concurrence) or executive agreements (that do not). A reading of present laws and rulings relating to this matter apparently indicates the latter to be true, to the detriment of our policymaking process.[66] Considering however, the incredible impact that trade agreements have on the lives of ordinary Filipinos, such agreements must simply be made under conditions of full and public scrutiny and debate.

Thus, new rules could be issued clarifying this matter so that any substantive agreement (and most trade agreements are substantive) will have to be submitted to the Senate for its concurrence. This is but right as our elected representatives need to have a say as to whatever trade commitment the Philippines is entering into. Suffice it to say that all the FTAs mentioned earlier to which the Philippines has committed itself to have far-reaching implications on all sectors of the Philippine economy and society. It appears only appropriate to set in place a system that will enable elected representatives to have their say on behalf of their constituencies before any decision to make an international commitment is made.

It would therefore be advisable for laws to be legislated directly dealing with the matter, expressly classifying trade agreements as treaties needing Senate concurrence (or making distinctions among the different trade agreements as are

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[66] Jeremy I. Gatdula, *Monitoring Trade Agreements*, Businessworld, 2005.

appropriate). A process clearly needs to be established whereby trade agreements being entered into are reviewed and discussed publicly. If such review be not practically possible during the negotiations stage so as not to undermine the strategies being employed, then an oversight committee (perhaps by Congress) should be established, with powers to conduct public hearings on the propriety (or not) of such agreements on a regular or periodic basis. It is necessary that a government official or officials be clearly designated as responsible or accountable for such trade agreements. The purpose of course is not to lay blame but to ensure a system of accountability that will result in the imposition of restraint, intellectual rigidity, and openness when dealing in such matters.

It should be pointed out that trade agreements are meant to foster competition. If—as most government economists believe—that competition redounds to the good of all, then there is no reason why an environment that draws out competition in ideas would not be to our benefit as well.

3. *Caution on FTAs*

In the meantime, it may perhaps be prudent to suggest restraint with regard to Philippine intentions or activities pertaining to regional trade agreements or free trade agreements. While not commenting on the direction of the RTA negotiations and focusing instead on RTAs itself, it must be stated that for all their supposed benefits, they are simply tricky propositions. The very existence and potential number of the same provides an increasingly complex international trading system. Even the governments' own research arm, the Philippine Institute for Development Studies, expressed doubt as to the benefits that could be derived from FTAs.[67] Dr. Josef Yap, President of the PIDS, suggested that instead of rushing into FTAs, the government should instead be channeling resources to

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[67] Dr. Josef Yap, *The Boom in FTAs: Let Prudence Reign*, Philippine Institute for Development Studies, 2006.

agricultural productivity, improving governance, and strengthening institutions.[68]

Furthermore, considering that there have been concerns raised regarding the capacity of the Philippines to keep up with its multilateral trading commitments, this obviously would be multiplied in view of the proliferation of FTAs because not only would the Philippines need to keep track of its own membership commitments but also, for purposes of keeping Philippine competitiveness, keep track of the arrangements of which the Philippines is not a part of but has been entered into by other countries.

Also, by relying on the benefits of FTAs, certain rules would be needed and these are inevitably complex. Most significant among these rules would be those pertaining to the rules of origin, the overlapping jurisdictions by the different dispute settlement systems in place between the multilateral trading system and the different FTAs, the non-tariff subjects (such as customs procedures, sanitary and phytosanitary measures, technical barriers to trade, and—perhaps—the issue of smuggling).

It is to be noted that if various Philippine stakeholders are disturbed by the complexity of the subjects involved in multilateral negotiations, these subjects (such as the Singapore issues, agriculture, non-agricultural market access, etc.) will be no less complex in bilateral and regional discussions. If these stakeholders are lamenting the muscular negotiating tactics of developed countries, these tactics will be no less demanding and aggressive in bilateral or regional talks. It must be emphasized that the safety mechanisms that multilateralism

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[68] It was reported (*No Benefit from Free Trade Deals*, Daily Tribune, February 5, 2006) that the PIDS study was "conducted in response to the government's initiative to negotiate FTAs, most of which x x x are knee jerk reactions to the initiatives of other countries. This "reaction," in fact, had been anticipated and warned against as early as 2003 (*see* Jeremy I. Gatdula, *After Cancun: Now What?* Businessworld, 2003).

brings (i.e., the comfort of numbers, transparency, and an established dispute settlement system) are not present to the same degree in bilateral or regional negotiations.[69]

More tellingly, even The Economist, a staunch advocate of liberalized trade, (in its November 18, 2004 issue; Trade Policy: Not All Trade Agreements are Good) has the following interesting things to say regarding FTAs:

> Alas, the passion for such agreements may be misguided. Economists have long pointed out that the gains from multilateral trade liberalisation are far greater than those from bilateral or regional deals. At best, regional deals offer smaller benefits. At worst, they do damage, artificially diverting trade away from excluded countries or clogging up commerce with fiendishly complicated 'rules of origin'. These are needed to define whether imported goods, which may consist of inputs from many different countries, qualify for favored treatment.
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> x x x x
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> Most bilateral agreements are far from ideal. Those between poor countries often exist more on paper than in practice. Bilateral deals between rich and poor tend to be better implemented, but are marred by restrictive rules of origin and by the routine exclusion of important agricultural products.
>
> In fact, the [World] Bank's boffins point out that most poor countries would be worse off in a world of rampant bilateral deals than they are today. x x x If developing countries all had bilateral agreements with big rich trading partners (the European Union, the United States, Canada and Japan), global income would rise by much less: $112 billion. The rich would scoop all this, and more: $133 billion. Although a handful of developing countries, such as Brazil and China, would gain a bit, poor nations as a group would be worse off than they are today.
>
> While the Bank's exact numbers should be taken with a pinch of salt, the broad lesson is clear. Bilateralism may be a route to freer global trade, but it is, at best, a risky one.

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[69] Jeremy I. Gatdula, *Going FTA*, Businessworld, 2004.

This is not to say that FTAs are destructive. Benefits certainly there may be and there is no dearth of economists who would point to such expected benefits. The point simply is that with regard to formulating a policy or view with regard to FTAs, there is always the need for greater information regarding the environment that surrounds it. For the moment, a certain degree of caution would perhaps be justifiable under the circumstances when even exploring the idea of possible bilateral or regional trading arrangements precisely because there are no categorical indications regarding the direction, benefits, and risks that are concomitant with FTAs.

In any event, the foregoing discussion on FTAs highlights what could perhaps be the theme of this paper, which is the issue that pervades overall Philippine trade policy and that is the seeming need for a re-evaluation of the way we engage the international trading system.

4. Establishment of Formal Written Trade Policy

Another is for the government to lay down publicly, in writing, a detailed draft of what our trade policy actually is. The USTR, for instance, regularly publishes a white paper containing its trade policy objectives for all to comment thereby allowing the USTR to refine its approach and make it more responsive to the national interest. Adopting a similar practice in the Philippines would not only better inform the public as to where the government intends to bring us in terms of trade, but would also give the most affected stakeholders (which is us, the private citizens) the opportunity to speak out on the wisdom of such policy.

5. RPTR

Apart from being limited, the current consultative mechanism is also ostensibly uncoordinated. It would actually appear that each individual agency (DTI, DA, NEDA, etc.) consults private sector groups independently of each other, with varying degrees of effectiveness, regularity, and scope. Continuing under this process may run the danger of formulating incomplete and incoherent negotiating positions at the multilateral table. Also,

as has been observed, negotiations for agriculture, NAMA, and services may actually cross boundaries through trade-offs and concessions at the negotiating table, and, verily, the need for better coordination would always be there to improve Philippine negotiating positions.

Put another way, trade negotiations in the Philippines are entrusted to several agencies, among which are the DTI, DA and NEDA, which handle different aspects of the negotiations and also attend extensively to various economic issues remotely related to international trade negotiations. It is precisely the possibility for conflicts of interests (which seem to be high in the present setup) that the creation of an RPTR would address, in order to have a single accountable office to have a focused handle on the negotiations.

The trade negotiations of today are highly different from the trade negotiations of the past. Ten years ago, our prime trade activities circled around two or three countries. Now our partners are becoming more varied and, incidentally, Asian-centric. The inter-relatedness of the matters under trade discussions are greater. Just last week, USTR nominee Susan Schwab was asked regarding China's financial services liberalization record, as well as on currency movements and how the latter affects the US trade deficit. There is, obviously, a need for greater coordination between the different government agencies that deal in trade. Finally, and most interesting, considering that it is a well-accepted fact that today's multilateral trading system has definitely moved away from the previous negotiations-based system to a rules-based system, there seems to be a dearth of lawyers working within government that focus on trade. The multidisciplinary approach to our trade activities needs to be recognized and developed.

Thus, the creation of the Office of the Republic of the Philippines Trade Representative (RPTR) is recommended. This should not necessarily be a huge bureaucratic creation, at least at the outset. When the Office of the US Trade Representative (USTR) was created in 1962, its legal counsel's office was composed only of two men (one of whom happened to be

Robert Hudec, one of the acknowledged fathers of international economic law). Incidentally, the reasoning of the US Congress that created it in 1962 was that trade policy should not be entrusted to the State Department (which, it is said, looked out for the interests of foreigners or broad foreign policy goals) or the Commerce Department (which always looked out for narrow domestic political interests) but rather to have an office that would take the objective position and have trade as its only mission. This was reiterated by Andreas F. Lowenfield in the Journal of International Economic Law.

> The idea was that the new emphasis on international trade as an important element of American foreign policy should not be entrusted to the State Department which, it was said, always looked out for the interests of the foreigners or for broader foreign policy goals, nor to the Commerce Department, which always looked out for narrow domestic political interests which tended to favor protectionism. USTR would stand in the middle, not as an umpire but as an office with trade as its only mission, not weighed down by the traditional bureaucracies and persistent constituencies.[70]

The Office of the USTR was created during the incumbency of President John F. Kennedy (through the Trade Expansion Act of 1962 as implemented by Executive Order [EO] 11075) at a time when US growth rates were on a regression. It was initially named the Office of the Special Trade Representative (STR) with Christian A. Herter being the first designated to serve as America's chief negotiator in trade agreements programs under the General Agreement on Tariffs and Trade (GATT). In 1974, the STR became part of the Office of the President. President Ford later elevated the STR to a cabinet level position and was renamed the USTR in 1980 by President Carter. The EO signed by President Carter expanded the role of the USTR, granting it authority within the jurisdiction of the Department of Commerce.

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[70] Journal of International Economic Law 6(3), 729–72 Oxford University Press 2003.

For the RPTR, it is ideal that the same be peopled with professionals of diverse backgrounds: diplomacy, law, economics, finance, etc. Such an office would have the function of taking the lead in dealing in matters involving Philippine engagement in the WTO, AFTA, APEC, and UNCTAD, as well as dealing with issues brought about by prospective or probably bilateral or regional trading arrangements. It has to be the primary source of information on matters dealing with international trade and, at least with regard to issues arising principally from trade negotiations, be responsible directly to the President.

The office must be given the responsibility of organizing an inter-agency committee that will effect closer coordination among the different affected or involved agencies of government. There should also be a mechanism setup that will result in the constant and consistent consultation with the Philippine Congress. There should also be a process formulated that will provide Congress the avenue with which to exercise "oversight" functions over the office of the trade negotiator (i.e., annual briefings, etc.)

Finally, the office of the trade representative should be handed the responsibility, through a formalized process, of consulting directly and constantly with the members of the private sector. This should include consumers, manufacturers, members of the academe, and civil society groups. The office of the trade representative should also take it upon itself to conduct its affairs in utter transparency, and in a manner that will inform and educate all Filipinos on issues pertaining to trade. It must be noted, however, that the right to be consulted is not synonymous to the right to decide. In the end, the government would and should still have the responsibility to weigh the competing concerns of the private sector vis-à-vis the country's interests.[71]

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[71] Jeremy I. Gatdula, *Time for a Philippine Trade Representative*, Businessworld, 2003.

In Conclusion

Considering the present state of the multilateral trading system, there is clearly a need to move the debate away from the narrow free trade versus protectionist confines that has constricted previous analysis on our trade policy. This paper definitely is not a call for us to be isolationists or protectionists. Nevertheless, if anything, if experience and history could be taken as a guide, there is nothing absolutely certain about trade and no one size fits all formula that we could or should want to duplicate *en toto*.

It is already a currently accepted view that free trade should not be considered a panacea for our nation's ills. As mentioned above, attention must also be given to infrastructure development, education, governance, peace and order, transportation, energy, a responsible workforce, contractual stability, and judicial reliability. Otherwise, any benefits that we could or may garner out of international trade may be of no use or, worse, be enjoyed only by an elite few.

Indeed, a simple fact that is sometimes overlooked when discussions come around regarding the WTO is that "free trade" is not the end-all and be-all of the WTO nor of the present multilateral trading system. What is sought rather is simply to raise standards of living, ensure full employment, increase income, expand trade in goods and services, and optimize use of the world's resources in accordance with the objective of sustainable development. In fact, a reading of the text of the World Trade Organization Agreements reveals that not once in its 492 pages, starting with the Marrakesh Agreement creating the WTO up to the Ad Articles of the GATT, do the words "free trade" appear.[72]

Trade is merely a means to an end[73] and what worked for other countries may not necessarily work for us. Though reliance

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[72] Jeremy I. Gatdula, The Practice of International Law, 2003.

[73] An idea echoed by former British Prime Minister Benjamin Disraeli when he said the "free trade is an expediency."

on the preponderance of evidence regarding the benefits of trade is good, one must be cautious that such reliance does not translate to ideological devotion. The opposing extreme, protectionism, has been proven to be no good either and this is admitted even by the critics of globalization and liberalized trade. Put simply, what we need is to find the right trade "mix" that is necessarily unique but appropriate for the Philippines.[74] It is an utterly complex matter and for which the Philippines needs a strong and deliberate foundation from which to move out and confidently engage our trading partners.

Thus, for the present, rather than burdening ourselves with further international obligations or seeking to do so, it is suggested instead that that we prioritize reorganizing and making our house in order: improving governance in developing the infrastructure, refining our laws and processes, and strengthening our institutions.

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[74] In this, we refer to Philippe Legrain's Open World (2002) where he wrote "It is time to move the debate about globalization forward. The important question is what kind of globalization we want. This presupposes two things: first, that we are still free to determine our future—as individuals, as groups of like-minded people and through the power of our elected governments; and second, that we can to a large extent pick and choose between the bits of globalization we like and those we don't. x x x Our challenge is to grasp the opportunities that globalization offers while taking the sting out of its threats."

Towards the Development of Philippine Agricultural and Service Exports in the Light of the Doha Round of Negotiations[*]

Mr. Raphael B. Madarang

I. Background and Introduction

Even prior to its becoming a founding member of the WTO in 1995, the Philippines had already instituted a comprehensive tariff reform program that provided for a liberal schedule of tariff reductions and concessions on selected industrial and agricultural products, which were overtly in excess compliance of the commitments required by the organization. This trend can be noted in the remarkable reduction of the country's average MFN tariff rates from 26 percent in 1992 to a little below 10 percent in 2003. Notwithstanding the crushing impacts of the Asian Financial Crisis of 1997, which crippled the financial viabilities of several industries across Asia, the Philippine government resolved to attain its target of a 5 percent average MFN tariff rate by January 2004[1] and managed to maintain wide differentials between its applied and bound rates.

Furthermore, beginning from the incumbency of President Fidel Ramos, the country pursued an aggressive liberalization program in trade and investment policy by opening up strategic

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[1] A reversal however was realized early in that same year, following the results of a tariff review commissioned in 2003 which entailed a long process of consultations with domestic industry representatives who clamored for additional tariff protection to preserve their viability.

sectors such as telecommunications, mining and retail trade to partial foreign ownership; progressively eliminating tariff peaks and setting a course towards the tarification of quantitative restraints (or the conversion of quantitative restrictions into their ad valorem or specific tariff equivalents). To provide vital safety nets for the protection of domestic industries, and as countermeasures against possible preparations of unfair trade practices, the country consequently ratified key legislation in the form of anti-dumping, countervailing and safeguard duty laws. These trends reveal an apparent firmness on the part of the Philippine Government to conscientiously advance in its unilateral path towards freer trade in all economic sectors notably in anticipation of reciprocity and special and differential treatment from its trade partners in the developed world to accommodate its high value export goods.

A. Unmet expectations and opportunities posed by negotiations

Unfortunately, the expected reciprocity and/or special and differential treatment, which were expressly anticipated by the country during the Uruguay Round of negotiations, did not completely materialize. The emergence and continued maintenance of subsidies in the agricultural sector, tariff discrimination, and non-tariff barriers such as sanitary and phytosanitary (SPS) measures and technical barriers to trade (TBT) in the developed countries of the EU, US, and Australia have remained perennial market access issues for the developing world, inclusive of the Philippine experience. The Doha Development Round of negotiations would therefore afford the Philippines another venue in which its interests and legitimate clamors, and those of the rest of the developing world, could reverberate and bear upon the hindrances to fair trade imposed by the developed world. This will enable members of the developing world to assertively rally their cause to exploit their respective comparative advantages in the agricultural and service sectors, as the modalities of negotiations are finalized.

In September 2003, the 5th Ministerial Conference was held in Cancun, Mexico, with renewed hopes that the developing countries would finally get their fair share of the bargain. The conference however, resulted in the now infamous impasse, that was attributed mainly to the insistence of developed countries to prioritize discussion of the "Singapore Issues"[2] ahead of agricultural market access, domestic support and export subsidies. Nonetheless, despite the retention of the status quo with time lost and nothing gained at the multilateral arena, some analysts still describe the Cancun collapse as a shining moment for developing countries which banded together to form the Group of 22 (G-22) and collectively resisted the muscle of the developed countries to prevent the entire conference from arriving at a bad deal. With multilateral talks at a standstill however, the rest of the world which was eager to liberalize and benefit from the gains of freer trade seemingly, for a while, saw their patience in the WTO waning and opted to consider bilateral and regional trade deals. In a matter of days after the collapse of Cancun, several countries such as the US and Singapore set out on FTA finding missions to engage potential trading partners via the bilateral route.

B. Revival of hopes with the "July Package"

Less than a year later, in July of 2004, movements once again picked up at the WTO when member countries worked round the clock under the auspices of the WTO General Council to arrive at a consensus to jumpstart the hitherto stalled Doha Development Round. Aiming to rectify the stalemate at Cancun, the General Council, at the closing hours of July agreed upon a set of modalities that would determine how the future negotiations of the Doha Round would proceed.

The July Package, as the document was called, contained a number of elements deemed favorable to developing countries

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[2] The trade topics of Competition Policy, Transparency in Government Procurement, Investments and Trade Facilitation which were first brought up during the Ministerial Conference in Singapore in 1996.

having incorporated a number of their proposals (including that of the Philippines which will be discussed briefly later). It tackled agriculture, non-agricultural market access, trade in the services and trade facilitation.

Among other things, the July Package called for a definite deadline for the elimination of all trade-distorting domestic support in developed countries, the use of a tiered formula in tariff and subsidy cuts and setting of final bound rates as the uniform basis for continual tariff reduction.

C. Overview of agricultural and services in total economic performance

The Agriculture and Service sector may be considered as the extremes of the spectrum of Philippine trade competitiveness. On one end, we can observe an irony in an agricultural sector, which despite the abundant existence of arable lands and natural resources, had failed to live up to its most productive potentials. For a fact, the country has become a net importer of essential agricultural products such as rice, milk, cream and wheat notwithstanding the dedication of 47 percent, or 13 million hectares[3] of its total land area for farming. In 2001, the trade deficit in agricultural products shot up by 27 percent to US$1 billion, while in 2005 agricultural growth declined to 2 percent from the 2004 growth figure of 4.9 percent.[4] Nonetheless, in 2004, agriculture's share of total exports increased by 13.2 percent with exports receipts moving up by 17 percent.[5]

On the other end, we have the multi-faceted sector of the services, which has proven to be a veritable repository of Philippine comparative advantage, particularly in low to high

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[3] <http://www.tradepartners.gov.uk/agriculture/philippines/profile/overview.shtml>.

[4] *Id.*

[5] <http://www.bar.gov.ph/news_out/agrisurges.asp>.

value-added labor-intensive services. In 2004, the service sector posted the highest rate of growth at 7.3 percent (up from its 2003 level of 5.8 percent) as against industry at 5.3 percent (from 3.8 percent in 2003) and 4.9 percent (also from 3.8 percent in 2003) for agriculture.[6] This considerable rate of growth in services was rallied by the transport, communications, and storage services which expanded by 12.2 percent, followed by finance at 8.4 percent, trade at 6.8 percent, private services also at 6.8 percent, real estate at 6.0 percent, and government services at 1.6 percent.[7]

These trends can be readily observed in the composition of the country's total production output, which reflects the underutilization of the country's agricultural factors and resources. In the beginning of the 1980s Philippine agriculture made up a quarter of GDP, with the services edging slightly ahead at 35 percent.[8] The coming years however will witness a widening performance gap between the two sectors, as the delineation of comparative advantage became much clearer. During the aftermath of the financial crisis, the service sector laid claim to a clear majority of the total Philippine GDP at 52 percent, while agriculture settled for a comparatively lower share of 17 percent. In 2002, owing to a rebound in the industrial sector, 46 percent of GDP was attributed to the services, while agriculture only accounted for 20 percent of total GDP.[9]

D. Purpose

This paper is meant to provide a brief factual background of the current political and economic situation enveloping the

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6 Data from the National Economic and Development Authority (NEDA) January 2005.

7 *Id.*

8 Data gathered from Philippine Statistical Yearbook of the National Statistics Coordinating Board.

9 *Id.*

Philippine agricultural and services sectors in view of the widening export opportunities brought before it by the multilateral round of negotiations and other regional trading initiatives. Furthermore, it will also discuss the initiatives that the country has done and is currently undertaking to promote its competitiveness in these sectors for the purpose of finally recommending possible focus areas of the present Doha Round.

II. Agriculture

A. Years of adversity under a regime of import substitution and industrialization

The immediate cause of the dismal performance displayed by agriculture in the Philippines can be partially ascribed to the country's hardline resolution to pursue a strategy of import substitution industrialization in the 1950s. This era was characterized by generous subsidies granted to heavy industries, high tariff walls for industrial products, and substantial disbursement of foreign loans to finance capital-intensive industries and bail them out from constant losses. This policy mindset diverted vital funds and attention from the country's failing agricultural sector, which was deprived of the necessary irrigation, infrastructure, and crop development projects during those crucial years. The failure to invest in farm-to-market roads, farmer training, advanced agricultural techniques and strategic irrigation facilities caused the sector to progressively lag behind relative to its ASEAN counterparts. Furthermore, the flow of public funds and incentives for business were concentrated on the development of the urban areas, particularly Metro Manila, instead of the farming and fishing villages in the hinterlands whose rudimentary methods of production barely surpassed levels of subsistence, making it impossible to achieve linear development and exploit economies of scale.

Perennial conflicts in the political sphere such as the protracted armed struggles of insurgent farmers and communist factions in the rural areas arising from discontentment over the

long delayed implementation of the agrarian and structural land reform served to aggravate the situation. Vast tracts of fertile lands and untapped natural resources thus became less accessible and less attractive to develop and extract due to the constant threat of violence and the likely extortion of so-called "revolutionary taxes" from the active insurgents who may take unsolicited interest in the land's produce. Less than concerned landlords, likewise, no longer bothered to harness the full potential of the hectares of farmland they owned and allowed their assets to lay idle and unproductive, much to the detriment of the domestic farmers who, then, rarely had the opportunity to own the lands they tilled.

B. Renewed hopes: export-orientation and WTO renegotiation

Towards the middle of the 1980s, however, late in the realization of the country's primeval source of comparative advantage and as the viabilities of infant industries turned for the worse, the Philippines started adopting a policy of export orientation and agricultural support. In 1994, Congress passed legislative measures to support the domestic export industries. RA No. 7844, or the Export Development Act of 1994, recognized that "the link between export growth and countryside development must be strengthened through policies favorable to small-and-medium-scale enterprises (SMEs), regional industrial centers, and export-processing zones to boost rural and farm-based entrepreneurship in identified geographic economic growth areas of the country" and articulated that "agricultural policies shall build up the viability and competitiveness of the country's agriculture sectors and facilitate their linkage with industry to strengthen the agro-industrial base of the country's export thrust."[10] Its provisions allow for the granting of tax incentives to Philippine exporters, and tax credits for the importation of non-locally produced raw material inputs destined for export processing and special economic zones; the existence of which

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[10] <http://www.virtual-asia.com/ph/bizpak/legalcodes/export_1994_01.htm>.

has provoked some anxieties and questions on the part of the developed countries.[11]

Holding true to its commitments under the WTO however, the country did not automatically call for a readjustment of tariff rates for agricultural products; instead focused on the tarification of quantitative restraints, except for rice, and sought refuge for 118 sensitive products under the Special Agricultural Safeguard Measures. Parallel to these developments, the Philippine government recognizing the necessity in the light of the imminence of multilateral tariff reduction and globalization in 1997, Congress ratified the Agriculture and Fisheries Modernization Act (AFMA) which granted various tax and duty exemptions for essential inputs to the agricultural sector such as machineries, fertilizers, and seeds. This same act likewise appropriated a fund of more than a billion pesos for the rehabilitation of the sector and afforded the establishment of social safety nets which may be needed to ameliorate the potential displacements brought about by the gradual elimination of agricultural tariffs.

C. Private sector consultations on modalities for future negotiations and Task Force for WTO Agriculture Agreement Renegotiations (TF-WAR)

To purvey and assert domestic agricultural concerns at the multilateral trade negotiating table, the Department of Agriculture and concerned private sector groups formed a Task Force for WTO Agriculture Agreement Renegotiations (TF-WAR) to discuss possible modalities for agricultural negotiations for the next WTO round of talks, which would be reflective of the interests of the country and, to a certain degree, the rest of the developing world. This task force convenes regularly and has already presented proposals for the negotiations on agriculture. These proposals contain a suggested framework for the modalities of the WTO round of negotiations giving due consideration to the interlinkages between the issues of market

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[11] <http://mkaccdb.eu.int/mkdb/stb/barrierdesint.pl?bnumber=010052>.

access, domestic support and export subsidies. Some elements of these proposals, as mentioned above, were incorporated in the July Package, to a certain degree.

D. The Philippine position

The Philippine proposal, which speaks of the country's adamant stance to assure market access and stimulate export development, argues that a scheduled tariff reduction will have to be complemented by a simultaneous, or interlinked compromise that will guarantee the commensurate phaseout of trade-distorting domestic support. This consists of two stages,[12] each to be implemented for a period of three years. The first phase, or the harmonization stage will entail the setting up of a mechanism for tariff reduction beyond negotiated levels, integrating special and differential treatment to address tariff peaks and mega tariff distortions. For purposes of harmonization and uniformity, this phase would entail the conversion of all tariff schedules into ad valorem terms, and the reference to Uruguay Round bound rates as the relevant base levels for reduction. To insulate developing countries from trade-distorting export subsidies and domestic support measures from the developed world, special and differential countervailing measures will be applied throughout the two phases. During the second stage, termed as the tariff reduction phase, the Philippines recommends the application of the Swiss formula,[13] without exception, provided that the coefficient of developing countries will maintain a comfortable magnitude higher than that of the developed countries to allow slower reductions and longer implementation periods for the developing countries. This completion of the first stage and the commencement of the second will be realized as soon as

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[12] Taken from a contribution of the Philippine mission to the WTO entitled *Integration of Reforms in Export Completion, Domestic Support and Market Access in World Agricultural Trade; Basic Elements.*

[13] New Tariff = (Current Tariff * coefficient) / (Current Tariff + coefficient).

the developed countries have substantially lowered their levels of trade-distorting domestic support. A call to reserve for developing countries the exclusive right to avail of special safeguards (SSG) is also incorporated in the proposal. This request is made in view of the fact that, although intended to address price volatilities and sensitivities in developing countries, these measures have only been extensively utilized by the developed countries.

Salient features of the proposal relative to domestic support include the simplified classification of such measures into two categories; the amber box, for trade-distorting support and the green box, for non-to-minimally-distorting support. The contents of the blue box (for payments directly linked to acreage or animal numbers, but under schemes which also limit production by imposing production quotas or requiring farmers to set aside part of their land) therefore, and the decoupled support payments under the green box will be rerouted to the amber box and scheduled for reduction. This will require a redefinition of the Aggregate Measures of Support (AMS) to include within its scope, the amber box and decoupled support payments.

With regard to export subsidies and domestic support, the Philippine position calls for the obligation of developed countries to immediately eliminate all forms of export subsidies and prohibit them permanently and unconditionally over three years, while extending the same obligation for developing countries for a longer time frame of six years. Minimum caps are also prescribed for various categories related to minimizing the advertising and transport costs of exportation in developed countries.

To supplement these movements toward greater market access and fewer trade distortions from domestic support and export subsidies, the Philippine proposal makes an equivalent clamor for the elimination of export monopolies held by exporting state trading enterprises and putting in place a system of discipline in their operation in order to avoid conflicts with subsidy reduction commitments and ensure transparency. The

same call for tighter discipline applies to the issuance of export credits.

It is perhaps worthy to consider that a notable number of these proposed modalities were incorporated in the so-called July Package, principally the clamor for a tiered formula in tariff reductions and the establishment of a fixed deadline for the abolition of domestic support. It must be borne in mind however that the contents of the July Package are not yet the long-awaited set of agreements themselves, but merely the modalities that will determine the parameters of the future negotiations to be done under the Doha Round.

E. Perennial impediments to market access

These pillars of the Philippine trade negotiating team in agriculture are designed to develop the domestic agricultural sector through the creation of market opportunities in the developed world, and the propagation of SMEs engaged in the export of local produce.

However, much remains to be done in installing teeth in the government's capabilities at the Dispute Settlement Body (DSB). Discriminatory tariffs against Philippine tuna exports to the EU and the US remain.[14] Meanwhile, excessive Australian sanitary and phytosanitary standards on the country's banana and pineapple exports[15] have served as a convenient, albeit questionable non-tariff barrier that has deprived local producers of an otherwise legitimately claimed international market share. Philippine desiccated coconuts have been slapped countervailing duties upon entry in Brazil, based on almost entirely technical grounds and questions on applicable laws.[16] While the Philippines remains wanting of the funds

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[14] See WTO Agreement of Agriculture: The Implementation Experience – Developing Country Studies (Food and Agriculture Organization of the UN, 2003) available online <www.fao.org>.

[15] *Id.*

[16] <http://www.sunsonline.org/trade/areas/commodit/10240096.htm>.

necessary to muster sufficient manpower and technical expertise to successfully manage its dispute settlement concerns, market access and export development would remain a formidable challenge on top of the arduous uphill climb it already faces in the next round of negotiations.

F. Other options for export markets

Dauntless, however, despite the road blocks that may lie ahead in securing its share of the international market under the auspices of the WTO (especially with the impasse at Cancun), the Philippine government continues its consultation with domestic agricultural players to seek viable options to penetrate other markets through a bilateral and regional route.

On one hand, if all goes according to plan, a free trade area (FTA) amongst ASEAN members, with the eventual inclusion of China (under the ASEAN-China FTA) is bound to materialize in the next 10 years. At the Tariff Commission, Philippine exporters of carageenan and coconut oil, for instance, are currently batting for their inclusion in the Early Harvest Package (EHP) for them to avail of lower tariffs and successfully gain a portion of the enormous China market. A proposal to draft an EHP list for the Philippines comprised of all non-locally produced unprocessed raw materials[17] has also been presented at the Tariff Commission. However, owing to the general consensus of the Department of Trade and Industry that no genuine comparative advantage for the Philippines exists in raw, unprocessed agricultural products, apart from a small minority of fruits, vegetables, extracts thereof and seaweeds, prospects for the country's participation in the EHP does not hold much optimism. Corollary to this, in almost every public hearing of the Tariff Commission, majority of the agricultural producers of meats and crops present urged the government to raise the duties of locally produced items to the levels of their

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[17] The coverage of the Early Harvest Package of the ASEAN-China FTA is limited to Chapters 1–8 of the Harmonized Commodity Description and Coding System.

maximum MFN bound rates; often with the heated remark that the acceleration of tariff cuts was a unilateral decision which was not initially consulted with the private sector and that the AFMA funds allocated to serve as their safety nets had not been disbursed properly. Nevertheless, during the 10th ASEAN Summit in Vientiane, Laos, last November 2004, the country has submitted its list of products (including processed foodstuffs) for inclusion in the EHP, which China is currently mulling over. The National Economic and Development Authority once issued a statement that the EHP would do more harm than good, if coverage would be limited to unprocessed agricultural produce, however, with China's apparent openness to flexibilities, hope remains for the EHP to prosper.

Conversely, the Philippines is set to enter into another bilateral FTA with Japan by way of the Japan-Philippines Economic Partnership Agreement (JPEPA) for which agriculture is said to be a critical element to be granted duty free market access in Japan in the next 10 years. Significant progress was made in the bilateral discussions with President Gloria Arroyo and former Japan Prime Minister Junichiro Koizumi arriving at a "firm consensus" at the sidelines of the 10th ASEAN Summit held in Vientiane, Laos, last November 2004, and the APEC Economic Leaders' Forum held in Santiago, Chile, in that same month. Philippine export winners that are seen to be extended tariff-free access to Japan within the next decade are bananas, pineapples and tuna. One other important (and controversial) aspect of the agreement, which is expected to enter into effect by 2006, are its provisions on the services (particularly for Filipino entertainers and medical professionals working or seeking to work in Japan) which will be briefly discussed in the subsequent portion.

Apart from the current impediments that Philippine agriculture must hurdle at the level of multilateral trade negotiations, several domestic concerns still require the immediate attention and action of government. Foremost is the long delayed institution of genuine agrarian reform to motivate domestic farmers to maximize idle, underutilized

agricultural assets. For the same purpose, agreeable profit-sharing schemes between land owners and farmers are also recommended. Various business organizations and civil society groups, such as the Philippine Chamber of Commerce and Industry (PCCI), are requesting government financial institutions to accept farm lands as collateral for loans that farmers can use to acquire advanced machinery and build the irrigation systems necessary to improve crop yield and productivity. Technology transfer should also be accompanied by a massive educational effort to impart the important skills and expertise related to the application and management of modern farming techniques such as crop rotation and hydrophonics. Research and development is currently being intensified for profitable pharmaceutical or industrial usages for indigenous flora. Current research initiatives should similarly explore the likely conditions and locations in which higher value crops, such as asparagus and lumber, can be planted and harvested for higher foreign exchange inflows from higher value exportations.

G. Other issues

Moreover, for the Philippine cause to be more favorable and attractive to its trading partners at the WTO, it should show adherence to greater reciprocity by toning down the politically motivated anomalies in its confidence to foster healthy competition through trade liberalization and facilitation. A case in point is rice, which stands as the final frontier for the tariffication of all quantitative restrictions. Secretary for Socio-Economic Planning Romulo Neri once broached that the status quo of giving government exclusive rights to rice importation is a primary occasion for rent-seeking activity. He reckoned that only unscrupulous traders who import rice during harvest season and sell at exorbitant prices during planting season, and not the farmers, are seen as the beneficiaries of this scheme.

In the greater interest of food security and transparency therefore, the lifting and tariffication of restrictions on rice would have to be seriously contemplated. Parallel to this,

research may have to be intensified to identify higher value crops that may be planted to offset possible displacements in the rice-producing sector.

III. SERVICES

A. Constant sector boom

Leaving the more sensitive issues of agriculture behind, we now delve into the background and future export development prospects for the country's service sector. It was already mentioned that the services, apart from accounting for almost half of local GDP, has also been the top performer in recent years, most especially in those related and incidental to the export processing of semiconductors and electronic equipment (cargo handling, air express, international banking, information and communication technology, etc.). Undoubtedly, the upswing in which the service sector currently finds itself is a function of the aggressive measures undertaken in the early 1990s to liberalize trade and investments in various sectors and open them to foreign competition, notable of which is the breaking of the inefficient telecommunications monopoly which had been an opprobrium to previous generations of consumers. The country's positive adoption of policies for domestic export support, and the conversion of the former US naval base of Subic and the airbase of Clark into special export processing zones further bolstered the expansion of service incidental to manufacture and trade.

B. Shortcomings: unemployment and underemployment

Despite the high growth rates registered by the domestic service sector, however, it has not expanded fast enough to arrest the shrinkage of the domestic labor market. Since the domestic economy could not accommodate the hundreds of thousands of potential entrants to the labor force each year, job hunting has become an extremely competitive feat. Matching the qualifications of applicants with the appropriate work descriptions has become even more difficult, compelling

a substantial portion of the domestic force to settle for low-income menial occupations that lag far behind their actual credentials. The lack of quality jobs with sufficient compensation has led to a continuing phenomenon termed as the “Overseas Filipino Worker (OFW) diaspora” which began in the 1970s, at the height of the debilitating oil shocks and the rise of the Arab oil economies. Thousands upon thousands of Filipino engineers, and technical experts seeking higher incomes flocked to the Middle East at the time to quench the demand for highly skilled labor of the burgeoning oil and construction industries in Saudi Arabia, Bahrain, Iraq, Dubai, Kuwait, UAE and other Middle Eastern nations. This trend intensified into the 1980s and 1990s, as shortages in caregivers, nurses and teachers befell developed economies with dwindling and aging populations. This attracted more and more Filipinos to serve abroad. This exodus continues today with equal intensity. In 2002 alone 77,601 Filipinos lost their jobs, an 8.1 percent increase from the previous figure of 71,764. In that same year (2002), 886,885 Filipinos left the country to take employment abroad.[18]

C. Human resources: bulwark of Philippine comparative advantage

As opposed to the agricultural sector, it is in the sector of the services where the country finds its greatest source of comparative advantage, made possible in large part by its highly competitive labor force which has been internationally recognized for their fast learning curves, high levels of literacy and extensive exposure to quality education and technical training. Based on its research surveys, the US-based Meta group ranked the country first in the availability of knowledge-based jobs and workers worldwide and fourth among Asian nations in terms of labor quality. These findings are put into perspective by the fact that the Philippines is the third largest English-speaking country in the world,[19] since the language has been

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[18] <http://www.virtual-asia.com/ph/weekly/030203ph.htm>.

[19] <http://www.boi.gov.ph/why_phils.html>.

designated as the medium of instruction at all educational levels since the early decades of the 20th century.

Today, Filipino labor and its distinct qualities can already be considered a fixture in nearly every country. Its managers, educators, professionals, engineers and staff share a competitive advantage with regard to service quality and proficiency. This unique advantage held by the country's human resources may be attested to by multinational companies, government agencies and other institutions both here and abroad who have previously hired the services of Filipinos. The General Agreement on Trade in the Services (GATS) therefore offers the country a more auspicious opportunity to exploit this comparative advantage and gain a substantial foothold in the international market. Further, through the GATS, it may negotiate for better terms, such as national treatment, fewer hindrances to labor mobility and special and differential privileges from the developed world. Established international linkages in the service sector abroad will facilitate technology transfer and skills training locally, enabling the Philippines to continuously upgrade the capacities of its workforce. All local professionals, including farmers and agriculturists, would likewise benefit from such arrangements and extensive global ties. This should reasonably imply, however, that local interests are safeguarded from further labor displacements, from the loss of regulatory powers over labor practices and pricing structures, and lastly, from the deterioration of cultural integrity.

D. Domestic silence with GATS

Despite the existence of the abovementioned considerations, however, circumstances still indicate inadequacies in the Philippine effort to exploit GATS to its greater advantage. In the ongoing sectoral talks in the services, the Philippines does not play as much of a role as it does for the controversial issues surrounding agriculture. As a matter of fact, one could surmise that the frequency of GATS as a topic in local debates and hearings is surprisingly low, considering the potential

ramifications it may have on the country's fastest growing sectors. According to Philippine professor Rene E. Ofreneo "GATS remains a big unknown, very little is known about it, nor are there extensive discussions in Congress and in the planning circles about Philippine participation in GATS."[20] Nonetheless, by virtue of the 1994 Senate hearings, the country committed to a "standstill" position, meaning a passive stand not to pursue any further entry restrictions in the following sectors: communications, financial, tourism and transport services.[21]

E. Oversights and shortcomings

The interests of the domestic service sector are not equally embodied in a formal task force comprised of private sector and government representatives with the same magnitude as the one organized for agriculture. This may explain the infamous oversight of the Philippine negotiating panel when it failed to assert the inclusion of Overseas Filipino Workers (OFWs) under the concept of Mode 4[22] of the GATS or the "movement of natural persons." Without their inclusion in the said definition, Filipinos working on completing overseas contracts will not be definitively considered as service providers abroad, but solely rather as overseas employment seekers. To fully purvey and develop the competitive advantage of the highly skilled Filipino

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[20] <http://apan-info.net/ndcp/occasional_papers/HTML/Phil%20under%20GATTS.htm>.

[21] *Id.*

[22] The GATS classifies trade in the services under four modes: Mode 1 refers to cross-border supply (e.g., call center agents in country A providing offshore support for customers in country B), Mode 2 refers to consumption abroad (e.g., a tourist from country B visiting country A to avail of medical services), Mode 3 refers to commercial presence (e.g., a bank based in country A setting up a branch in country B to provide financial and banking services to its people), and Mode 4 pertains to the movement of natural persons (e.g., citizens of country A going to country B to render professional expertise in the construction industry of that country).

laborer, future negotiators should decisively resolve this contention.[23]

F. Foregone challenges to hurdle

The waters that Philippine negotiators will tread turn rough when the discourse begins to focus on the demands of OECD countries for the Philippines to lift its exemptions that the country holds with respect to the financial and professional services. At present, the Philippines only accords MFN treatment to foreign financial service providers who render the same preferential treatment for their Philippine counterparts abroad. The opening up of the professional services to foreign applicants is forbidden under the Foreign Investments Act of 1991, pursuant to the admonition prescribed by the Philippine Constitution. Although some exemptions have already been granted to accommodate foreign professionals covered by contracts with foreign organizations and companies related to the country's thrust to intensify infrastructure and construction development, this negative list is still bound to be questioned. Foreign engineers, doctors and managers have been hired in the Philippines on a consultancy for specific development projects. Particular attention may be brought to the continued practice of "labor market tests"[24] in the country and the criteria by which the results of these tests are based. Labor market tests may be conducted through a manner in which a foreign professional's application would be subject to the results of a public survey (usually through the newspapers) to first determine whether no local citizens are capable of handling the specific line of expertise for which the application is sought. Furthermore, land ownership restrictions for foreigners, which are explicitly mandated by the

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[23] *Id.*

[24] These are conducted prior to the acceptance of a foreign application to ascertain whether the qualification for the occupation he/she is to fulfill in the country is or is not available among the ranks of the domestic labor force.

constitution, may be construed as inconsistent with GATS provisions could likewise be raised for debate.

It is most unlikely that the Philippines would bend over these demands just yet, since doing so would necessarily entail amending the constitution. In recent experience, any motion or proposal to alter specific provisions in the Philippine charter has been met with violent protests that have threatened to cause deep crevices in the country's social cohesion. Therefore, it will be in the best interests for the country's political and economic stability to have these exemptions extended or kept off the negotiating table until domestic issues have been first put to rest.

G. Identification and support for globally competitive services

Outside the negotiations, the country must focus its energies on identifying and extending the needed support for domestic service sector industries that have the potential to effectively compete internationally. A few years back, education, tourism, recreation, and medicine have already been identified by the government as prospective areas wherein Filipinos can excel and make a dent in the global market.[25] All that remains to be done are the investment in research and development projects and effective marketing strategies to further promote local services abroad. In the event that further liberalization could no longer be averted in the sensitive sectors of the utilities, professions and financial services, government will have to immediately contemplate and research on the installation of safety nets or relief programs to find alternative occupations for potential displacements. Repercussions that may ensue from rescinding the country's "standstill" or *status quo* attitude in the sensitive service sectors however may be minimized, provided that direct competition would be limited to larger players, with due exemptions for micro to medium enterprises, just as the country did when it liberalized the retail trade sector in 2000.

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[25] <http://apan-info.net/ndcp/occasisional_papers/HTML/Phil%20GATTS.htm>.

H. Other service market opportunities

As with agriculture, the other FTA engagements to which the country has or is about to enter also include provisions on trade in services. For one, the Framework Agreement of Comprehensive Economic Cooperation between ASEAN and China, calls for a "progressive liberalization in trade in the services." However, in spite of the opportunity it alludes to at the moment, negotiations for the services may first have to take a backseat whilst the recently approved Agreement on Trade in Goods and the Philippines' Early Harvest request is set for further discussion. Nonetheless, in parallel with the country's preparations for the GATS negotiations, the services trade in the China-ASEAN FTA will also have to be within the radar of the country's trade negotiators.

With regard to JPEPA, the concerns regarding trade in the services (primarily Mode 4, or the natural movement of persons) has apparently taken precedence in garnering controversy. The stickiest issue which has to be hurdled before the JPEPA is finally put into motion would seem to be that of Filipino overseas workers–for which the country is batting to include amongst the concessions for Japan to accommodate. As of this writing, reports have been released pointing at the possibility for Japan to allow a few hundred medical professionals and entertainers to work there under the JPEPA, provided that certain educational requirements set by Japan are first met. Among these educational requisites are certifications from schools recognized by the Japanese government, a degree of experience in their respective fields, and a proficiency in the Japanese language. Simultaneously, reports have likewise been sounded off that Japan will soon initiate a campaign against over 30,000 overstaying Filipinos, after just recently implementing stricter rules for entertainers applying to work there.

IV. Conclusions/Recommendations

The Philippines is currently undertaking a simultaneous effort to develop its agriculture and service sectors, while securing a

fair and favorable bargaining position for the exports of the same at the WTO as a new wave of commitments under the ambit of the Doha round of negotiations draws nearer. This time around, notwithstanding a few setbacks, the country will have sufficiently mastered and fine-tuned its arguments and straightened out its priorities to build a stronger case for these two sectors before the international trade negotiating community.

The country already manifested a high level of capability in unifying and rallying the cause of developing countries along its side in the ongoing talks regarding the access of their agricultural products to the markets of the developed world. Its proposed framework of modalities expounding on the inter-linkage of tariff reduction with the export subsidies and domestic support has proven to be an effective contribution in turning the tides of the discussion nearer the favor of the needier nations.

With regard to the service sector, a similar task force akin to TF-WAR will have to be organized to effectively represent the country's interests, in particular reference to the millions of OFWs whose remittances contribute heavily to the stability of the country's domestic system of finances. A shrewd manner of bargaining must be planned and employed in order to assure that, upon the conclusion of the following round of negotiations, OFWs would have already been included under the conceptual definition of "movement of natural persons" to recognize them as service providers or agents thereof, rather than job seekers. The Philippines would lose a great deal and miss out on fully maximizing the single most profitable advantage it grasps in its highly competitive labor force, if it does not successfully purvey this aspect of the negotiations. In this regard, the government should shake off from its long dormancy in tackling the fate of the country's service sector under GATS, and initiate bold moves to secure a more active role in the negotiations by conducting the needed consultations with the private sector.

At the end of the day however, what would constitute a defensible case for enhanced market access to developing countries and more favorable terms of negotiations, would be determined less by the specific contents of a single framework proposal than the overwhelming concurrence of the developing world to settle differences and rally in unison behind this cause. The capability of developing countries to surmount the likely adversities that they may encounter in the next decade of the multilateral trade order will rest upon the consistency and harmony of their respective positions. Lines of communications between and among members of the developing world should be kept open, especially in these trying times, for the threshing out of elusive commonalities in negotiating positions. Supplemental to the continuing dialogues, efforts must also be focused in keeping the public and private sectors steeped in the discourse of previous and prevailing trade issues, to avoid the difficult situation of being left behind as negotiations, particularly in agriculture and the services, prosper during the Doha Round.

ASEAN Trade in Focus *

Mr. Raphael B. Madarang

In 1992, the Association of Southeast Asian Nations (ASEAN) embarked on an ambitious endeavor to establish the ASEAN Free Trade Area (AFTA) in pursuit of functional and dynamic economic integration. The idea was to meld the disparate economies and political peculiarities of ASEAN member countries into a single, regional economic unit, akin to the European Communities (EC). This environment will allow goods and services to freely move about and encourage member countries to efficiently exploit gains from specialization. However, over a decade hence, much potential still remains untapped with several business issues still up for practical resolution. To address this, efforts to further step up the integration process in both goods and services within ASEAN and its main Asian trading partners (Korea, India, China, and Japan) have since been a perennial topic of deliberation in the ASEAN Summits held yearly, the last one (the 12th) having been hosted in Cebu.

One major aim of AFTA is to transform ASEAN into a single market, investment destination, and production base where international businesses can set up regional operations. The AFTA framework was envisioned as a catalyst that would instill harmony, stability, and transparency affording global companies a conducive environment to invest not only in a single country, but across the entire region. Through the reduction of trade barriers, companies are given the opportunity to more strategically and efficiently plot out their regional cross-border

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supply chains, drawing from the comparative advantages of each country.

As a first step towards regional economic integration, ASEAN agreed to implement a substantial tariff reduction scheme called the Common Effective Preferential Tariff (CEPT). Developments on this front have been dramatic, with 98 percent of all products traded within ASEAN now enjoying CEPT rates in the range of 0–5 percent. In the first decade of its implementation, the average CEPT rate for the first six members of ASEAN (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand) dropped from 12.76 percent to a low of 1.61 percent. For the Philippines, the average CEPT rate has already been reduced to 3.77 percent as of 2003.

Tangible effects of the AFTA in the Philippines can already be perceived. It is no longer uncommon to find consumer and industrial products from soaps and detergents, to cars and heavy equipment bearing the distinct markings of our ASEAN neighbors. You may have come across a car component labeled in Thai and Bahasa Malaysia, or a shampoo bottle with ingredients translated in Bahasa Indonesia all produced by a single company under a single brand. It is fascinating to note that the parts and ingredients of these products were obtained from different countries within the region. These were processed in varying degrees (accumulating value-added) in different ASEAN countries, before finally being retailed off to the end user. Interestingly, apart from the tangible products, the design and idea behind these products and their components were most probably conceptualized in one ASEAN country and implemented in another.

Economists of different orientations have long been at loggerheads in responding to the debate on whether the economic and policy adjustments to accommodate AFTA (or any FTA for that matter) has or would indeed be beneficial. Questions have been raised on whether such would lead not only to positive marks in our economic indicators, but also in net welfare gains for the common Filipino. Debates continue in search of a clear and convincing answer to this, but it is

undeniable that efficiency gains from specialization and economies of scale are increasingly being exploited through the AFTA. Companies no longer have to establish duplicate facilities in different ASEAN countries to produce the same product. They can instead capitalize on the comparative advantage and resource endowments of each country by setting up specialized production facilities in different strategic locations. Efficiency gains in specialized production can generate broader economic activity in the host countries leading to wider employment and higher levels of income. One may observe this in the heavy intra-industry trade taking place in the automobile industry, wherein different parts and components (e.g., brakes, wiring harnesses, chassis, windows) are manufactured in the ASEAN countries where it is most cost-effective to produce them and sent to major assembly plants in Thailand and the Philippines. Intra-industry trade has also been facilitated by the ASEAN Industrial Cooperation (AICO) Scheme which offers tariff rates even lower than the CEPT for enrolled manufacturers. Consumers, on the other hand, benefit from the lower prices brought about by reduced tariff and transaction costs at the level of raw material inputs and finished items. Other unquantifiable benefits, such as closer diplomatic relations and the positive recognition of the region as a solid economic unit and viable investment area, lend a very helpful hand in promoting the Philippines to international businesses.

After all is said and done in touting the benefits of economic integration, however, it remains fair and valid to comment that, frankly, ASEAN has not been up to the mark as far as the promotion of trade and investments (a cornerstone of economic integration) is concerned. Positive manifestations as to the effectiveness of the region in luring international business to agglomerate and establish regional operations may be tangibly observed. However, the benefits that have so far been reaped are still but a far cry from the true economic potential that ASEAN and its resources have to offer.

A prominent indication of ASEAN's apparent lack of success in economic integration is its wanting performance in promoting

intra-ASEAN trade. As present figures stand, trade amongst ASEAN member countries account for a little over 20 percent of total ASEAN trade. In so far as investments go, intra-ASEAN investments barely exceed 10 percent of total investments in ASEAN in cumulative terms since the past five years. Note that these results came out notwithstanding a substantial reduction in intra-ASEAN tariffs. There is no dearth of explanation for this less than satisfactory outcome but some of the more common will be discussed below. Notably, business has one of the largest roles to play in addressing each of these.

Given the fact that not much headway has been made in the expansion of international trade and investments in spite of substantial tariff reductions in the region leads one to deduce that the root of the problem lies more on non-tariff barriers. ASEAN economic officials have come to recognize this issue and have opened more functional debates on how the region should iron out the finer details of economic integration beyond the initial step of tariff reduction. The new issue areas now being deliberated include among others: trade facilitation, rules of origin, and a complementation between trade and investment policies.

Trade facilitation, which deals with the speedy clearance of goods from customs jurisdiction, is becoming a growing concern among businesses in ASEAN. A number of importing companies in the region apparently have developed an impression that the costs they save from the reduced tariff rates are merely offset by the administrative costs of managing through tedious customs bureaucracies. To assuage this, an initiative called the ASEAN Single Window has already been set in motion, for which pilot tests were conducted in the Philippines. This program is intended to introduce common documents and to set up a common information sharing network among Customs administrations in ASEAN that will allow the easy transmission of official trade information (importers, trade profiles, statistics, pricing, tariff classifications, certificates of origin etc.) to reduce time costs whilst managing the risks of technical smuggling.

The Rules of Origin is the system by which a product is deemed as originating from an ASEAN country and thus granted preferential tariff treatment. On a general note, the main method of determining this is based on a minimum percentage (40 percent) of the product's freight-on-board (FOB) value. However, strict criteria apply as to which particular cost components can be treated as counting within that minimum percentage. A number of certain cost items which are incurred in ASEAN are still omitted in the calculations which preclude some goods from being allowed preferential access to ASEAN markets. These rules, however, are constantly being reviewed to ensure that they are neither too lenient enough to be vulnerable to transshipment leaks nor too strict so as to mitigate intra-ASEAN preferential trade altogether.

It was discussed in an ASEAN Report that trade and investment polices in ASEAN have to be harmonized for the region to fully optimize the benefits of the CEPT. Notably, trade policies have already significantly lowered tariffs within ASEAN. Investment policies, on the other hand, are already granting comprehensive incentives to prospective investors. Then again, trade and investments within and among ASEAN members have remained relatively low. Observers pin down the reason for this to a seeming disconnect in the way trade and investment policies are conceived and formulated. Trade policy, they say, seems to have limited itself to liberalization, while investment incentives in ASEAN seem bent on attracting similar and competing (rather than complementary) operations in the region. Commentators aver that trade policies, apart from just focusing on the reduction of tariffs, will also have to serve as a vehicle for the promotion of complementary investment activities. Investment policies in ASEAN, on the other hand, should be envisioned within the framework of objectives for which AFTA was created, which is to promote cooperation over competition among ASEAN members. Investment in Research and Development (R&D), where ASEAN is known to be lacking, is also strongly recommended.

The recently concluded 12th ASEAN Summit put into effect a new set of agreements that would chart ASEAN's future as an economically integrated region and a collective global player. Some 11 new agreements were signed during that event, at least nine of which are related to trade and economic issues. Such agreements were aimed at liberalizing trade in goods and services between China and ASEAN, bolstering cooperation between ASEAN and China in the agricultural sector, allowing mutual recognition of the nursing profession in ASEAN, and an expedited tariff reduction and services liberalization package in the ASEAN Priority Sectors. To note, there are 12 priority sectors, namely: electronics, information and communications technology, health care, wood-based products, automotives, rubber-based products, textiles and apparels, agro-based products, fisheries, air travel, tourism, and (the most recently added one) logistics.

RTAs: Building Blocks or Stumbling Blocks? (Are Regional Trading Agreements Good or Bad?) *

Dr. Marissa Maricosa A. Paderon

Objectives

First, to describe regional trading arrangements (RTAs), or trading blocs, and the gains from their existence as well as the reasons for their failure and, second, to discuss the arguments behind the opposing propositions that they can be building blocks or they can be stumbling blocks to a more liberal global trade.

What is a Trading Bloc?

A trading bloc covers a number of possible trading arrangements. It involves common access for countries within the bloc but different access for countries outside the bloc.

Types of Trading Blocs

There are several types of trading blocs. These are preferential trading arrangement (PTA), free trade area (FTA), customs union, common market and economic union. They are characterized by their different degrees of economic integration.

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In a *preferential trading arrangement*, the member countries apply lower tariffs to import from each other than to those from non-member countries. For example, there used to be an Association of Southeast Asian Nations (ASEAN) PTA whereby members of the ASEAN granted preferential rates among each other. Assume the import duty on garlic is 40 percent in the Philippines and 30 percent in Thailand. Being both member countries of ASEAN, imports of garlic by the Philippines from Thailand is granted say a 50 percent Margin of Preference (MOP) or discount. The ASEAN PTA rate of duty on imported garlic by the Philippines is 20 percent while Thailand and Philippines apply individual duties on garlic from non-members of the ASEAN.

In a *free trade area*, the members also extend preferential treatment to each other but they completely eliminate tariffs on each other's imports, while maintaining individual protection regimes for other trading partners. Examples include the European Free Trade Association (EFTA), the Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA or CER Agreement), ASEAN Free Trade Area and the North American Free Trade Agreement (NAFTA). In the case of the ASEAN FTA, members Thailand and Philippines eliminate tariffs on traded goods like garlic but still maintain individual duties of 30 and 40 percent, respectively, on imports of garlic from the rest of the world.

A *customs union* is like an FTA, except that members of the union impose a common external tariff against trade with countries outside the union. For example, a customs union between Belgium, Netherlands and Luxembourg (Benelux) was formed in 1947. Before they were integrated, the member countries had to review line by line the tariff rates for each product of each member country. Thereafter, a common tariff rate (set equal to the lowest tariff applied to that good by any member of the bloc before the bloc was formed) is established for each product to be levied on imports from non-members. Prior to integration, the import duty on garlic is 10 percent from Belgium, 20 percent from Netherlands, and 30 percent from

Luxembourg. After the formation of the customs union, traded garlic among these members, is then levied a zero duty while a common external tariff of 10 percent is applied for non-members.

A *common market* has the same characteristics as the customs union, plus the free movement of labor and capital between members. This represents a deeper level of economic integration and, at the same time, a further reduction in national control of the individual economy. The Treaty of Rome (1957) established a common market and later became the European Community, which officially began on January 1, 1958, and which became the European Union (EU) on November 1, 1993. In the EU, some member countries signed what is called as the Schengen Agreement, which, among others, allows the visa-free movement of people. Thus, an Italian national can find a job in England or anywhere else in the EU, while a Dutch firm can establish operations in Spain or anywhere else, as if they are in the same country.

An *economic union* includes all features of a common market plus the unification of economic institutions and coordination of economic policy—monetary and fiscal policy—throughout all member countries. An example is the European Union. The harmonization of monetary policies also leads to a monetary union. In the case of EU, some members have even agreed to use a common currency, the euro.

Trade blocs pose an analytical problem: they are at once *trade liberalizing* (for those inside bloc) and *trade restricting* (for those left out).

Why Do Countries Integrate?

Trade blocs involve both trade creation and trade diversion; whether members gain overall depends on which of the two predominates. If there is trade diversion, however, countries outside the bloc will always lose.

Trade creation occurs when after formation of a trade bloc a partner country's imports displace higher cost domestic production and, through lower prices, allow greater domestic consumption of the products concerned, generating additional trade and raising real national income in the process. This means that after forming a trade bloc, the member countries are able to access cheaper goods from each other. For example, if prior to integration, country A is a price taker in the world market at $1.00 per unit and imports the same good from country B at a 50 percent tariff. Hence, the resulting domestic price of the good in country A is $1.50 (=$1.00 in country B plus the 50 percent tariff). After integration, tariffs are eliminated between the two countries, and so country A imports the same good from country B at zero duty or $1.00 per unit.

There is *trade diversion* when increased trade among the trade bloc partners occurs merely at the expense of lower cost imports from outside the bloc, without any increase in total trade or consumption, thus lowering real national income. It means that before joining the bloc, country A is actually importing cheaper goods from a cost-efficient source, country B. Suppose country B did not join the bloc, so a tariff will be levied on its goods. Country A's trade may end up being diverted from B to a less efficient bloc member, say country C.

Countries integrate to be able to reap the gains from more trade. These are gains from economies of scale, specialization, increased productive efficiency, expanded export markets and improved terms of trade.

It should be noted, however, that joining a trading bloc does not ensure that the country will be better off. A country can be *better off or worse off* from participating in a trade bloc, depending on its size, the nature of its trade and that of its trading partners, its initial (relative) protection levels, the scope for economies of scale and other factors.

Tariff reductions within a trade bloc may or may not bring larger gains to a country than could be obtained through non-discriminatory reductions. The extent to which global welfare

is enhanced (or diminished) by trade blocs depends on the circumstances of the case at hand.

A trading bloc is more likely to bring gains to participants:

1. *The higher the initial levels of protection*

   Higher protection means larger gains from displacement of high cost of domestic production when protection is removed. It also means that pre-bloc imports are lower, reducing the scope for trade diversion relative to trade creation. For example, six countries aim to form a trading bloc where four countries have initially high tariffs on their goods traded with other countries. More gains are expected by the participating countries, knowing that prospective four member countries will reduce the tariffs after the economic integration.

2. *The more intensive is trade with the other countries forming a bloc*

   With less imports from other countries, the potential for trade diversion is also smaller. Simply put, if country A is applying to be part of trade bloc, it must first check if it has trading relations with other countries of the bloc or countries forming the bloc.

3. *The more competitive are countries within the bloc compared to those outside*

   The cost of any trade diversion will be lower, because the cost of goods within the bloc is closer to world levels. This means that higher gains are expected by country A if it will join a bloc composed of member countries that are cost-effective suppliers of goods in the world market.

4. *The larger the number of partner countries*

   This increases the scope for the lowest cost suppliers of goods within the bloc. For example, the present 27-member EU having more members implies greater number of lowest cost suppliers relative to when EU

had 15 members only or the NAFTA with three members only.

5. *The larger the partners*

   Preferential access to larger foreign markets increases the scope for scale economy gains and export price increases. For instance, before the formation of Asia Pacific Economic Cooperation (APEC), a number of countries were induced to be part of the bloc since it will be composed of large partners like the US, Australia, Japan, Canada and China.

Why Economic Integration Fails

Economic integration can also fail for several reasons. There are issues about benefits being unequally distributed among members and on national countries. For example, China joined the multilateral treaty negotiations of the WTO in view of greater gains through market access of its goods with its member partners.

RTAs can be used as a bargaining threat to encourage multilateral trade liberalization. EU was motivated to agree with the WTO-Uruguay Round for fear of a trading bloc that might arise out of APEC or the Western Hemisphere.

RTAs allow the member countries to liberalize beyond what could have taken place multilaterally. With the collapse of WTO Cancun Ministerial Meetings, large countries started to look at possibilities for deeper economic integration (e.g., US-ASEAN FTA, US-RP FTA, Japan-RP FTA).

Formation of RTAs can increase efficiency of multilateral negotiations. The number of negotiating country partners are reduced when RTAs negotiate as a trading bloc, such as in the case of EU negotiations with the rest of the world.

RTAs as Stumbling Blocs

An alternative proposition is that *RTAs are stumbling blocks that hinder and undermine multilateralism*.

Bhagwati (1995) refers to the proliferation of RTAs in the second wave of regionalism as something like a 'spaghetti bowl' phenomenon because of the numerous and crisscrossing preferential agreements. Bhagwati coined the "'spaghetti bowl' to refer the entanglements resulting from limited membership-trade pacts."[1] That manipulation of the rules of origin will increase transaction costs and thus facilitate protectionism. An example is the case of EU, a single market but with preferential agreements with non-EU countries like Algeria, Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia and other African Carribean Pacific countries (ACP). Thus, in importing banana from EU partners, it applies zero duty but applies different preferential rates to non-EU countries as covered by its Mediterranean and Lome Agreements.

The negotiation process to form RTA provides possibilities for special interest politics to manipulate process. This is the case for trade-sensitive industries to lobby/influence policymakers in their decision-making. Political initiatives may be diverted to RTA process, depriving multilateral process of support it requires.

The negotiating process to form the RTA also draws on scarce resources. This implies that scarce resources like capital and labor may be reduced by the competing demand for RTAs. For instance, the numerous preferential agreements of the United States and Japan with other countries (e.g., US-Singapore FTA, US-Thailand, US-ASEAN, NAFTA; and Japan-Singapore, Japan-Philippine Economic Partnership Agreement etc.) imply greater competition to draw in the needed capital and labor to achieve the objectives of free trade area.

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[1] Ronnel Domingo, "In Asia, bowls full of pacts spoil trade," *Philippine Daily Inquirer*, August 14, 2006, 8.

Furthermore, RTAs contain provisions that go beyond the WTO such that countries with many bilateral agreements may find multilateralism unnecessary.

CONCLUSION

There is little evidence that RTAs have retarded globalization whether in terms of trade or FDI. Several examples attest to this: Mexico via the NAFTA, Central and Eastern European countries via the EU, Australia-New Zealand Closer Economic Relations Trade Agreement, ASEAN, EU, Andean Group, and MERCOSUR.

Nevertheless, RTAs are permanent, discriminatory and rule-evading. Their power influencing potential is undesirable. There is a need for the GATT-WTO to reform Article XXIV[2] to subject RTAs under the restrictions of global trading system and make them 'GATT-plus' trade policy.

Given the arguments and recent events, it is perceived that the next arena for trade liberalization may well be through the RTA process, i.e., broadening of the NAFTA, Free Trade Area of the Americas (FTAA), deepening of the EU, APEC and between regional trading blocs.

In sum, the rise of RTAs may pose a threat to global trading system if the motive is only protectionism. Article XXIV must be reformed and enforced. Otherwise, RTAs will certainly undermine the global trade liberalization.

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[2] Article XXIV of the GATT allows regional integration in so far as it does not raise barriers with the rest of the world.

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A Review of the Economic Decisions of the Supreme Court (An Excerpt)*

Atty. Cecille L. Mejia

The Supreme Court has decided a number of cases which carry with them the heavy burden of not only determining facts and the application of the law but also deciding questions that would affect future conduct in terms of economic policy formulation, a function which traditionally pertains to the province of the Legislature and the Executive.[1]

This paper traces the trend in the decisions of the Supreme Court in cases involving major economic policies of the government. The cases are divided into two categories: the first set of cases involves the constitutionality of statutes enacted by Congress and the second involves the validity of contracts entered into by the Executive. These cases describe the interaction of the Court with the two other branches of government in the exercise of its constitutional powers.

I. Constitutionality of Statutes

The Court has traditionally withheld judgment on matters falling under the discretion of the other two branches of government. Lately however, the expansion of judicial power

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* Cecille L. Mejia, A Review of the Economic Decisions of the Supreme Court (Academic Year 2006–2007) (unpublished J.D. thesis, Ateneo School of Law) (on file with author).

[1] Solomon Ricardo B. Castro and Martin Israel Pison, *The Economic Policy Determining Function of the Supreme Court in Times of National Crisis*, 67 Philippine Law Journal 354, 377 (1993) [hereinafter Castro and Pison].

under the 1987 Constitution obscured the lines between the legislative and judiciary.

A. *Ichong v. Hernandez*: The First Attempt in Economic Decision Making

The most popular legitimating economic decision of the Supreme Court in the past was the one rendered in *Ichong v. Hernandez*.[2] The case involved the constitutionality of RA No. 1180,[3] an attempt to nationalize the retail trade business. This was the response to the growing dominance of the Chinese retailers. While the Court is reluctant to interfere with the exercise of the legislative prerogative, it will exercise judicial review upon showing of a clear, patent or palpable arbitrary and unreasonable abuse of said prerogative.

The Court, in upholding the constitutionality of the said law, based its decision primarily on the sentiments of the public with regard to the position of the alien retailer vis-à-vis the Filipino retailer, the fear of alien dominance and control of the retail industry as shown by the official statistics. It concluded that the disputed law was not a product of racial hostility but rather a legitimate expression of the desire and determination of the people to free the nation from the economic situation that has unfortunately saddled upon it rightly or wrongly, to its disadvantage.

B. *Guingona v. Carague*: The Court and the Foreign Debt Dilemma

The foreign debt problem plagued the Court after the assumption of power of former President Corazon Aquino. In *Guingona v. Carague,*[4] the Court was asked to make a judgment call as to the constitutionality of the automatic appropriation for debt service in the 1990 budget. Although the Constitution provides that education would have the biggest appropriation

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[2] G.R. No. L-7995, May 31, 1957.

[3] An Act to Regulate the Retail Trade Business.

[4] G.R. No. 94571, April 22, 1991, 196 SCRA 221.

in the budget, the Court declared that Congress was not deprived of its power to respond to the imperatives of the national interest and for the attainment of other state policies or objectives. The Court thus deferred to the judgment made by Congress.

While the Constitution is clear regarding the budget appropriations, the Court upheld the validity of the statute even if it did not strictly follow the black-letter law on the ground that education had the highest appropriation in the domestic budget. Debt servicing, the Court reasoned, is not only a matter of honor and protection of credit standing but is necessary for the very survival of the economy is at stake.

Several cases followed the heels of *Carague* but this time pertaining to the contracts executed pursuant thereto. The latest of these was decided by the Court on October 13, 2005.[5]

In *Spouses Constantino v. Cuisia*, the petitioners assailed the contract entered into pursuant to the Philippine Comprehensive Financing Program for being violative of the constitutional state policies to promote a social order that will "ensure the prosperity and independence of the nation" and free "the people from poverty, foster social justice in all phases of national development," and develop a self-reliant and independent national economy effectively controlled by Filipinos."[6] In upholding the validity of the governmental act, the Court reiterated that the exercise of the power of judicial review is merely to check—not supplant—the Executive, or to simply ascertain whether he has gone beyond the constitutional limits of his jurisdiction but not to exercise the power vested in him or to determine the wisdom of his act.[7] In cases where the main purpose is to nullify governmental acts whether as unconstitutional or done with grave abuse of discretion, there

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5 *Spouses Constantino v. Cuisia*, G.R. No. 106064, October 13, 2005.

6 *Id.* citing Philippine Constitution, Art. II, § 9, 10 and 19.

7 *Id.* citing In the Matter of the Petition for Habeas Corpus of Lansang, et al., 149 Phil. 547 (1971).

is a strong presumption in favor of the validity of the assailed acts. The heavy onus is on petitioners to overcome the presumption of regularity.

Thus, the Court reiterated its stand that it is neither an academic forum nor a convention on development economics. Its resolution of the legal issue presented is limited to the appreciation of the constitutional provision that empowers the President to contract and guarantee foreign loans.[8] The Court, in taking cognizance of the petition, was aware that its determination of the issues will have a bearing on the state of the country's economy, its international financial ratings, and perhaps even the Filipinos' way of life.

C. *Garcia v. Executive Secretary*

The Court, in this case,[9] exercised its legitimating function.[10] The constitutionality of RA No. 7042[11] was challenged on the ground that it defeated the constitutional policy of developing a self-reliant and independent national economy by allowing foreign investors to invest in a domestic enterprise up to 100 percent of its capital. The Court upheld the legislation by saying:

> What we see here is a debate on the wisdom or the efficacy of the Act, but this is a matter on which we are not competent to rule. x x x The judiciary does not pass upon questions of wisdom, justice or expediency of legislation x x x It is true that, under the expanded concept of political question, we may also determine whether or not there has been grave abuse of discretion on the part of any branch or instrumentality of the Government. We find however, that that irregularity does not exist in the case at bar x x x The Court is not a political arena. His objections to the law are better heard by his

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[8] *Id.* citing PHILIPPINE CONSTITUTION, Art. VII, § 20.

[9] 204 SCRA 516 (1991).

[10] Castro and Pison, *supra* note 1, at 379.

[11] An Act to Promote Foreign Investments, Prescribe the Procedures for Registering Enterprises Doing Business in the Philippines, and for Other Purposes.

> colleagues in the Congress of the Philippines who have the power to rewrite it, if they so please, in the fashion he suggests.[12]

D. *Tatad v. DOE*[13] and *Garcia v. Corona*[14]: The Oil Deregulation Cases

In these cases, the Court was asked to pass upon the validity of the deregulation of the Downstream Oil Industry. In declaring the law unconstitutional in the first oil deregulation case [*Tatad v. DOE*, G.R. No. 124360, November 5, 1997], the Court took cognizance of the spirit and intent behind the Constitutional provision as found in Article XII, Section 19 of the Constitution. The Court went on to discuss the technicalities of tariff differentials and how the same constitute as barriers to a "fair" competition. The Court recognized the implication of its decision when it stated:

> With this Decision, some circles will chide the Court for interfering with an economic decision of Congress. Such criticism is charmless for the Court is annulling RA No. 8180 not because it disagrees with deregulation as an economic policy but because, as cobbled by Congress in its present form, the law violates the Constitution. The right call therefore should be for Congress to write a new oil deregulation law that conforms with the Constitution and not for this Court to shirk its duty of striking down a law that offends the Constitution. Striking down RA No. 8180 may cost losses in quantifiable terms to the oil oligopolists. But the loss in tolerating the tampering of our Constitution is not quantifiable in pesos and centavos. More worthy of protection than the supra-normal profits of private corporations is the sanctity of the fundamental principles of the Constitution. Indeed when confronted by a law violating the Constitution, the Court has no option but to strike it down dead. Lest it is missed, the Constitution is a covenant that grants and guarantees *both*

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[12] 204 SCRA 515, 523–524 (1991).

[13] *Tatad v. DOE*, G.R. No. 124360, November 5, 1997.

[14] *Garcia v. Corona*, G.R. No. 132451, December 17, 1999.

> the political and *economic rights of the people*. The Constitution mandates this Court to be the guardian not only of the people's political rights but their economic rights as well. The protection of the economic rights of the poor and the powerless is of greater importance to them for they are concerned more with the esoterics of living and less with the esoterics of liberty. Hence, for as long as the Constitution reigns supreme so long will this Court be vigilant in upholding the economic rights of our people especially from the onslaught of the powerful. Our defense of the people's economic rights may appear heartless because it cannot be half-hearted.

The dissent of Justice Melo, however, reflected the sentiments of the Court's critics when he said that the issues raised were within the ambit of political questions and hence, not justiciable. This case, according to the dissent, concerned the wisdom of the law.

In the second oil deregulation case [*Garcia v. Corona*, G.R. No. 132451, December 17, 1999], the Court said that it is not concerned with whether or not there should be deregulation. Rather, the question that should be addressed is whether the method and the manner chosen by Government to accomplish its cherished goal is offensive to the Constitution. The Court went on to say further:

> While the Court respects the firm resolve displayed by Congress and the President, all departments of Government are equally bound by the sovereign will expressed in the commands of the Constitution. There is a need for utmost care if this Court is to faithfully discharge its duties as arbitral guardian of the Constitution. We cannot encroach on the policy functions of the two other great departments of Government. But neither can we ignore any overstepping of constitutional limitations. Locating the correct balance between legality and policy, constitutional boundaries and freedom of action, and validity and expedition is this Court's dilemma as it resolves the legitimacy of a Government program aimed at giving every Filipino a more secure, fulfilling and abundant life.

The Court reiterated that RA No. 8180 was declared invalid not because deregulation was unconstitutional. The law was

struck down because three key provisions plainly encouraged the continued existence, if not the proliferation, of the constitutionally proscribed evils of monopoly and restraint of trade.

E. *La Bugal-B'laan Association v. Ramos*

What is most striking in this case[15] is the comment made by the Court regarding the role of the judiciary under Article XII of the Constitution. The Constitution officially mandated the Chief Executive to enter into agreements with foreign-owned corporations for the exploration, development, and utilization of natural resources. The Congress reviews the action of the president once it is notified of every contract entered into in accordance with the constitutional provision. However, despite the silence of the Constitution as to the role of the judiciary, the Court may still exercise judicial scrutiny by virtue of their residual duty under Article VIII.[16] The Court further stated that "the Constitution should be read in broad, life-giving strokes. It should not be used to strangulate economic growth or to serve narrow, parochial interests."[17] Rather, it should be construed to grant the President and Congress sufficient discretion and reasonable leeway to enable them to attract foreign investments and expertise.[18]

> When an act of the legislative department is seriously alleged to have infringed the Constitution, settling the controversy becomes the duty of this Court. By the mere enactment of the questioned law or the approval of the challenged action, the dispute is said to have ripened into a judicial controversy even without any other overt act.[19]

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15 G.R. No. 127882, December 1, 2004.

16 *Id*., 445 SCRA 1, 79.

17 *Id*.

18 *Id.*

19 336 SCRA 201, 223, July 19, 2000.

The Court, through Chief Justice Panganiban declared,"[l]et the development of the mining industry be the responsibility of the political branches of government. And let not this Court interfere inordinately and unnecessarily.[20] The Court upheld the constitutionality of RA No. 7942.[21]

F. *ABAKADA Guro Partylist v. The Honorable Executive Secretary Ermita*

This case involves the constitutionality of several provisions of Republic Act No. 9337 which amend Sections 106–108 of the National Internal Revenue Code.[22] These concern the value-added tax on the sale of goods or properties, the importation of goods, and the sale of services and use or lease of properties. At the outset, the Court declared that it cannot go into the wisdom behind the enactment. It recognized the chilling situation presented by the country's gloomy state of economic affairs. In this case, the tax measure is considered an enema, a first-aid measure to resuscitate an economy in distress. The Court stated that it is neither blind nor is it turning a deaf ear on the plight of the masses. But it does not have the panacea for the malady that the law seeks to remedy. As in other cases, the Court did not strike down a law as unconstitutional simply because of its yokes. The Court echoed its sentiments in *Vera v. Avelino*,[23] where it stated:

> Let us not be overly influenced by the plea that for every wrong there is a remedy, and that the judiciary should stand ready to afford relief. There are undoubtedly many wrongs the judicature may not correct, for instance, those involving political questions. x x x
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> Let us likewise disabuse our minds from the notion that the judiciary is the repository of remedies for all political or social

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[20] 445 SCRA, 1, 237.

[21] The Philippine Mining Act of 1995.

[22] G.R. No. 168056, September 1, 2005.

[23] G.R. No. L-543, August 31, 1946, 77 PHIL. 365.

> ills; We should not forget that the Constitution has judiciously allocated the powers of government to three distinct and separate compartments; and that judicial interpretation has tended to the preservation of the independence of the three, and a zealous regard of the prerogatives of each, knowing full well that one is not the guardian of the others and that, for official wrongdoing, each may be brought to account, either by impeachment, trial or by the ballot box.

II. Validity of Contracts

The Executive derives its powers from the constitution and statutes. It must therefore act within this framework. If it exceeds the authority given it, or if it exercises that authority unlawfully, the judiciary must exercise the power of review conferred by the constitution. The judiciary should use this power to determine the consequences of the executive's actions.[24]

A. *Garcia v. Board of Investments*

This case has been considered as an illustration of the flagrant judicial intrusion into economic policymaking.[25] The shift from its passive stance to a more interventionist one can be deduced from the reasoning used by the Court. The Court blatantly disregarded its earlier policy of deferring judgment to the department with the proper expertise. In specifying the main reasons why the Court decided against the transfer, the Court made considerations of the technical aspects of petrochemical production. It formulated policy judgments using technical management tools which could have been better made by the BOI and the investors. The mundane effect of the decision was to reject the investors' study on the viability of their business venture evaluated by all the parties involved and to forcibly

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[24] Aharon Barak, *Foreword: A Judge on Judging: The Role of Supreme Court in a Democracy*, 116 Harv. L. Rev. 16, 138–139 (2002).

[25] Castro and Pison, *supra* note 1, at 390.

substitute the Court's business decision on the matter.[26] "The Court arrogated upon itself the power to decide on the wisdom behind the transfer when it decided on the 'clear advantages manifest in the plant's remaining in Bataan.' This is obviously policy formulation which the Court had no authority or competence to make."[27] Justice Griño-Aquino, in her dissent, had eloquently stated:

> Only the BOI or the Chief Executive is competent to answer that question, for the matter of choosing an appropriate site for the investor's project is a political and economic decision which, under our system of separation of powers, only the executive branch, as implementor of policy formulated by the legislature (in this case, the policy of encouraging and inviting foreign investments into our country), is empowered to make.[28]

Justice Melencio Herrera expressed concern about the actuation of the Court:

> It has made a sweeping policy determination and has unwittingly transformed itself into what might be termed a "government by the Judiciary," something never intended by the framers of the Constitution when they provided for separation of powers among the three co-equal branches of government and excluded the Judiciary from policy-making.[29]

This case opened the gate for other economic legislation by the Supreme Court.

B. *Manila Prince Hotel v. GSIS*

The Court came under fire when it decided the case of *Manila Prince Hotel v. GSIS*.[30] In this case, the GSIS decided to sell 51

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[26] *Id.* at 390–392.

[27] *Id*. at 393.

[28] *Garcia v. Board of Investments*, 177 SCRA 374, 299.

[29] *Id.* at 302.

[30] G.R. No. 122156, February 3, 1997.

percent of the shares of the Manila Hotel Corporation pursuant to the privatization program of the government. A Malaysian firm offered to pay more than its domestic competitor. When the domestic corporation offered to match the bid of the Malaysian firm, the same was rejected by the GSIS. It then filed a case to stop the award in favor of the Malaysian firm on the ground that the Manila Hotel was part of the national patrimony. The Court was thus asked to make a factual determination of whether Manila Hotel forms part of national patrimony for it to come under the ambit of Article XII, Section 2. The Court first made a discussion on the meaning of Article XII, Section 10:

> The *Filipino First Policy* is a product of Philippine nationalism. It is embodied in the 1987 Constitution not merely to be used as a guideline for future legislation but primarily to be enforced; so must it be enforced. This Court as the ultimate guardian of the Constitution will never shun, under any reasonable circumstance, the duty of upholding the majesty of the Constitution which it is tasked to defend. It is worth emphasizing that it is not the intention of this Court to impede and diminish, much less undermine, the influx of foreign investments. Far from it, the Court encourages and welcomes more business opportunities but avowedly sanctions the preference for Filipinos whenever such preference is ordained by the Constitution.

The Court expressed its reluctance to step into the fray of two fiercely competitive bidders but found itself compelled to do so.

> x x x [w]hile it is no business of the Court to intervene in contracts of the kind referred to or set itself up as the judge of whether they are viable or attainable, it is its bounden duty to make sure that they do not violate the Constitution or the laws, or are not adopted or implemented with grave abuse of discretion amounting to lack or excess of jurisdiction. x x x Indeed, the Court will always defer to the Constitution in the proper governance of a free society; after all, there is nothing so sacrosanct in any economic policy as to draw itself beyond judicial review when the Constitution is involved. Under the doctrine of constitutional supremacy x x x *since the Constitution*

> *is the fundamental, paramount and supreme law of the nation, it is deemed written in every statute and contract*.[31]

The Court went on to explain:

> x x x [i]n case of doubt, the Constitution should be considered self-executing rather than non-self-executing x x x. Unless the contrary is clearly intended, the provisions of the Constitution should be considered self-executing, as a contrary rule would give the legislature discretion to determine when, or whether, they shall be effective.
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> x x x x
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> Quite apparently, Sec. 10, second par., of Art XII is couched in such a way as not to make it appear that it is non-self-executing but simply for purposes of style. But, certainly, the legislature is not precluded from enacting other further laws to enforce the constitutional provision so long as the contemplated statute squares with the Constitution.
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> x x x x
>
> The omission from a constitution of any express provision for a remedy for enforcing a right or liability is not necessarily an indication that it was not intended to be self-executing. The rule is that a self-executing provision of the constitution does not necessarily exhaust legislative power on the subject, but any legislation must be in harmony with the constitution, further the exercise of constitutional right and make it more available. (citation omitted)
>
> Respondents also argue that the non-self-executing nature of Sec. 10, second par., of Art. XII is implied from the tenor of the first and third paragraphs of the same section which undoubtedly are not self-executing. The argument is flawed. If the first and third paragraphs are not self-executing because Congress is still to enact measures to encourage the formation and operation of enterprises fully owned by Filipinos, as in the first paragraph, and the State still needs legislation to regulate and exercise authority over foreign investments within its national jurisdiction, as in the third paragraph, then a *fortiori*, by the same logic, the second paragraph can only be

[31] Quoting CJ Narvasa, (emphasis supplied).

> self-executing as it does not by its language require any legislation in order to give preference to qualified Filipinos in the grant of rights, privileges and concessions covering the national economy and patrimony. A constitutional provision may be self-executing in one part and non-self-executing in another. (citation omitted)
>
> x x x x
>
> x x x [S]ec. 10, second par., Art. XII of the of the 1987 Constitution is a mandatory, positive command which is complete in itself and which needs no further guidelines or implementing laws or rules for its enforcement. From its very words the provision does not require any legislation to put it in operation. It is *per se* judicially enforceable.
>
> x x x x
>
> Where there is a right there is a remedy.

The Supreme Court found itself in the eye of the storm with this decision.[32] Among the criticisms against the decision were the entitlements arising from the Constitutions' Declaration of State Policies and principles. The Court made a factual determination although it was not designed to undertake factual inquiries. Time and again, the Court has reiterated that it was not a trier of facts, however, it takes exception in this case. But many observers believed that the case did not warrant the Court's application of the exception to this rule.

The comment of *amicus curiae*, Fr. Joaquin Bernas, embodied the reaction towards the same: "From what has been said it can be concluded that what the petitioners are asking the Court to do is to make a judgment reserved for economic managers and policy makers of the State. But the conduct of business decisions is not part of judicial power."[33]

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[32] *See* Sereno, Maria Lourdes A. *The Power of Judicial Review and Economic Policies: Achieving Constitutional Objectives.* PHILJA-AGILE-USAID PROJECT ON LAW AND ECONOMICS at 18 (2001).

[33] *Comments of Amicus Curiae Joaquin Bernas, SJ*, 1 COURT SYSTEM JOURNAL 134, 149 (1996).

C. *Chavez v. PEA*

The case was considered as one of first impression.[34] It involves the validity of the Joint Venture Agreement (JVA) entered by the Executive through the Philippine Estate Authority (PEA) with AMARI, a private corporation, which seeks to transfer reclaimed, and still to be reclaimed, lands to the latter. The transfer is alleged to be violative of the constitutional ban on the alienation of lands of public domain to private corporations. The President had already given the amended JVA a stamp of approval when the petition was filed. The Court held that the signing of the JVA and the approval of the President did not divest the Court of its jurisdiction. Presidential approval does not resolve the constitutional issue or remove it from the ambit of judicial review. This is because the JVA still has to be implemented and the Court stated that if the Amended JVA indeed violates the Constitution, it is the duty of the Court to enjoin its implementation, and if already implemented, to annul the effects of such unconstitutional contract.

The Court recognizes that the amended JVA is not just an ordinary commercial contract because it seeks to transfer title and ownership to 367.5 hectares of reclaimed lands and submerged areas of Manila Bay to a single private corporation. It becomes more compelling for the Court to resolve the issue to insure the government itself does not violate a provision of the Constitution intended to safeguard the national patrimony. In striking down the agreement as void *ab initio*, the Court based its decision on the constitutional prohibition on the sale of lands of public domain to private corporations.

D. *Agan v. PIATCO*

The Court, in *Agan v. PIATCO*,[35] was once again faced with an issue made difficult by intersecting legal and economic implications. The Court stated that it was aware of the far-reaching fallout effects of its decision. However, it proceeded

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34 G.R. No. 133250, July 9, 2002.

35 G.R. No. 155001, January 21, 2004.

to nullify the contract entered into by the Executive through the Department of Transportation and Communication. The Court declared that it has never shirked from its solemn duty to dispense justice and resolve actual controversies involving rights which are legally demandable and enforceable, and to determine whether or not there has been grave abuse of discretion amounting to lack or excess of jurisdiction when the exigencies of the times demand it.

The case involved the validity of the 1997 Concession Agreement and its supplements regarding the development and operation of the Ninoy Aquino International Airport International Passenger Terminal III (NAIA IPT III). The government granted to PIATCO the franchise to operate and maintain the terminal during the concession period despite allegation by the other bidder of irregularities in pre-qualifying the PAIRCARGO, the predecessor of the former, as bidder.

The Court recognizes that the controversy gives rise to significant legal questions and matters of transcendental importance considering that it involves the construction and operation of the country's premier international airport. The crucial issues submitted were of first impression and entailed the proper interpretation of key provisions of the Constitution, the BOT law and its Implementing Rules and Regulations.

In holding that the 1997 Concession Agreements and its supplements void, the Court took note of public policy considerations. In the first place, PAIRCARGO was not a qualified bidder. Thus, the award of the contract in its favor is considered as null and void. The Court stated that the first determination was sufficient to resolve the case. However, it proceeded with its determination of the other issues involved. The allowance of the amendment to the contract so as to include provisions not contained in the original contract bidded upon constitute grave abuse of discretion amounting to lack or excess of jurisdiction which warrants proper judicial action. Furthermore, the provision regarding direct government guarantee and compensation for temporary takeover by the government violates the BOT law and the Article XII, Section 17 of the Constitution, respectively.

E. *Southern Cross Cement Corporation v. The Secretary of DTI*

This case concerns the imposition of general safeguard measures by the Department of Trade and Industry (DTI) Secretary despite the negative report of the Tariff Commission.[36] The DTI, relying on the decision of the Court of Appeals, declared that the finding of the Tariff Commission was not binding upon it. Petitioner Southern Cross asked the Court to review the acts of the DTI Secretary.

The Court ruled that the acts of the DTI Secretary constitute grave abuse of discretion on the ground that the law which allows him to impose safeguard measures is subject to limitations. Although the President may impose tariffs and similar measures, this power is not inherent and subject to limitations prescribed by the Constitution. First, this authority must be delegated by Congress. Second, it is subject to the limitations imposed by law. When the DTI proceeded to impose safeguard measures, it exceeded the authority granted to it by Congress and by law thus committing grave abuse of discretion. It erred when it relied on the decision of the appellate court considering that the latter did not have jurisdiction filed by private respondent in the first place. The Court used the wordings of the Constitution and the RA No. 8800[37] in the interpretation of the pertinent provisions.

This section surveyed the decisions of the Supreme Court involving economic issues. The cases were divided into two categories: the first one involves policy formulation, the validity of which is challenged on constitutional grounds; and the second one involves the legality of the execution of said policies, assailed on the ground of grave abuse of discretion on the part of the executive. Thus, it may be stated that the Court exercised its legitimating function in the first set of cases while in the latter set, its checking function.

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[36] G.R. No. 158540, August 3, 2005.

[37] The Safeguard Measures Act.

The cases reviewed show the evolution of the Court's participation in economic policies—from deference to the political departments to activism after the enactment of the 1987 Constitution. The most recent cases, however, show the Court reverting to its earlier stance: that of restraint. However, this is not sufficient assurance that the Court will no longer intervene in economic matters, taking into account the differing views within the Court itself.

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*The Color of Money**

Dr. Luis F. Dumlao

Introduction[1]

According to Milton Friedman, "MONEY is whatever is generally accepted in exchange for goods and services—accepted not as an object to be consumed but as an object that represents a temporary abode of purchasing power to be used for buying still other goods and services." Its main uses are:

1. *Medium of exchange*. Without money, agents have to trade by barter. Suppose that Juan's only disposable wealth is his pair of jeans and he wants to buy a cellular phone. Then he needs to find someone who is willing and able to sell a cellular phone and at the same time willing and able to accept his pair of jeans as payment. Consider that Juan prefers a certain brand and kind of cellular phone and others prefer a certain kind and size of jeans. Barter is difficult. With money, Juan can sell his pair of jeans to someone who does not necessarily sell cellular phones. He can go to someone else selling cellular phones and that someone is not necessarily looking for a pair of jeans. Other commodities can be used as medium of exchange, like gold. For example, Juan can sell his jeans for gold and use the gold to purchase a cellular phone. At least money especially in the form of paper is not as heavy. It is more convenient especially if one buys goods that are rather expensive. At the same time, using money rather than commodities

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[1] Reference readings: G13.

allow the economy to use the latter for more productive purposes.

2. *Store of value*. If Pedro is a fisherman and there is no such thing as money, he needs to buy quick or his fish rots and loses value. With money, he can sell his fish and keep the money until he finds something he wants to purchase. Alternatively, he can barter his two-year catch for a car, not use the car and store it. But a car is not as liquid and easy to dispose of as money.

3. *Unit of account*. Apples, oranges, and legal services cannot be measured together without assigning them a single unit of valuation. With money, their values can be added, hence monetary value.

Macroeconomics of Money[2]

Over 150 years ago, most financial institutions print money and give them intrinsic values by backing it with gold. For example, Bank X keeps 10 ounces of gold, prints 10 pieces of paper, and each piece says that: "Bank X promises that each piece of paper is redeemable for 1 ounce of gold." To that extent, agents become willing to use these pieces of paper as medium of exchange, store of value and unit of account. However, most economies these days use a central bank to print money and give them intrinsic values by making them legal tender and backing them with "reputation."

If there is such a thing as goods markets like fish and beef, there is also such a thing as a money market. In typical supply and demand analysis, the price of the good like fish is its monetary value and quantity is the kilo of fishes supplied and demanded. In a money market, the price of money is the INTEREST RATE, the cost of borrowing money and the reward for lending money. The quantity is the number units of currency in circulation. For instance, the central bank circulates pieces of paper whose printed values amount to P10 billion. If money

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[2] Reference readings: G13, D11, D15, D16, D18, M18.

circulation increases, the supply of money or MONEY SUPPLY increases. And just like typical markets, increasing supply makes it more abundant and cheaper. Thus increasing money supply decreases interest rate.

When firms invest by expanding or entering new markets, they buy capital and hire labor. If the money they spend is theirs, they lose the opportunity of lending money and forego the interest earning. If the money they will spend is to be borrowed, they will have to pay interest. Thus, the cost of investing is the interest rate. If interest increases, the cost of investing increases and firms tend to invest less. Because increasing money supply decreases interest and decreasing interest increases investment, increasing money supply eventually increases investment.

When investment increases, expenditure in the economy increases. The above hints that expenditure goes to buying capital and/or hiring laborers. Ultimately, households own capital. So in buying capital and or hiring laborers, national income increases. Because increasing money supply increases investment, increasing money supply eventually increases national income and generates economic growth.

However, increasing money supply also has costs. First, increasing money supply decreases the value of each unit of currency. Consider the following metaphor. Suppose that there are 10 ounces of gold and nothing else in the economy. If the central bank circulates ten P100 bills, money supply is P1 thousand and each ounce of gold is equivalent to P100. If the central bank circulates twenty P100 bills, money supply is P2 thousand and each ounce of gold is equivalent to P200. Hence, increasing money supply inflates the monetary value of goods and service in the economy.

Increasing money supply also decreases or depreciates the value of the national currency. The explanation has to do with the LAW OF ONE PRICE. According to the theory, the value of any good across the world is the same. For example, suppose that the price of a basketball is P500 in the Philippines and that

an identical ball is priced $10 in the US. Because these same basketballs serve the same purpose for agents in the Philippines and the US, both economies value them identically. The same ball worth P500 coming from the Philippines has the same value as the identical ball worth $10 coming from the US. Hence, P500 is worth the same as $10, so that the exchange rate is P50/$. To the extent that increasing money supply inflates the price of basketball to P550, P550 becomes worth $10, so that the exchange rate depreciates to P55/$.

Sometimes, governments use money supply to cause inflation and use inflation as a form of tax. This is called SEIGNORAGE. For example, suppose that there are 10 ounces of gold in the economy and nothing else. If the money supply is P20, then each ounce of gold is worth P2. If the private sector holds all P20, its wealth is the same as 10 ounces of gold. Suppose that the central bank prints P5 more and gives this to government to spend. The money supply is now P25 and each ounce of gold is P2.50. Effectively, the government wealth of P5 is worth 2 ounces and the private sector wealth of P20 is now worth 8 ounces. To the extent that government wealth increases by 2 ounces and private sector wealth decreases by 2 ounces, government taxes the private sector without collecting money but by inflation.

Governments use seignorage for many reasons. First, it is simple; just print money and spend. Second, it may be politically easier. Print the money and raise revenue, and this is without having taxpayers take money directly from their pockets. So in a way, it creates a perception that economic conditions not the ruling administration per se are causing the decrease in their real wealth. Third, the inflation tax makes up for the government's inability to raise revenue via traditional taxation. If government cannot directly tax corporations because of legal loopholes and incompetence, it can just print money as source of revenue. Fourth, governments may just print to quickly pay their debt. And fifth, it is a way to tax the informal sector of the economy and those who deal with illegal activities. These days

in the era of neoclassical dominance, governments rarely use seignorage precisely to avoid inflation.

The NEOCLASSICAL school believes that the priority of central banks is to target inflation. It has been noted above that increasing money supply results in economic growth, and this usually reduces unemployment. But economic growth also increases expenditure that pressures prices to increase and induces inflation. With inflation, workers eventually ask for higher wages and firms eventually give in. So once wages increase, firms lay off workers and this increases unemployment back to the level before the central bank increased the money supply. In the eventual long run, monetary policy cannot affect unemployment but only affects inflation. Thus, neoclassical economists prescribe inflation targeting as the main goal of central banks.

The KEYNESIAN school believes that the priority of central banks is to target employment. Keynesian economists do not deny that increasing money supply eventually increases inflation. They just believe that the "eventual" inflation takes time to the extent that improving unemployment becomes worthwhile from one moment to another. And even if inflation increases, the increase tends to be modest because of some market imperfections.[3] Thus, the tradeoff between improving unemployment and worsening inflation becomes acceptable.

Among international institutions, the International Monetary Fund (IMF) tends to favor neoclassical prescriptions the most. This is understandable. Neoclassical school targets inflation, inflation affects finance most, and IMF's mandate is to ensure international financial stability. The World Bank tends to favor neoclassical prescriptions to a less extent because of

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[3] Some explain this through market rigidity, coordination problem (nobody wants to be the first to increase price so that the general price level does not increase), less than full use of capacity (reducing unemployment from 12 percent to 5 percent when 5 percent is still too high unemployment does not induce inflation), etc.

its mandate to reconstruct and develop economies. It thinks that inflation is an important variable to induce economic development. But super stable price levels with 20 percent unemployment does not induce development either. The United Nations Development Program (UNDP) tends to favor Keynesian prescriptions. They prefer an economy that grows 5 percent and with low unemployment of say 5 percent even with 10–20 percent inflation over an economy that does not grow and with high unemployment of say 20 percent even with only 5 percent inflation.

International Finance and Money[4]

BALANCE OF PAYMENTS or BOP is "a summary of all economic transactions between a country and all other countries for a specific time"[5] and it is usually expressed in US Dollars. The BOP has three main parts. The first is CURRENT ACCOUNT. In the interest of simplicity, we express current account as export less import, or trade balance. The second is CAPITAL ACCOUNT and it is mainly composed of foreign investment less investment outflow. The third is ACCOMMODATING TRANSACTION or the part that balances the account.

For example, suppose that the country receives $11 billion export revenue and pays $8 billion import cost, so that the difference is $3 billion current account surplus. Suppose that $4 billion of foreign investment came and $5 billion of investment went out so that the difference is "negative $1 billion" or a $1 billion capital account deficit. The sum of current account surplus of $3 billion and capital account deficit of $1 billion is $2 billion "BOP surplus." To balance the surplus, an accommodating transaction of "negative $2 billion" is entered, thus "balance" of payment.

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4 Reference readings: D12, D17, M15.

5 Gwartney, et al. (2006), page 403.

On paper, the BOP balances because in principle it should balance. In reality, if the country receives excess of $2 billion, it does not keep them in vault as if they are idle. Instead, the central bank opens an overseas dollar account usually in New York. To the extent that $2 billion went out, the accommodating transaction is indeed an outflow and therefore "negative". Still, it increases the asset of the nation in the sense that it has a capital asset abroad. And if a country experiences a "BOP surplus" year after year, it increases its stock of capital assets abroad. This explains the accumulation of financial assets abroad of countries like Japan and China.

In the 1980s debt crisis, many countries including the Philippines had an opposite experience. Suppose that the country receives $8 billion export revenue and pays $11 billion import cost, so that the difference is "negative $3 billion" or a $3 billion current account deficit. Suppose that $5 billion of foreign investment came and $4 billion of investment went out so that the difference is $1 billion capital account surplus. The sum of current account deficit $3 billion and capital account surplus of $1 billion is $2 billion BOP deficit. To balance the deficit, an accommodating transaction of $2 billion is entered, thus "balance" on paper.

In reality, the country spends an excess of $2 billion and it funds this excess two ways. The first is by using US dollar reserves from an account abroad, say in New York, and second is by borrowing from international institutions like Citibank. To the extent that $2 billion came in, the accommodating transaction is an inflow. Still, it either decreases its asset account from abroad or increases liability through debt. And since many countries like the Philippines experienced BOP deficits year after year, much of these assets were depleted and the stock of debt accumulated to unsustainable levels. This led to the debt crisis of the 1980s.

The initial reaction of the Philippines prior to 1986 was to declare a debt moratorium. However, debt moratorium is outright admission of government of its inability to pay, and sending negative news to the investing public triggers capital

flight, worsens capital account, and worsens the "BOP deficit." Creditors obviously reject the idea of forgiving the Philippines even if the moratorium is temporary. Mainstream economists also reject the idea of forgiving the Philippines of its debt because it is unfair for countries that successfully balance their finance. Why should the Philippines be absolved for failing to balance its finance year after year when countries like Japan work so hard to balance their finance? In addition, it does not guarantee that the Philippines will do anything differently to avoid the same crisis in the future. Debt forgiving probably even sends the wrong message to other countries that they can get away with lack of effort to balance finance.

One solution more acceptable to creditors was to continue payment and devalue the peso. The continuance of payment sends a message that the government's financial position is sustainable and this at the very least does not trigger capital flight and does not worsen the capital account and the BOP deficit. The devaluation cheapens the dollar value of domestic goods and services and increases the peso value of imported goods and services. As a result, export increases and import decreases so that the current account improves.

The problem with devaluation is that it increases inflation. For instance, a devaluation from P10/$ to P15/$ increases the peso price of a $1 imported oil from P10 to P15, and this increases the price of so many other commodities in the market. Devaluation also increases the peso debt of a country. For instance, the same devaluation increases the peso debt of say $20 billion from P200 billion to P300 billion. Worse, it triggers a vicious cycle as:

1. Debt increases;
2. Government debt servicing increases;
3. Government budget on infrastructure, competitive buildup and development decreases;
4. Economy does not grow;

5. Lack of infrastructure, competitiveness and development discourages investment which dampens the capital account;
6. Lack of infrastructure, competitiveness and development dampens export which dampens current account;
7. BOP remains negative, or at best remains dampened;
8. Not enough taxes can be collected so that government has to borrow;
9. Go back to number 1.

The final solution in the 1980s was to continue payment, adopt the flexible exchange rate and liberalize finance. The continuance of payment at least does not worsen the capital account position. Financial liberalization cheapens the cost to invest in the Philippines. It makes investment flow more fluid. And because one can take money out as easily as one can put money in, it creates security in the sense that capital will not be held hostage. Finally, flexible exchange rate or market-determined exchange rate creates an automatic adjustment of balancing the BOP. For example, a BOP deficit means that the country spends more dollars than it receives. In others, it demands more dollars than it can supply, thus excess demand. The excess demand automatically depreciates the value of peso per dollar. The depreciation cheapens the dollar value of exports and increases the peso value of imports. This improves the current account to the point where BOP automatically balances.

Adoption of flexible exchange has its disadvantages. It is market-determined so that it fluctuates daily to market supply and demand that make the exchange rate less predictable. To the extent that uncertainty discourages trade, it reduces economic activity. Also, much of demand for dollar (and other foreign currency) is not meant to buy imported goods and services for consumption or investment. Much of demand is meant to speculate that the value of dollar will increase (or the value of peso will decrease). The same goes with supply. In

other words, a market-determined exchange rate is many times determined by speculation, not fundamentals. For these disadvantages, many countries do not fully adopt flexible exchange rate but interfere in the market so that their exchange rates become managed flexible exchange rates. In the early 1990s to the first half of 1997, the Philippines adopted managed flexible exchange rate when exchange rate fluctuated within P25/$ to P26/$.[6]

Liberalization of finance also has its disadvantages. Here, the heterodox criticism is discussed. Suppose that the country receives $8 billion export revenue and pays $11 billion import cost, so that the difference is "negative $3 billion" or a $3 billion current account deficit. Suppose that $22 billion of foreign investment came and $19 billion of investment went out so that the difference is $3 billion capital account surplus. The sum of current account deficit of $3 billion and capital account surplus of $3 billion zeroes so that BOP balances. Note that under flexible exchange rates, the exchange rate automatically adjusts to balance the BOP.

Also, note that the volume of capital account activity is so much greater than previous examples and greater than the current account flow to emphasize the extent that financial liberalization increases financial flow. Particularly, the volume of current account activity is the sum of export $8 billion and import $11 billion or $21 billion, and the volume of capital account is the sum of investment coming in of $22 billion and capital outflow of $19 billion or $41 billion. Suppose that speculative and herd behavior hit the country. For example, foreign investment suddenly stops coming and $19 billion goes out of the country. This means that the capital account surplus of $3 billion suddenly reverses to "negative $19 billion" or a $19 billion capital account deficit. Because the change is too quick and the current account is not given enough time to offset the outflow, the balanced BOP suddenly becomes a big deficit. And

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6 Whether the Philippines had managed exchange rate due to the mentioned disadvantage is another issue of discussion.

because the financial flow is so voluminous, the current account is not able to offset the outflow even if it is able to adjust quickly.

This means that most if not all adjustments will have to come from the foreign exchange rate in the form of sudden and major depreciation. All other complications follow. First, the central bank at one time interfered to make the change less sudden by using its dollar reserve. But because the flow was too voluminous, the interference depleted much of reserve. Second, the sudden depreciation suddenly increased inflation. High inflation was bad in itself but the suddenness made it all the worse. Second, the drastic depreciation of the peso drastically increased the peso debt of government and private investors alike. And fourth, the drastic changes that took place and the loss of profit due to sudden increases in debt dragged economic activity resulting in recession.

As to how countries hit by the crisis reacted, most like the Philippines borrowed from the IMF for financial resources to rebuild foreign currency reserve and to spend to ignite economic activity. Malaysia implemented the opposite by not relying on international institutions and then reversing financial liberalization via capital flight control. At present, East Asian economies have recovered and Malaysia continues to impose capital flight control. Thus far, its imposition has no strong negative effect. It even performed better than Thailand, the Philippines, and Indonesia.

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Topics covered:

I. Introduction: G13

II. Macroeconomics and money: G13, D11, D15, D16, D18, M18

III. International finance and money: D12, D17, M15

*The International Monetary Fund Articles of Agreement and the Current Framework for Sovereign Debt Renegotiations: "An Expanding Role for Standby Arrangements in National Economic Policy Making in Developing Country Debtors"**

Prof. Sedfrey M. Candelaria

I. Introduction

The rise of the United Nations and its specialized agencies as fora for cooperation in various aspects of international relations had the positive effect of introducing new methods of creating rules of customary law and general principles of law. In the case of specialized agencies, scientific and technical progress requiring new approaches necessitated the generation of "new rules of lawmaking which often tend to deviate from traditional treaty processes (whenever unsuitable in modern conditions) and from some of the tenets of jurisprudential orthodoxy."[1] These specialized agencies have facilitated the adoption of law-making treaties, conventions and treaty-like texts and in some

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[1] C.H. Alexandrowicz, *The Law-Making Functions of the Specialized Agencies of the United Nations* 1 (Sydney: Angus and Robertson, in assoc. with the Australian Institute of International Affairs, 1973).

of the agencies' constitutions the power to unilaterally generate technical rules or standards have been fully entrusted upon these organizations.[2]

One of the most influential specialized agencies in the area of international economic relations which now performs an important role in resolving the international debt crisis is the International Monetary Fund. The practices of this specialized agency in the monetary field have become an important process of either lawmaking by custom or by the generation of general principles of law.[3] One writer remarked that frequent interpretation and modification of the IMF treaty regime is necessary on account of the constant adjustment that the IMF had to undertake to adapt to changing conditions of the world financial equilibrium.[4] Its practice of conditional balance of payments financing in the form of standby or extended arrangements (SBA), for instance, has given rise to a set of norms which has been extensively relied upon in most modern sovereign debt renegotiations. The dependence of international lenders, whether official or private, upon the surveillance authority of the IMF over its heavily indebted developing members has been expressed in a complex system of documenting new international loan and restructuring or rescheduling agreements linked either formally or informally to the IMF-SBA. This paper aims to discuss this "new" role that the IMF-SBA has assumed in the current renegotiation process.

II. Bretton Woods System and the Development of New International Economic Rules

The "beggar thy neighbor" policy which promoted extreme economic nationalism among the industrialized nations and triggered the "trade wars" before the Second World War became

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[2] *Id*. at 3–4.

[3] *Id.* at 5.

[4] *Id.*

a grim reminder of the harshness of an international economic environment which paid lip service to customary international rules of commerce which either existed or were evolving at that time. In fact, Professor Georg Schwarzenberger observed that during the inter-war period, the assumption that "As long as the economic mechanisms of international trade were allowed to operate more or less automatically, a bilateral framework for the standard international economic law sufficed" had been abandoned by states.[5]

The need for a system of international economic rules to address the abuses committed by states in the exercise of near absolute economic sovereignty before the Second World War was urged as early as 1941 by Professor Quincy Wright in his speech before the American Society of International Law when he argued that:

> International Law is x x x ill-adapted to the present interdependent world. The economic sovereignty of States must be limited by rules of positive law if a more stable and prosperous world order is to be achieved.[6]

He suggested six approaches under international law to achieve this goal: first, the development of the concept of abusive exercise of powers by international tribunals; second, the development of the concept of basic human right to trade limited only by reasonable governmental control in the public interest; third, the establishment of an international economic commission charged with the task of conciliating claims and controversies arising from unjust governmental acts of business concerns; fourth, the founding of an international economic organization which could investigate and publicize the commercial practices of states; fifth, the negotiation of bilateral treaties on the basis of reciprocal and unconditional most-favored-nation treatment gradually reducing tariffs and

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[5] Georg Schwarzenberger, *The Province and Standards of International Economic Law*, 2 Int'l L.Q. 413 (1948).

[6] Quincy Wright, *International Law and Commercial Relations*, 2 Am. J. Int'l L. Proc. 37 (1940–41).

eliminating other obstructions to trade; and sixth, through multilateral treaties, the evolution of a code of fair practice in international commerce could be evolved.[7]

In response to the experience of the 1930s and anticipating the economic needs after the war, the United States and Great Britain led other Allied powers at Bretton Woods, N.H. in 1942 in designing the post-World War II international economic system based on a "directed order, a treaty order of made norms" as one contemporary writer described it.[8] Professor Andreas Lowenfeld recalls the distinction between the American and British expectations of this new economic order as follows:

> For the United States, the essential policy objective was 'the reconstruction of a multilateral system of world trade.' In the words of Secretary of the Treasury Henry Morgenthau, new international financial institutions were conceived as 'the alternative to the desperate tactics of the past—competitive currency depreciation, excessive tariff barriers, uneconomic barter deals, multiple currency practices, and unnecessary exchange restriction—by which governments vainly sought to maintain employment and uphold living standards.' The British statement of goals, though similar in purport, was more modest, and reflected the prospect that the United Kingdom would occupy a debtor's position at the war's end: 'Our long-term policy must ensure that countries which conduct their affairs prudently need not be afraid that they will be prevented from meeting their international liabilities by causes outside their control.'[9]

Out of these policy objectives emerged proposals to establish a trade organization (whose function now rests upon

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[7] *Id*. at 37–38.

[8] Roessler Frieder, *Law, de facto Agreements and Declarations of Principle*, 21 German Y.B. Int'l Law 30 (1978).

[9] Andreas Lowenfeld, *International Economic Law,* 4 International Monetary System, 14–15 (2nd ed., New York: Matthew Bender and Co., Inc., 1984).

the General Agreement on Tariffs and Trade),[10] an international bank (International Bank for Reconstruction and Development or World Bank)[11] to provide capital for the reconstruction of Europe and an international institution composed of professional economists which will promote international monetary cooperation and provide temporary financing for countries facing severe balance of payments situation (International Monetary Fund).

In the international monetary field two plans were proposed again by the United States and Great Britain. While both proposals recognized the need for governments to assume the obligation to maintain the value of their currencies and to change applicable rates of exchange based on a set of rules enforceable by an international organization, they debated in regard to the issue of providing resources to countries requiring adjustment on account of serious balance of payments difficulties.[12] Mr. John Maynard Keynes, then a special consultant to the British Treasury, sought to convince the participating states of the need to make credit "more or less automatically available at the request of a member"[13] to which Mr. Harry Dexter White of the United States, then Secretary Morgenthau's assistant for international finance, took exception by proposing that the international monetary institution should be empowered to require the borrowing member to bring its international accounts into balance.[14] This difference was eventually resolved at the conference in 1944 during which the

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10 *See generally* John Jackson and William Davey, *Legal Problems of International Economic Relations*, (2nd ed., Minnesota: West Publishing Co., 1986).

11 For a concise history of the World Bank *see* Asher and Mason, *The World Bank Since Bretton Woods* (Washington, D.C.: Brookings Institute, 1973).

12 Lowenfeld, *supra* note 9, at 16–17.

13 *Id*. at 16.

14 *Id.* at 17.

(original) Articles of Agreement of the IMF was adopted. Suffice it to note that the imposition of conditions were viewed to be necessary with respect to the use of Fund resources.[15]

III. Norm-Creating Function of the International Monetary Fund Articles of Agreement

Customary or conventional international law had consistently recognized in the past that "a State is entitled to regulate its own currency."[16] Although central banks had adhered to the use of the gold standard in the past for the purpose of balance of payments adjustments and domestic monetary policy control, Sir Joseph Gold observed that the so-called "rules of the game x x x were not regarded as binding on states."[17] He argued, therefore, that this "traditional attitude toward the rules of the game makes the achievement of Keynes and White all the more remarkable," because "both were aware that they were proposing a new legal order in international monetary relations."[18]

With the creation of the IMF, legal norms have arisen constituting the "Law of the Fund." These legal norms have been hierarchically classified into three main categories, namely:

(i) the Articles of Agreement, accepted by members;

(ii) the by-laws, resolutions, and other decisions of the Board of Governors, and

(iii) the rules and regulations and other decisions of the Executive Board.[19]

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15 IMF Articles of Agreement, Art. V, Sec. 3(a).

16 Joseph Gold, *The Rule of Law in the International Monetary Fund,* 2 (Washington, D.C.: IMF, 1980).

17 *Id*. at 3.

18 *Id*.

19 *Id*. at 5.

Gold opined that "the Articles are a treaty, and, therefore the law of the Fund includes the applicable norms of treaty law and of other aspects of public international law."[20] The provisions of the Articles have been construed to be paramount in relation to the other legal norms,[21] but in so far as individual norms within a class are concerned no ranking exists.[22] For instance, the statement of purposes in Article I of the Agreement according to Gold "[does] not represent an order of precedence."[23]

Legal norms under the Articles may be viewed as either mandatory or permissive. A mandatory norm is one which prescribes "specific prohibitions for members."[24] Gold cites as an example Article VIII, Section 2(a) of the amended Articles which obligates a member "not to impose restrictions on the making of payments and transfers for current international transactions unless [it] is authorized by the Articles or approved by the Fund."[25] On the other hand, a member may be allowed under several norms "to adopt measures, take actions, or pursue policies provided that certain conditions are observed."[26] Article VI, Section 3 according to Gold fits into this category. This provision declares "that members may apply controls to regulate international capital movements, provided that these controls are exercised in a manner that will not restrict payments and transfers for current international transactions or will not unduly delay transfers of funds in settlement of commitments."[27] Several norms are deemed permissive according to Gold.

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[20] *Id*.

[21] *Id*.

[22] *Id*.

[23] *Id*.

[24] *Id*. at 7.

[25] *Id*.

[26] *Id*. at 7.

[27] *Id*. at 7–8.

Decisions of the Fund's organs that are formulated in general terms have been a major source of new legal norms.[28] However, it has occurred that previous decisions for individual members have evolved into a general decision expressive of an established Fund practice.[29] An example typically cited to illustrate this development is the decision of the Executive Board of March 2, 1969, on the "use of the Fund's General Resources and Standby Arrangements" wherein the said body laid down the guidelines on conditionality for the use of the Fund's resources and for standby arrangements. This decision was incorporated in the Articles of Agreement during the second amendment thus fully establishing its legality.[30]

In regard to the legal effect and the consequence of a violation of decisions of the Fund, Gold is of the view that a distinction must be made between "those x x x that require members to behave in a particular way because that conduct is explicitly or implicitly made obligatory by the Articles x x x [and] hose that make recommendations or provide guidelines for conduct."[31] Insofar as the Fund is concerned, non-compliance with decisions requiring specific action is automatically a breach of obligation but non-compliance with recommendations or guidelines must first be established "to be neglect of an obligation under the Articles as well."[32]

IV. Mandate of the International Monetary Fund

In this section three purposes of the IMF which have considerably affected sovereign debt renegotiations in the post-World War II period will be briefly discussed. Emphasis

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[28] *Id*. at 9.

[29] *Id*. at 9–10.

[30] *Id*. at 10.

[31] *Id*. at 11.

[32] *Id*.

will be given to the practice of conditionality and the legal aspects of the standby arrangements.

Article 1 of the amended Articles of Agreement enumerates the following purposes of the Fund:

(i) To promote international monetary cooperation through a permanent institution which provides the machinery for consultation and collaboration on international monetary problems.

(ii) *To facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy.*

(iii) To promote exchange stability, to maintain orderly exchange arrangements among members, and to avoid competitive exchange depreciation.

(iv) *To assist in the establishment of a multilateral system of payments in respect of current transactions between members and in the elimination of foreign exchange restrictions which hamper the growth of world trade*.

(v) *To give confidence to members by making the Fund's resources temporarily available to them under adequate safeguards, thus providing them with the opportunity to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity*.

(vi) In accordance with the above, to shorten the duration and lessen the degree of disequilibrium in the international balance of payments of members. (Italics mine)

A. Development as a Secondary Purpose

Gold maintains that it is clear from the history of the Fund's creation that "development is not a direct purpose."[33] In support of this argument he referred to Mr. H.D. White's distinction in his proposed plan at the beginning of the Bretton Woods meetings in 1942 of the functions of the two financial institutions: one "to stabilize foreign exchange rates and strengthen the monetary systems of the United Nations;" and the other, "to provide capital for economic reconstruction, to facilitate rapid and smooth transition from war-time economies to peacetime economies, to provide relief for stricken people during the immediate post-war periods, to increase foreign trade and permanently increase the productivity of the United Nations."[34] As we are now aware, the two functions have been divided between the Fund and the World Bank, respectively. According to Gold, while the Articles of Agreement of the Fund[35] state in its first article that it will "facilitate the expansion and balanced growth of international trade, and x x x contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy," the reference to "development" in paragraph (ii) must be interpreted in the light of the history of the negotiations which led toward its adoption.[36]

The Indian delegation's proposed draft of the paragraph, deemed to be the most definitive statement invoking a direct involvement of the challenged on the ground that the proposal, which read

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33 Joseph Gold, "'. . . *To Contribute Thereby to . . . Development . . .' Aspects of the Relations of the IMF with Its Developing Members,*" COLUM. J. TRANSNAT'L L. 10:2 (1971) 267.

34 *Id*.

35 IMF Articles of Agreement *as amended*.

36 Gold, *supra* note 33, at 270–276.

> To facilitate the expansion and balanced growth of international trade, *to assist in the fuller utilization of the resources of economically underdeveloped countries* and to contribute thereby to the maintenance in the world as a whole of a high level of employment and real income, which must be a primary objective of economic policy; x x x[37] (Italics mine)

described more the function of the World Bank and would fall beyond the means of the Fund as a source of financing.[38] After intense negotiations according to Gold the Indian delegation declared in a press release that, "the Fund cannot directly assist but can facilitate these aims in pursuing its purpose of the expansion and balanced growth of international trade."[39] The proper view insofar as the Fund's responsibility is concerned, as Gold suggests, is "expressed in the phrase 'to contribute thereby,' but if the Fund's contribution is indirect, the language of the provision is not a 'one-way pendulum' because the aims are recognized as 'primary objectives of economic policy.'"[40]

B. "Freedom for Payments" and External Debt Service

The mandate in paragraph (iv) has become increasingly relevant in the management of external debts of developing country borrowers particularly during the 70s and 80s. Pursuant to this mandate, accompanying provisions have been laid down by the drafters of the Agreement.

Sec. 2(a) of Article VIII of the amended version provides:

> (a) subject to the provisions of Article VII, Sec 3(b), and Article XIV, Section 2, *no member shall, without the approval of the Fund, impose restrictions on the making of payments and transfers for current international transactions*.[41] (Italics mine)

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[37] *Id*. at 272–273.

[38] *Id*. at 273.

[39] *Id*. at 276.

[40] *Id*.

[41] *See* IMF Articles of Agreement, Art. VIII, Sec. 3(b) and XIV, Sec. 2.

The term "restrictions" as it has been defined in the Fund's law and practice refers to "governmental prohibition of, limitation on, or hindrance to the availability or use of exchange in connection with current international transactions."[42] It has been distinguished from the term "control" in that the latter may entail "a procedure that is not unreasonable as a condition precedent to a payment or transfer x x x to assumable statistics or x x x to prevent the illicit transfer of capital."[43] This procedure does not amount to a breach of the obligation under the Fund's Articles of Agreement.

The other term which needs to be clarified under the abovementioned provision is "current international transactions." Article XXX(d)[44] defines current transactions as follows:

> (d) Payments for current transactions means payments which are not for the purpose of transferring capital, and includes, without limitation:
>
> (1) *All payments due in connection with foreign trade, other current business, including services, and normal short-term banking and credit facilities*;
>
> (2) *Payments due as interest on loans and as net income from other investments*:
>
> (3) *Payments of moderate amount for amortization of loans or for depreciation of direct investments;*
>
> (4) *Moderate remittances for family expenses*;
>
> The Fund may, after consultation with the members concerned, determine whether certain specific transactions are to be considered current transactions or capital transactions. (Italics mine)

It is implied from the provision that members are free to restrict capital transfer particularly when read with Article VI,

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[42] Joseph Gold, *International Monetary Fund and Private Business Transactions* 7 (Washington, D.C.: IMF, 1965).

[43] *Id*. at 8.

[44] This is formerly Art. XIX(i) of the original IMF Articles of Agreement.

Section 3 which states that "members may exercise such controls as are necessary to regulate international capital movements x x x."[45] But Gold emphasized that the "recognition of the right of members to limit or prevent capital transfers does not apply to those categories of transactions that would be considered capital but for the fact that the Articles declare them to be current."[46] This is supported by the qualification in the same provision just cited to the effect that "no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments, except as provided in Article VII, Section 3(b) and in Article XIV, Section 2."

C. Use of the Fund's Resources: Balance of Payments Financing

Paragraph (v) of the statement of purposes expresses the financial function of the IMF. The IMF administers a pool of resources derived mainly from subscriptions of its members determined by quotas assigned to the latter. Before the Second Amendment of the Articles of Agreement in 1978 the subscription of each member based on its assigned quota was made payable 75 percent in its currency and the rest in gold.[47] Under the present arrangement each member is assigned a quota expressed in special drawing rights.[48] Many of the rights and duties of membership under the Articles of Agreement have been determined based upon quota assignment. An example of this is found in terms of the extent of financial

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45 Gold, *supra* note 42, at 13.

46 *Id.* at 13.

47 Joseph Gold, *International Monetary Fund and International Law: An Introduction* 22 (Washington, D.C.: IMF, 1965).

48 For a detailed discussion of SDRs, *see* M.R. Shuster, *Public International Law of Money* 198–225 (Oxford: Clarendon Press, 1973).

assistance a member can avail of in times of balance of payments difficulty.[49]

The temporary character of the use of the Fund's resources is emphasized with the insertion of the word "temporarily" before the phrase "available to them" during the First Amendment of the Articles of Agreement in 1968. In Decision No. 102-(52/11)[50] the Fund had interpreted the temporary character of its balance of payments financing scheme as not exceeding three to five years at the most.[51]

As the paragraph also suggests, it is the Fund's policy to make its resources available under "adequate safeguards." This policy is aimed not only to protect the level of resources in the Fund's holding but primarily to ensure that the transaction will be consistent with the principal purpose of "the achievement of a multilateral system of payments and transfers for current international transactions in order to promote international trade and the benefits that flow from it."[52] It is, therefore, essential from the Fund's point of view that in making the use of its resources available, a member engaging in such a transaction would be expected to pursue an "economic and financial program x x x consistent with the purposes of the Fund."[53] The concept of economic development supported by the provision of the Fund's resources is otherwise known in Fund practice as the doctrine of conditionality. This institutional policy has also given rise to a unique instrument called the standby arrangement which guarantees access by a member seeking to engage in a transaction for balance of payments reasons. Conditionality and the standby arrangements have now

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49 Joseph Gold, *Financial Assistance by the International Monetary Fund: Law and Practice* 22–23 (2nd ed., Washington, D.C.: IMF, 1980).

50 Gold, *supra* note 47, at 23.

51 *Id*.

52 Gold, *supra* note 49, at 4.

53 *Id*.

become a central feature of the Fund's financial function and, in fact, the principal consideration in most instances before international creditors agree to a renegotiation of sovereign debts. Reliance by the international creditors, upon the authority of the Fund, to recommend politically sensitive economic adjustment measures upon sovereign debtors through the policy of conditionality has filled a void in the evolving sovereign debt renegotiation procedures.

V. The Doctrine of Conditionality and the Development of the Standby Arrangement

The Fund observes the practice of setting quantitative limits on the use of its resources.[54] These quantitative limits are described as "the amounts defined by the Fund's 'tranche policies,' in which the Fund has clarified the kinds of policies it will expect members to follow for the purpose of avoiding balance of payments problems if they wish to use the Fund's resources, and the kind of scrutiny that the Fund will give to members' requests to use the Fund's resources."[55] Conditional use of the Fund's resources essentially carry the following important elements:

(a) the need on the part of the member to adopt policies intended to overcome its balance of payments problem;

(b) consistency of these policies with the purposes of the Fund;

(c) the member's policies should be able to correct the problem within a "temporary" period; and,

(d) the policies must aim to increase the reserves of the member to enable it to repurchase its currency

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[54] Joseph Gold, *The Stand-By Arrangements of the International Monetary Fund* 12 (Washington, D.C.: IMF, 1970).

[55] *Id*.

> immediately consistent with the temporary character of the use of the Fund's resources.[56]

It has been argued by Gold that conditionality is not aimed at changing the basic character or the organization of a member's economy and he stresses in fact that "the social objectives or priorities of a member are accepted as beyond negotiation, subject to the proviso that the policies to promote them will permit the member to achieve a sustainable balance of payments position."[57] Furthermore, in assessing the severity of the policies expected of a member Gold points out that the Fund considers a number of factors among which are "the hardships for the population or sectors of it, the political difficulties for the government in introducing and following policies of adjustment, the period of adjustment, and the volume of resources made available."[58]

In the application of standards of conditionality the Fund makes a distinction based on its tranche policies. It has been mentioned earlier that the member's quota is determinative of the extent of the member's rights and privileges among which is the amount of resources it can request from the Fund. Originally, the members were obliged to comply with their quota partly in gold and partly in their own currency. The significance of this distinction between the gold and currency contribution is explained as follows:

> The practical significance of the gold tranche as originally defined was that it was equal to a member's net economic contribution to the Fund x x x. The rest of the member's currency subscription did not have the same significance because it was only a potential economic claim against the member until the currency was put in the hands of others. Because the gold tranche at any particular moment was equivalent to the net economic contribution that a member had made to the Fund up to that time, the standards applied by the Fund to requests

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[56] Gold, *supra* note 49, at 19.

[57] *Id*. at 20.

[58] *Id*. at 20–21.

> to make gold tranche purchases were the least searching. The Fund sought to give as automatic a treatment to these requests as could be reconciled with the Articles.[59]

A second amendment in 1978 modified the original definition of the gold tranche.[60] The term "reserve tranche" was introduced and came to be understood as the "excess of a member's quota over the Fund's holdings of its currency after excluding holdings of the member's currency obtained by the Fund in transactions under policies that the Fund decides shall lead to these exclusions."[61] In determining the reserve tranche today, the Fund excludes holdings of the member's currency resulting from transactions or requests under their facilities intended to meet specific needs of a member caused by other difficulties.[62] As in the case of the gold tranche, Article IV, Section 3(c) of the Agreement provides that "requests for reserve tranche purchases shall not be subject to challenge."

Purchases by a member that necessarily go beyond its net economic contribution are governed by the "credit tranche policy."[63] This policy has been regarded as the central or basic policy on the conditional use of the Fund's resources.[64] For purposes of determining the kind of conditionality which should be applied to a purchase beyond the reserve tranche, the Fund had distinguished in practice between the first credit tranche and the upper credit tranches. A purchase in the first credit tranche has the effect of raising the Fund's holdings of the purchasing member's currency from an amount equal to its quota to no more than 125 percent of quota after excluding the holdings obtained under other facilities.[65] On the other hand,

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59 Gold, *supra* note 54, at 13–14.

60 Gold, *supra* note 49, at 27.

61 *Id*.

62 For a discussion of other facilities, *see id*. at 29–37.

63 *Id*. at 27–29.

64 *Id*. at 27.

65 *Id*. at 28.

an upper credit tranche purchase increases the Fund's holdings of the purchasing member's currency from 125 percent of quota to no more than 200 percent of quota also after excluding the holdings from the other facilities.[66] The upper credit tranche is divided into three tranches of 25 percent of quota each, and standards of conditionality become more severe as a member increases its purchase within these tranches.[67] Substantial justification is required when making a request for transactions in the upper credit tranches.[68]

The main instrument utilized by the Fund in making its resources available in the credit tranches is called a standby arrangement.[69] Under Article XXX of the Agreement the standby arrangement is defined as follows:

> x x x a decision of the Fund by which a member is assured that it will be able to make purchases from the General Resources Account in accordance with the terms of the decision during a specific period and up to a specified amount.[70]

According to Gold, the Fund emphasized in its earlier practice the analogy of a confirmed line of credit when granting a standby arrangement.[71] This view is supported by a decision of the Fund dated February 13, 1952, in which the Managing Director was quoted to have considered the availability of drawing from the Fund's resources within a period of 6 or 12 months.[72] In the same year the Fund adopted its first general

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66 *Id*.

67 *Id*.

68 *Id*.

69 A more recent treatment of the SBA is found in Joseph Gold, *The Legal Character of the Fund's Stand-By Arrangements and Why It Matters* (Washington, D.C.: IMF, 1980).

70 This is a new provision.

71 Gold, *supra* note 54, at 29.

72 Decision No. 102-(52/11); February 13, 1952, in *id*., Appendix D.3.

policy on the use of the standby arrangement.[73] Decision No. 155-(52/57) of October 1, 1952 contained the following essential points:

1. Standby arrangements would be limited to periods of not more than six months. They could be renewed by a decision of the Executive Board.
2. In considering the request for a standby arrangement or a renewal of a standby arrangement, the Fund would apply the same policies that are applied to requests for immediate drawings including a review of the member's position to make purchases of the same amount of exchange from the Fund.
3. Such arrangements would cover the portion of the quota which a member would be allowed, under Article V, Section 3, to draw within the period provided in the arrangement. However, this does not preclude the Fund from making standby arrangements for larger amounts on terms in accordance with Article V, Section 4.
4. A charge of 1/4 of 1 percent per annum would be payable to the Fund at the time a standby arrangement is agreed. This change would be payable in gold (or United States dollars in lieu of gold) or the member's currency as specified for other charges by Article V, Section 8(f). In the event a standby arrangement is renewed, a new charge at the rate of 1/4 of 1 percent per annum would be payable to the Fund.
5. A member having a standby arrangement would have the right to engage in the transactions covered by the standby arrangement without further review by the Fund. The right of the member could be suspended only with respect to requests received by the Fund after: (a) a formal ineligibility, or (b) a decision of the Executive Board to suspend transactions either generally (under Article XVI, Section 1(a)(ii) or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of the member.[74]

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[73] *Id*., Appendix E.

[74] *Id*. at 245–246.

A subsequent decision modified the general policy by introducing, among other provisions, a statement recognizing an extended arrangement under the following circumstance:

> x x x If a member believes that the payments problems it anticipates (for example, in connection with positive programs for maintaining or achieving convertibility) can be adequately provided for only by a standby arrangement of more than six months, the Fund will give sympathetic consideration to a request for a longer standby arrangement in the light of the problem facing the member and the measures being taken to deal with them. With respect to standby arrangements for periods of more than six months, the Fund and the member might find it appropriate *to reach understandings additional to those set forth in this decision*.[75] (Italics mine)

The effect of the new policy was a movement away from the original concept of a confirmed line of credit toward the additional understandings.[76] Through these understandings the Fund had introduced "protective clauses" such as the obligation to consult and the observance of performance criteria or specific policies in a member's program which give the Fund an assurance that the objectives of the standby arrangement are being realized.[77]

An in-depth examination of the standby arrangement in 1968 led to a number of important conclusions on the use of protective clauses and the characterization of the standby arrangement. It was decided that the Fund policies and practices on the use of its resources, including tranche policies, would continue to apply subject to the following:

> 1. Appropriate consultation clauses will be incorporated in all standby arrangements.

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[75] Decision No. 270-(53/95), December 23, 1953 in *id*., Appendix E.2.

[76] *Id*. at 29–30.

[77] *Id*. at 30.

2. Provision will be made for consultation, from time to time, with a member during the whole period in which the member is making use of the Fund's resources from a standby arrangement.
3. Phasing and performance clauses will be omitted in stand-by arrangements that do not go beyond the first credit tranche.
4. Appropriate phasing and performance clauses will be used in all standby arrangements other than those referred to in paragraph 3, but these clauses will be applicable only to purchases beyond the first credit tranche.
5. Notwithstanding paragraph 4, in exceptional cases phasing need not be used in standby arrangements that go beyond the first credit tranche when the Fund considers it essential that the full amount of the standby arrangement be promptly available. In these standby arrangements, the performance clauses will be so drafted as to require the member to consult the Fund in order to reach understandings needed on new or amended performance criteria, even if there is no amount that could still be purchased under the standby arrangement x x x.
6. Performance clauses will cover those performance criteria necessary to evaluate implementation of the program with a view to ensuring the achievement of its objectives, but not others. No general rule as to the number and content of performance criteria can be adopted in view of the diversity of problems and institutional arrangements of members.
7. In view of the character of standby arrangements language having a contractual flavor will be avoided in the standby documents.[78]

Increased use of the standby arrangement during the 70s by the developing countries required further clarification of the Fund's policy of conditionality and the framework of the standby arrangement. The new guidelines on conditionality

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[78] Decision No. 2603-(68/132), September 20, 1968, in *id*., Appendix E.6.

were approved by the Executive Board in its decision of March 2, 1979.[79] The important aspects of the Fund's new policy on the use of its resources were as follows:

1. Members should be encouraged to adopt corrective measures, which could be supported by use of the Fund's general resources in accordance with the Fund's policies, at an early stage of their balance of payment difficulties or as a precaution against the emergence of such difficulties. The Article IV consultations are among the occasions on which the Fund would be able to discuss with members its adjustment programs, including corrective measures, that would enable the Fund to approve a standby arrangement.

2. The normal period for a standby arrangement will be one year. If, however, a longer period is requested by a member and considered necessary by the Fund to enable the member to implement its adjustment program successfully, the standby arrangement may extend beyond the period of one year. This period in appropriate cases may extend up to but not beyond three years.

3. Standby arrangements are not international agreements and therefore language having a contractual connotation will be avoided in standby arrangements and letters of intent.

4. In helping members to devise adjustment programs, the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members, including the causes of their balance of payment problem.

x x x x

7. The Managing Director will recommend that the Executive Board approve a member's request for the use of the Fund's general resources in the credit tranches when it is his judgment that the program is consistent with the Fund's provisions and policies and that it will be carried out. A member may be expected to adopt and carry out a program

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[79] *See* Lowenfeld, *supra* note 9, DS 228–230.

consistent with the Fund's provisions and policies x x x these cases the Managing Directors will keep Executive Directors informed in an appropriate manner of the progress of discussions with the member.

8. The Managing Director will ensure adequate coordination in the application of policies relating to the use of the Fund's general resources with a view to maintaining the non-discriminatory treatment of members.

9. Performance criteria will normally be confined to (i) macroeconomic variables, and (ii) those necessary to implement specific provisions of the Articles or policies adopted under them. Performance criteria may relate to other variables only in exceptional cases when they are essential for the effectiveness of the member's program because of their macroeconomic impact.

Paragraph 5 of the new guidelines reiterates paragraphs 1 and 2 of the 1968 decision while paragraph 6 corresponds with the previous paragraph 3. And the first sentence of paragraph 9 merely reiterates the sixth paragraph of the old decision. Paragraph 10 requires a provision for review in programs extending beyond one year where a member is unable to establish in advance one or more performance criteria, or in which an essential feature of a program cannot be formulated as a performance criterion at the beginning of a program year on account of substantial uncertainties concerning major economic trends. The final two paragraphs of the present decision mention the Fund's assessment of the member's performance under the programs and the conduct of studies of programs supported by standby arrangements.

The process of approving a standby arrangement consists of several stages.[80] Initially, negotiations are conducted almost exclusively between the requesting member's representatives (usually the Governor of the Central Bank and/or the Minister of Finance) and the Fund's mission whose function is "to arrive at a thorough understanding of the member's policies so as to be able to explain them to the Fund and to follow their progress"

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[80] Gold, *supra* note 54, at 40–44.

and "to assist the member in the preparation of its letter of intent (by making) available the Fund's knowledge of the experience of other members in dealing with difficulties comparable to those of the host member."[81] A letter of intent and the standby arrangement are drafted with the understanding that "the mission must refer them to headquarters."[82] These standby documents are submitted to the Managing Director and the staff for discussion before a decision is made by the Managing Director to recommend to the Executive Directors their approval of the standby arrangement based on the letter of intent.[83] The letter of intent is signed by the Governor of the Central Bank and/or the Minister of Finance upon completion of the discussions and transmitted to the Managing Director whose responsibility is to submit to the Executive Directors a memorandum containing the proposed standby arrangement and the letter of the intent.[84]

VI. Sovereign-Debt Renegotiation Process and the IMF Standby Arrangement

According to Gold, the uniqueness of the standby arrangement as a form of financial assistance is expressed in the various ways by which the instrument can be used to address a wide range of problems.[85] Even before the financial crisis in the 1970s and early 1980s the Fund had envisioned the influence of the standby arrangement in the decision of international lenders, both official and private, in extending loans to the Fund's members.[86] Gold describes the Fund's approval of a standby

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[81] *Id*. at 41.

[82] *Id*.

[83] *Id*.

[84] *Id*. at 43.

[85] Gold, *supra* note 54, at 36–40.

[86] *Id*. at 37.

arrangement for a member as useful whenever the member is concerned with the "creation of international confidence" and, as a matter of fact, such decision constitutes a "leading international judgment on the soundness of a member's policies."[87]

Another important use of the standby arrangement which has gained wide acceptance among the international lenders today is its catalytic role in the renegotiation of sovereign debt.[88] This role connected with debt relief strategies for most developing borrowers in recent years actually grew out of a general policy for the Fund's membership which was defined in its Annual Report of 1965 as follows:

> The Fund has the opportunity to assist in preventing a recurrence of the need for debt renegotiation when a standby arrangement is being negotiated parallel to the debt refinancing, x x x mutual benefits can be derived from commitments given to the Fund under a standby arrangement, since if adequate measures to restore the payments balance are implemented, there can be assurance that such problems as the accumulation of arrears will not recur.[89]

As a result of the abovementioned policy, interlocking agreements have become commonplace and, in fact, institutionalized in current sovereign debt renegotiation procedures. In the succeeding discussion, the legal ties which have arisen between the sovereign debtors and their various creditors in the light of the provisions embodied in these interlocking agreements will be examined.

A. Paris Club Rescheduling Process

Rescheduling of debt-service payments on loans extended by, or guaranteed by the governments or the official agencies of the creditor countries has customarily been conducted through

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[87] *Id*.

[88] E. Walter Robichek, *The IMF: An Arbiter in the Debt Restructuring Process*, 23 Colum. J.L Transnat'l L.143–154 (Winter: 1984).

[89] Gold, *supra* note 54, at 39.

the so-called "Paris Club."[90] The Paris Club history dates back to 1956 when a group of European creditor governments convened a meeting in Paris with Argentina for the purpose of outlining an arrangement to enable the latter state to resume orderly trade and payments relations and to provide for the renegotiation of supplier credits insured by the participating creditor governments.[91] Since that time creditor states have adhered to a set of practices and procedures during renegotiations with a debtor state.

The Paris Club meetings have usually been held in Paris under the chairmanship of an official of the French Treasury. There is no formal legal organization to speak of despite the existence of a uniform process observed during the meeting with the debtor state. One writer explains that this non-legal approach

> reflects the creditor point of view that the debtor rescheduling is an extraordinary event justified in only the most extreme circumstances. If the Paris Club were viewed as a permanent institution, it would be an admission that rescheduling is a normal financial transaction. This would undermine the concept of the sanctity of contracts, and would encourage debtor countries to seek debt relief.[92]

Another writer suggests, however, the political advantage enjoyed by the creditors through the present characterization of the Paris Club meetings:

> The *ad hoc* nature of the Club is also frustrating to debtors because it allows political considerations to color a primarily financial process. For example, the renegotiation terms accorded Indonesia in 1970 did not reflect the cautious and essentially commercial approach accorded Ghana in the same year x x x. In part, the Indonesian terms were due to the political

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[90] *See generally* Alexis Rieffel, *The Paris Club, 1978–1983*, 23 Colum. J. Transnat'l L. 83–110 (Winter: 1984).

[91] Albert C. Cizauskaus, *International Debt Renegotiation: Lessons from the Past*, 7 World Dev. 201–202 (1979).

[92] Rieffel, *supra* note 90, at 91–92.

orientation of that country toward the capitalist bloc after a coup in the 1960's.[93]

Three underlying principles govern the financial relationship between the participating official creditors and the debtor state, and among the creditors themselves, whether participating or not. Firstly, there must be a strong evidence of imminent default as "when a debtor country's uses of foreign exchange, which are usually projected for one year in advance, exceeds its sources."[94] Secondly, debt relief is coupled with conditionality. It has become the practice of creditors participating in the renegotiation within the Paris Club to make debt relief conditional "upon the existence of an economic program supported by a borrowing arrangement with the IMF, involving drawings in the upper credit tranches."[95] A debtor state which is not a member of the IMF is expected to negotiate directly with the creditor governments on policy reforms similar to those contained in the IMF standby arrangements entered into by a member.[96] Finally, the principle of burden-sharing engages creditors to "provide relief that is commensurate with their exposure in the debtor country."[97] Excluded from the operation of this principle are the multilateral lending institutions such as the IMF, the World Bank, the major regional development banks (Inter-American Development Bank, Asian Development Bank, and African Development Bank), European Investment Bank, and the OPEC Special Fund.[98]

The Paris Club process is actually initiated by a debtor state through a formal request sent to the Chairman. Invitations are sent out to creditor governments having significant exposure

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[93] Robert V. Hawn, *The Renegotiation of Official International Debt: Whose Club is It?* U.C. Davis 17(1984): 873.

[94] Rieffel, *supra* note 90, at 84–85.

[95] *Id*. at 85–87.

[96] *Id*. at 86.

[97] *Id*. at 87–90.

[98] *Id*. at 87.

in the debtor state. Participating governments have come almost exclusively from the OECD although in some developing countries such as Abu Dhabi, Israel, Argentina, Mexico and South Africa have appeared as creditor participants.[99] Representatives of the Fund, the World Bank, the United Nations Conference on Trade and Development (UNCTAD) and concerned regional development banks are also present to provide material information and technical advice as regards the debtor state seeking rescheduling. Negotiations normally proceed in stages which involve a debtor's presentation, statements by the representatives of the multilateral financial institutions (particularly an evaluation of the debtor's proposed economic stabilization polices under an IMF standby arrangement), and a closed meeting of delegates from the creditor governments.[100] The whole exercise is usually concluded after two or three days.

Official creditors sign *ad referendum* an agreement known as the "Agreed Minute"[101] which outlines the broad terms of

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[99] *Id*. at 92.

[100] For a more detailed account of the proceedings in a Paris Club meeting, *see id*. at 97–99.

[101] Some Agreed Minutes may be found in the following rescheduling agreements between the United States and some of its developing country borrowers: Agreement Regarding the Consolidation and Rescheduling of Certain Debts, February 6, 1974, United States – Chile, 25 U.S.T. 1757, T.I.A.S. No. 7908; Memorandum of Understanding Regarding the Consolidation and Rescheduling of Certain Debts, June 17, 1974, United States – Chile, 25 U.S.T. 2712, T.I.A.S. No. 7940; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, July 3, 1975, United States – Chile, 28 U.S.T. 5602, T.I.A.S., No. 8649; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, June 17, 1977, United States – Zaire, 28 U.S.T. 7621, T.1.A.S. No. 8731; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, July 28, 1980, United States – Zaire, 32 U.S.T. 9907, T.I.A.S. No. 9907; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, October 24, 1980, United States – Turkey, 32 U.S.T. 3688, T.I.A.S. 9909; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, May 17, 1980, United States

rescheduling. The terms of the agreement or informal understanding are recommended by the representatives of these official creditors to their respective governments for incorporation into bilateral agreements with the debtor concerned. While Agreed Minutes are clearly not international treaties, it has been argued that their character is that of "an international agreement entailing political, non-legal obligations x x x (creating) a shared expectation of all actors concerned that debt restructuring will take place according to the terms of the document."[102] In an earlier analysis of the implication of this type of agreement, Professor Oscar Schachter noted two aspects which may be useful in arriving at a better appreciation of the character of the obligation:

> One is internal in the sense that the commitment of the state is 'internalized' as an instruction to its officials to act accordingly x x x. The political commitment implies, and should give rise to, an internal legislative or administrative response. These are often specific and determinate acts.

– Sudan, 32 U.S.T. 9952, T.I.A.S. No. 9952; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, United States – Liberia, May 7, 1981, T.I.A.S. No. 10156, Annex D.; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, September 24, 1981, United States – Turkey, T.I.A.S. No. 10432, p. 16; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, September 27, 1981, United States – Pakistan, T.I.A.S. No. 10246, Annex D.; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, August 26, 1982, United States – Senegal, T.I.A.S. No. 10475, Annex D.; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, November 1, 1982, United States – Liberia, T.I.A.S. No. 10528, Annex D.; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, March 10, 1983, United States – Romania, T.I.A.S. No. 10683, p. 14; Agreement Regarding the Consolidation and Rescheduling of Certain Debts, March 10, 1983, United States – Malawi, T.I.A.S. No. 10684, Annex D.

[102] Michael Bothe and Josef Brink, *Public Debt Restructuring, the Case of International Economic Co-operation*, GERMAN Y.B INT'L LAW 7 (1986): 105.

> The second aspect is 'external' in the sense that it refers to the reaction of a party to the conduct of another party. The fact that the states have entered into mutual engagements confers an entitlement on each party to make representations to the others on the execution of those engagements x x x. By entering into an international pact with other states, a party may be presumed to have agreed that the matters covered are no longer exclusively within its concern. When other parties make representations or offer criticism about conduct at variance with the undertakings in the agreement the idea of a commitment is reinforced, even if it is labeled as political or moral x x x.[103]

One writer has maintained that the above tests are clearly applicable to the Paris Club renegotiations in that "each creditor in a Paris Club agreement instructs its administration to enter into a subsequent binding, bilateral agreement with the debtor x x x (and) the state's commitment to the agreement is externalized by allowing each state to offer representations or criticism regarding the behavior of commitment of the other states privy to the agreement."[104] On the part of the debtor state there is an understanding that it should have an arrangement with the Fund in upper credit tranches and that it consents to the Fund informing the Chairman of the Paris Club regarding the status of their (debtor state-Fund) relationship.[105] Future renegotiation of debt service payments have also been made conditional upon the continued eligibility of the debtor state to make purchases under the upper tranche conditionality of the Fund.[106] Bilateral agreements implementing the terms of the Agreed Minute, however, do not contain provisions which tie-up performance criteria under the standby arrangement with the Fund unlike the restructuring agreements forged by the private commercial banks with a debtor state.[107] This may be

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[103] Oscar Schachter, *Twilight Existence of Nonbinding International Agreements*, AM. J. INT'L L. 71 (1977): 304.

[104] Hawn, *supra* note 93, footnote 42, at 863–864.

[105] *See* various Agreed Minutes, *supra* note 101.

[106] *Id*.

[107] This shall be discussed further in the next section.

explained by the fact that in the renegotiation of sovereign debts owed to the private commercial banks no elaborate procedure comparable with the Paris Club process exists to date.

Attempts at formulating sovereign debt renegotiation policies on the international level have been conducted under the auspices of the UNCTAD. As early as 1967, the UNCTAD has stirred discussions in regard to the improvement of official debt renegotiations.[108] A significant instrument adopted by the Trade and Development Board was Resolution 132 (XV) of August 15, 1975 endorsing the recommendation of the *ad hoc* Group of Governmental Experts which provided, among others, that "on the initiative of debtor developing countries, *ad hoc* meetings may be convened, with participation of major creditor countries concerned and of interested developing countries to examine at the international level a debtor's solution in a wider development context, prior to debt renegotiations in the customary forums."[109] Subsequently, at a Conference on International Economic Cooperation held in Paris in 1977–1978 the positions of the creditor group and the debtor states became more defined but no agreement was arrived at on a common framework for debt renegotiation.[110] A joint proposal by the United States and the European Economic Community crystallized the basic concepts and principles adhered to by these creditor countries in the official debt renegotiation process:

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[108] *See* the *Report of the Committee on Invisibles and Financing Related to Trade on Its Second Session* (April 1967), Official Records of the Trade and Development Board, 5th Sess., Supp. 3 (TD/B/118 Rev. I and Rev. II conn. 1).

[109] United Nations Conference on Trade and Development, Official Records of the Trade and Development Board, *Resolution 132 (XV): "The increasing burden of debt-serving in developing countries.*"

[110] Hawn, *supra* note 93, footnote 104, at 875, and *see further* Ursula Wasserman, *UNCTAD: The External Indebtedness of Developing Countries*, 12 J. World Trade L. 74–79 (1978).

(ii) *The debtor would undertake a comprehensive economic programme designed to strengthen its underlying balance of payments situation. This programme would, as a general rule, be worked out with, and monitored by the IMF.*

(iii) Debt reorganization and the programme of economic measures would take into account the development prospects of the debtor country, thereby enabling it to continue debt service payments and restore its creditworthiness and to increase its capacity to discharge its debt servicing obligations over the longer term.

(iv) The modalities of the debt reorganization would be determined flexibly, on a case-by-case basis, taking into account, on the other hand, the economic situation and prospects of the debtor country, the development prospects and the factors causing the debt service difficulties and, on the other hand, the legitimate interests of the creditors. It should also be recognized that the country's implementation of its viable economic policies is essential to the long-term effectiveness of a rescheduling exercise.

(v) Debt reorganization would cover official and officially guaranteed debt with a maturity of over one year.

(vi) Consolidation periods would normally be kept relatively short and generally would not extend, as to future maturities, beyond the year in which the reorganization is undertaken.

(vii) Equality and non-discrimination among all creditors, including those not participating in the creditor club is an essential principle underlying the operation of debt renegotiations. Creditor countries with minor debts due, which frequently include developing countries, would generally, however, be excluded from the multilateral debt negotiation.

(viii) In respect of its private non-officially guaranteed debt, the debtor country would be expected to negotiate debt reorganization with private creditors on terms similar to those agreed in the creditor club for its official and officially guaranteed debt.

(ix) Debt reorganization arrangements would provide for flexibility to review the situation at the end of the consolidation period in the light of unforeseen circumstances. They would also provide for accelerated repayments in an agreed manner if the debtors' economic situation improved more rapidly than anticipated.[111]

Official creditors stressed the distinction between a default or imminent default situation, which would be dealt with through creditor clubs, and cases of longer term structural problems, which would be considered expeditiously and individually in an appropriate forum.[112] In the latter case, the creditors recommended the following procedure: *first*, the developing country concerned would, before the problem reached crisis proportions, request an examination by the World Bank or another appropriate multilateral development finance institution mutually agreed upon; *second*, if, after examination of the request, further steps seemed necessary, the institution would analyze the economic situation of the country; *third*, if the institution found that the development prospects of the country in question were seriously hampered, it would contact the aid donors to discuss urgently the country's need; *fourth*, donor countries and the recipient country would take the conclusions of the institution's analysis into serious consideration; and, finally, where the analysis led to broad agreement that the developing country was encountering long-term financial difficulties impinging unduly on its development progress, donor countries would, to the best of their abilities, enhance assistance effort directed toward increasing the quantity of aid in appropriate forms and improving its quality,

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[111] "Debt Problems of Developing Countries," draft resolution of the Trade and Development Board, United Nations Conference on Trade and Development Doc. No. TD/B/L498, March 8, 1978. This joint proposal of the European Economic Community and the United States was presented at the earlier Conference on International Economic Co-operation. *See* annex to the *Report of the Conference on International Economic Co-operation* in Doc. No. A131/476/Add.1.

[112] Wasserman, *supra* note 110, at 77.

in response to the developing country, for its part, demonstrating its willingness to take corrective measures on its own behalf, insofar as it was able.[113]

The developing countries submitted two proposals, one dealing with immediate and generalized debt relief[114] and another on the future debt reorganization.[115] Of particular interest in the second set of proposals were the guidelines suggested by the developing countries for reorganization operations:

First: Creditor and debtor countries should ensure that reorganization would be completed expeditiously in order to reduce to the minimum any uncertainties associated with them.

Second: Measures to be adopted should be consistent with an accepted minimum rate of growth of *per capita* income.

Third: International and national policy actions to be adopted should be consistent with the socio-economic objectives and priorities of the country's development plan, and should be conducive to restoring the country to its development path as quickly as possible.

Fourth: The provision of new flows and the terms of debt renegotiation should be on a long-term basis consistent with the country's long-term financial and developmental needs as reflected in the analysis.

Fifth: The terms and conditions of rescheduling the official and commercial debts should be no harsher than the softest terms prevailing for the same kind of loans at the time of reorganization.

Sixth: Provisions should be included to facilitate additional flows or accelerated repayments if the analysis

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113 *Id*. at 78.

114 *Id*. at 79–80.

115 *Id*. at 80–81.

> proved either too optimistic or too pessimistic with respect to the pace of the country's recovery.[116]

Developing countries called for the establishment of a more permanent institutional machinery empowered to convene, organize and supervise reorganization operations based on a set of internationally agreed principles and procedures.[117] Noticeably absent from the proposal is the commitment to undertake a comprehensive economic programme under the auspices of the IMF.

As a compromise, the creditor states and the developing country borrowers agreed on four basic concepts which would govern future debt renegotiations. The guidelines embodied in UNCTAD Resolution 165 (S-IX) of March 11, 1978 were as follows:

(a) International consideration of the debt problem of a developing country would be initiated only at the specific request of the debtor country concerned;

(b) Such consideration would take place in an appropriate multilateral framework consisting of the interested parties, and with the help as appropriate of relevant international institutions to ensure timely action, taking into account the nature of the problem which may vary from acute balance of payments difficulties requiring immediate action to longer term situations relating to structural, financial and transfer of resource problems requiring appropriate longer term measure;

(c) International action, once agreed by the interested parties, would take into due account of the country's economic and financial situation and performance, and of its development prospects and capabilities and of external factors, bearing in mind internationally agreed objectives for the development of the developing countries;

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116 *Id*. at 82.

117 *Id*. at 83.

(d) Debt reorganization would protect the interest of both debtors and creditors equitably in the context of international economic co-operation."[118]

Upon the suggestion of the Trade and Development Board, the Secretary-General of the UNCTAD convened a meeting of an intergovernmental group of experts at Geneva on October 2, 1978 which laid down the detailed feature of the multilateral debt negotiation process.[119] After three plenary meetings the group produced an informal note which served as a provisional document but deemed as non-operational in character.[120] The work was endorsed by the Trade and Development Board in resolution 222 (XXI) of September 27, 1980.[121] Under paragraph 4 of the detailed features it is mandated that

> international action x x x (a) should be expeditious and timely; (b) should enhance the development prospects of the debtor country, bearing in mind its socio-economic priorities and the internationally agreed objectives for the development of developing countries; (c) should aim at restoring the debtor country's capacity to service its debt in both the short term and the long term, and should reinforce the developing country's own efforts to strengthen its underlying balance-of-payments situation; and, (d) should protect the interests of debtors and creditors equitably in the context of international economic cooperation.[122]

Studies on the conduct of multilateral debt renegotiations within the framework of the Paris Club have shown that there has been little progress with regard to the implementation of the detailed features.[123] The focus on the restoration of debt-

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118 UNCTAD Resolution 165(S-IX), March 11, 1978, Debt and Development Problems of Developing Countries.

119 U.N. Doc. No. TD/B/730, Annex, at 1.

120 *Id*.

121 UNCTAD Resolutions and Decisions Supplement No. 1, September 1980.

122 U.N. Doc. No. TD/B/980, at 11.

123 U.N. Doc. No. TD/B/945.

servicing capacity in the short term has failed to enhance the development prospects of the debtor states.[124] Fund conditionality, however, has become central and an essential element in seeking a solution to the debt problem of these states. The multi-year restructuring agreements (MYRAs) concluded by official creditors with some debtor states in recent years required continued Fund assistance in designing economic programs and monitoring their implementation by these debtor states.[125]

B. Commercial Banks and Private Debt Restructuring Agreements

In the 1960s and the early 1970s, some developing country borrowers, such as Argentina, Brazil, and Chile, have already engaged in private debt rescheduling with commercial banks[126] but the method adopted by the lenders was characteristically *ad hoc* in nature without any coordination among themselves. As signs of imminent or even actual defaults by a number of heavily indebted non-oil producing developing countries emerged in the later 1970s, private commercial banks finally recognized the need for a more enlightened approach toward alleviating the debt-service payments difficulty of the debtor states. In comparing the earlier reschedulings and those which transpired in the latter part of the 1970s one writer observed that:

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[124] U.N. Doc. No. TD/13/945, at 1.

[125] *See* K. Burke Dillon and Gumersindo Oliveros, *Recent Experience With Multilateral Official Debt Rescheduling* 14–16 (Washington, D.C.. IMF, February 1987).

[126] Richard Huff, "The Rescheduling of Country Debt: Is a More Formalized Process Necessary?" in *Group of Thirty, Risks in International Lending* (New York: Group of Thirty, 1982), Appendix B, at 49.

> What distinguished the reschedulings of the later 1970s, then, was not so much their novelty as their scope. Instead of the relative handful of banks, often from a single country that once had been involved in negotiations, there were now 100, 200, or more x x x. And where a few million dollars were once at issue, the stake had grown to the hundreds of millions, or, in some cases, billions of dollars.[127]

The banks' new approach was tested through the agreement between Zaire and its bank creditors in November 1976.[128] An analysis of the succeeding rescheduling process between 1976 and 1980 identified some interesting features which now form part of the so-called "London Club" renegotiation process: First, banks began to reschedule medium-term syndicated Eurocredits.[129] Second, bargaining was conducted by a steering committee of half a dozen or so lead banks on behalf of all commercial bank creditors.[130] Third, creditor banks became bound by the doctrine of "fair treatment" whereby each bank was expected to participate in debt relief in proportion to its existing exposure.[131] Fourth, the banks suggested the adoption of economic programs by debtor states under close surveillance of the IMF through standby credit arrangements.[132]

Bank lending to developing country borrowers since the late 1970s remarkably decreased. But during the "Mexican rescue" in 1982, the IMF assumed a leading role in the renegotiation process by virtually dictating commercial lenders to refinance Mexico (and eventually future defaulting debtor states) in exchange for the banks' insistence upon the debtor states undertaking painful economic austerity measures

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[127] *Id*.

[128] Lewis D. Solomon, *Developing Nations and Commercial Banks: The New Dependency*, J. Int'l L. & Econ. 12 (1978): 346.

[129] Huff, *supra* note 126, at 50.

[130] *Id*. at 51.

[131] *Id*.

[132] *Id*. at 53–55.

monitored by the IMF.[133] A former General Counsel of the World Bank described the Mexican rescheduling in 1982 as "the beginning of a new era in debt rescheduling, one aspect of which is the emerging cooperative roles of governments, central banks and the Fund.[134] The involuntary nature of commercial bank involvement in refinancing scheme received further reinforcement under the Baker Plan in 1985.[135] Baker's request for combined financing from private creditors and multilateral institutions was coupled with the condition that debtor states continue to adopt adjustment programs which must be agreed before additional funds are made available, and should be implemented as the funds are disbursed by these institutions.[136] This strategy was designed mainly to encourage more commercial bank participation in balance of payments financing, which the IMF alone could not adequately provide in favor of several debtor states.

Cooperation between the IMF and the commercial banks in the management of the debt crises, however, has led the banks to devise ways of establishing a formal linkage between IMF standby arrangements and private loan agreements. Today, the practice among the syndicate banks reveals a tendency to bind debtor states to extremely tight "protective clauses" in standard Euro-dollar loan agreements and collective restructuring agreements. Subsequent paragraphs will illustrate this established linkage.

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[133] *See* the introductory remarks by the Chairman during the *78th Annual Meeting of the American Society of International Law Proceedings*, April 12–14, 1984, p. 301.

[134] *Id*. at 301–302.

[135] Statement of the Honorable James A. Baker, III, Secretary of the Treasury of the United States before the Joint Annual Meeting of the International Monetary Fund and the World Bank on October 8, 1985 in Seoul, Korea, *International Legal Materials* XXV (March 1986), p. 412.

[136] *Id*. at 414.

Firstly, the purpose clause of a syndicated term Loan Agreement may provide, for instance, that

> The proceeds of the Loans shall be applied in or towards providing financing for investments included in the economic plan of the Republic of _________ for 1987 or other productive projects *in the context of the stabilisation policy agreed between the Borrower and the International Monetary Fund* x x x.[137] (Italics mine)

Secondly, parallel financing by commercial banks with the IMF has increasingly made a linkage between new money drawings under either a syndicated term loan agreement or restructuring agreement and the purchases by IMF members under a standby arrangement or similar facility. Paragraph 4 (entitled "Draw Down") of the specimen syndicated term loan agreement provides the following:

> Subject to the terms of this Agreement (*including* but not limited to *the conditions set forth in Clause 12*), loans will be made to the Borrower at anytime and from time to time during the commitment period x x x.[138] (Italics mine)

Clause 12 referred to under paragraph 4 refers to "Conditions Precedent" to loans. Section (2) of Clause 12 states, on the other hand, that

> The obligations of each Agent and each Bank hereunder are subject to the further precedent that, both at the time of the request for and at the time for the making of each Loan, *the representations and warranties of the Borrower set out in Clause 13(1) are true and accurate on and as of such times as if made at each such time* and no Default has occurred and is continuing or would result from the proposed loan.[139] (Italics mine)

Among the standard representations and warranties required of a debtor state in Clause 13(1) is a provision which relates to IMF membership stating that

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137 A. Arora, G.A. Penn, and A.M. Shea, *The Law and Practice of International Banking*, 399 (London: Sweet and Maxwell, 1987).

138 *Id*. at 400.

139 *Id*. at 410.

> The Borrower is a member in good standing of the International Monetary fund and *no limitation or restriction has been imposed on its use of the resource; thereof.*[140] (Italics mine)

In relation to the above-quoted representation, banks have maintained in practice that amounts under the syndicated term loan agreement or the restructuring agreement shall be disbursed "only when the program on the basis of which they agreed to reschedule or provide new financing is in place and progressing successfully."[141] One writer has expressed the view that the use of compliance with performance criteria under the IMF standby arrangement as an express condition would have the effect of incorporating directly all of the performance criteria into the new money or restructuring Agreement.[142]

Finally, Clause 16 on "Events of Default" includes the following circumstance:

> (c) any representation, warranty or statement made or deemed to be repeated in this Agreement or in any notice, certificate, statement or the Information Memorandum delivered, made or issued by or on behalf of the Borrower hereunder or in connection herewith or any information provided by the Borrower to any of the Agents, the Managers and the Banks hereunder shall be at anytime incorrect in any respect or any such representation, warranty or statement would, if made or repeated at any time with reference to the facts and circumstances then subsisting, be incorrect in any respect at that time x x x.[143]

In a more recent development, commercial loan documentation had also incorporated as covenants and events

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140 *Id*. at 413.

141 ASIL Proceedings, *supra* note 133, at 312.

142 Lee C. Buchheif and Mark A. Walker, "Legal Issues in Restructuring of Commercial Bank Loans to Sovereign Borrowers," in *Sovereign Lending, Managing Legal Risk*, Michael Gruson and Ralph Reisner, (Eds.) (Great Britain: Euromoney Publications, 1984), p. 150.

143 Arora, Penn, and Shea, *supra* note 137, at 416.

of default commitments by debtor-states to undergo a closer surveillance. The February 26, 1986 Restructuring Agreements between Venezuela and its commercial bank creditors (which represent the latest arrangement utilized in several multi-year restructuring agreements) contain the following pertinent clauses:

> **Sec. 10.02 *Covenants of the Republic***. So long as any Credit or any other amount payable by the Obligor or the Republic under this Agreement shall remain unpaid, the Republic agrees as follows:
>
> (e) *Monitoring Procedures. The Republic will complete the implementation of, and maintain, the Monitoring Procedures as provided in Schedule 6 to the Restructuring Principles*. The Republic agrees that any changes limiting the Monitoring Procedures (including, without limitation, any limitation thereof which affects the scope of any of the Annual Economic Programs to be prepared as described in Part 1 of the Monitoring Procedures, the implementation and maintenance of the procedures for the monitoring of the Venezuelan economy described in said Part 1, expanded as provided in the last paragraph of said Part 1, or the nature or extent of the consultations with international agencies described in Part 2 of the Monitoring Procedures) shall be mutually agreed by the Republic and the Overall Majority Banks before being implemented.
>
> (f) *Reporting and Information*. The Republic will furnish to the Servicing Bank the following:
>
> x x x x
>
> (iii) Promptly after the same becomes available to the Republic, a copy of each report referred to in the last paragraph of the description of the Monitoring Procedures set forth in Schedule 6 to the Restructuring Principles (including, without limitation, each report specifically referred to in the fourth and penultimate paragraphs of Part 2 of said Monitoring Procedures).

(iv) Within 30 days after the end of each calendar quarter, information concerning the Republic's consultations with international agencies (such as the Inter-American Development Bank, the IBRD and the IMF) described in the first paragraph of Part 2 of the Monitoring Procedures, and a comprehensive description of the preceding quarter's major macroeconomic policies and objectives, plans and assumptions, a statement of specific and quantified economic targets, and an update of the short and medium-term fiscal, economic and financial objectives of the Plan de la Nacion then in effect.

x x x x

Sec. 11.01 ***Events of Default***. If any of the following events ("*Events of Default*") shall occur and be continuing:

x x x x

(s) The Overall Majority Banks shall notify the Overall Coordinating Bank (through the respective Overall Servicing Banks that they have determined in their reasonable judgment that any of the following events or conditions has occurred (provided that, in the case of a determination contemplated by clause (iii) below, such determination shall have been notified by the Overall Coordinating Bank to the Republic and 30 days shall have elapsed since the date of such notice):

x x x x

(ii) *Based on the information furnished pursuant to Section 10.02 (f) hereof and the corresponding provisions of other Restructuring Agreements and the Relending Facility Agreement, the results of the economic program of the Republic of Venezuela are or will be materially incompatible with a viable external payments position consistent with continuing debt service*; or

(iii) The reporting and consultation procedures outlined in the Monitoring Procedures are

> not being implemented as contemplated by the Monitoring Procedures; or x x x[144]

This brief review of current loan documentation shows increasing dependence of international private lenders upon the surveillance authority of the IMF over its members. While banks have the tendency to adopt a more formal linkage with IMF standby agreements there is a more cautious attitude on the part of the IMF officials to reinforce this legal tie. Not only does the IMF interpretation of the legal nature of standby arrangements prohibit this formal linkage but, more importantly, the IMF cannot now risk losing the confidence of its developing country members who have continually exerted their best efforts to respect the evolving renegotiation procedure.

VII. International Financial Obligations: Tracing the Evolution of the IMF Policies from the Years 1990–Present**

A. The IMF and Developing Countries

Low-income members hold less than 10 percent of the institution's voting power and a roughly similar share of its quotas, which are based on the relative size of each member's economy. Low-income members are a large group within the IMF; however, comprising 78 countries (see Table A in the Appendix). They make up more than 40 percent of the organization's membership.

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[144] *Monitoring Procedures in Venezuelan Restructuring Agreements*, 25 Int'l Legal Materials 480–481 (1986).

** Rosalyn Co, Camille Lanton, Jeland Omer Pormentilla and Anthea Villaruel, International Financial Obligations: Tracing the Evolution of the IMF Policies from the Years 1990–Present (Academic Year 2006–2007) (unpublished JD thesis, Ateneo School of Law) (on file with the author).

The purposes of the IMF, as set out in Article I of the Articles of Agreement, apply to the low-income members as much as to all the others. Former First Deputy Managing Director Stanley Fisher made this point clear in his farewell remarks to the Executive Board: "The issue is not whether the Fund should take an interest in poverty, but whether it should continue working, and working better, with its poorest member countries. The answer to that is yes: as a universal financial institution, we have to stay involved with all our member countries."[145] More recently, the Executive Board of the IMF has adopted a statement, "The Role of the Fund in Low-Income Member Countries," to serve as an operational framework for the Fund's work with such member countries. The statement defines the Fund's role as one of providing policy advice, financial programs, and assistance in capacity building to low-income member countries in its areas of expertise and in accordance with its institutional mandate.

Involvement of the IMF with its low-income members generally takes the form of various lending and structural arrangements. From the perspective of donors and investors, such lending is typically assumed to boost the credibility of a multilateral's seal of approval, as a multilateral that lends money has a stronger incentive to monitor the quality of the policies being implemented in a member-State than one that plays a strictly surveillance role. This, among other reasons, allows the IMF to exercise conditionality, affecting the nature of policies implemented by the recipient country's government rather than simply monitoring their quality.[146] From the point of view of borrowing countries, conditionality may also provide a way of sorts to undertake decisions that, although desirable *ex ante*, would be difficult to carry out *ex post*.[147] It has been observed

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145 James Boughton, *Does the World Need a Universal Financial Institution?* 6(2) World Econ. 27–46 (2005).

146 International Monetary Fund, The Role of the Fund in Low-Income Countries (2004).

147 Dani Rodrik, "TFPG Controversies, Institutions, and Economic Performance in East Asia," NBER Working Paper 5914 (1997).

that this blend of conditionality and a multilateral organization helps offset the intrusiveness of the former in the national sovereignty of a borrowing country, allowing the intrusion to be more politically feasible and legitimate.[148] Furthermore, conditionality offers a way for further resources to be mobilized by providing other lenders with greater confidence that an appropriate reform program will be implemented and that, as a result, sound policies will return the economy to a path of sustainable growth.

IMF concessional lending is provided through the Poverty Reduction and Growth Facility (PRGF) at a fixed interest rate of 0.5 percent. The grace period for concessional loans is comparatively longer than that for standard IMF arrangements. A borrowing low-income member begins repaying a loan five and a half years after the disbursement of the first tranche, while the grace period for a standard credit tranche is two and a half years, which can be extended up to three and a quarter years. The maturity of a concessional arrangement is, at 10 years, five years longer than that of a standard IMF arrangement. In addition to PRGF-supported programs, lending on concessional terms is available for post-conflict members through the Emergency Post-Conflict Assistance. Established in 1995, the facility provides assistance to members with urgent financing needs unable to develop a comprehensive economic program due to severe capacity limitations in the aftermath of a conflict. The facility—which often plays a valuable role as a bridge to a subsequent PRGF—has a subsidized interest rate of 0.5 percent for low-income members and a maturity between three and a quarter and five years.

B. Debt Relief for Low-Income Countries and the HIPC Initiative

Since the 1980s, there have been various efforts by members of the international community to alleviate the debt burden of low-income countries (LICs). In the late 1980s, industrial

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148 Niall Ferguson, The House of Rothschild: Money's Prophets 1798–1849 (1998).

countries, primarily members of the Paris Club, first agreed to reschedule low-income countries' debts on concessional terms in the context of the so-called Toronto[149] terms. By the mid-1990s, there was a general recognition that the debt problems of the low-income countries were more structural and permanent in nature than it was initially thought.

Consequently, under what came to be known as Naples terms, Paris Club creditors were forgiving two-thirds of low-income countries' eligible debts. Despite these efforts, some low-income countries, especially those in sub-Saharan Africa, continued to face heavy external debt burdens and difficulties in servicing them, sometimes repeatedly resorting to debt rescheduling. This often reflected a combination of factors, including a lack of perseverance with structural and economic reform programs, a deterioration in their terms of trade, poor governance, civil unrest, and also a willingness of creditors to continue to provide new loans.

In the mid-1990s, increasing poverty and a general perception of development failure in many of the least developed countries, primarily in sub-Saharan Africa, coincided to intensify the pressure for a strategy to deal with the LIC debt crisis. The complex relations between heretofore relatively distinct groups of actors started to come together and influence official thinking on the issue. The growing influence of civil society, with NGO networks at its forceful core, transformed the international debt regime through political reach into the higher echelons of international governance, especially with the G-7 governments and the Development and Interim Committees of the Bretton Woods institutions. The alliance's efforts led to a call by the governing body of the World Bank at its annual meetings in 1994 and 1995 to study multilateral debt and develop an effective strategy to deal with the issue.

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149 The Toronto terms were granted in October 1988. They provide for a concessional rescheduling with a reduction in the net present value (NPV) of eligible debt of up to one-third of debt. The Naples terms, granted from January 1995, effect a two-thirds reduction in the NPV of eligible debt.

Within the World Bank, concern was already growing about the rising debt problem for a large number of its poorest borrowers, particularly in the Africa Region. At first the voices were disjointed; they were also discounted under the presumption that the poor countries had a short term cash-flow constraint that was readily amenable to policy reform. The major tool in this strategy was structural adjustment programs, which provided the resources to get through the short-run problems and targeted much needed policy reforms.

By the early 1990s however, it had become clear that structural adjustment programs were not working as expected. Lack of ownership of reform programs combined with governance dysfunctions, weak public expenditures management, and inadequate emphasis on infrastructure, private sector development, and agricultural productivity had hindered supply responses to macroeconomic policy adjustment.

To address increasing concerns about LIC debt, especially the rapidly increasing multilateral debt, the World Bank established a working group to assess the magnitude of the multilateral debt problem and develop possible mechanisms to deal with it. The group sought to complement the World Bank's existing instruments and traditional mechanisms[150] for providing relief for bilateral and commercial debt. The mechanism proposed by the group, a "multilateral debt fund," was deliberately designed to be a concerted and comprehensive effort to effectively deal with the HIPC (Heavily Indebted Poor Countries) debt problem.

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[150] These traditional mechanisms may be summarized as: the adoption of stabilization and economic reform programs supported by concessional loans from the IMF and the World Bank; flow rescheduling agreements with Paris Club creditors on concessional terms followed by a stock-of-debt operation after three years of good track records under the IMF arrangements and the rescheduling; agreement by the debtor country to seek at least comparable terms on debt owed to non-Paris Club bilateral and commercial creditors; new financing on appropriately concessional terms.

The development community quickly embraced the idea, which soon translated into the proposal for the HIPC Initiative put forth by the World Bank and the IMF in 1996. Through more uniform rules, the HIPC Initiative marked a significant advance from traditional debt relief mechanisms for eligible LICs. It transformed the debt regime toward more open and accountable norms, and introduced some key innovations, including, for the first time, a systematic treatment of multilateral debt, the notion of debt sustainability, and the focus on poverty reduction.

The major evolution of the treatment of sovereign debt was the move from debt collection, to debt rescheduling, to aid and structural adjustment, to debt "sustainability," to forgiveness and poverty reduction—what one G-7 official called the "slippery slope of debt."[151] The resulting momentum brought about the original HIPC Initiative and the Enhanced HIPC Initiative.[152]

The HIPC Initiative was new in several important ways. The HIPC Initiative involved all creditors. For the first time, World Bank and IMF debt became eligible for relief. The Initiative also provided for the write-off of all creditor debt stock rather than just yearly relief on repayments—it was a permanent relief deal that could not be reneged upon later. Until HIPC, bilateral creditors would only write off a certain amount of debts owed them: 33 percent, 50 percent, or 67 percent. The concept of committing to writing off an amount of debt that would take debt levels down to a "sustainable" level was a real shift in debt relief policy.

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151 Madhur Gautam, Debt Relief for the Poorest: An OEd Review of the HIPC Initiative (2003).

152 The 1996 Initiative was enhanced following extensive consultations with interested parties from civil society and the Group of Seven (G-7) countries. The Enhanced HIPC Initiative launched in late 1999 by the IMF and World Bank Executive Boards, aimed to provide broader, faster, and deeper debt relief to a larger number of countries.

There are two requirements to be eligible for HIPC status. First, HIPC is only for the poorest countries. This is defined by which countries are eligible to receive assistance from the International Development Association (IDA) arm of the World Bank. IDA countries are defined as having a GDP per capita of $885 or less. Second, a State's debt burden must be large enough to be considered unsustainable. HIPC defines "debt sustainability" as a ratio of debt to exports. A country's total debt burden must be more than 150 percent of its annual exports in order to qualify for relief.

In recognition of the need to address the debt burden of the low-income countries, the international financial community has over the past decade introduced and implemented a wide range of instruments which were designed to alleviate the debt burden of these countries. In general, for the different categories of creditors, the main trend has been a move towards increasing the concessionality of external assistance to the low-income countries.

The "traditional" mechanisms for addressing the debt problems of low-income countries are: the adoption of stabilization and economic reform programs supported by concessional loans from the IMF and the World Bank; flow rescheduling agreements with Paris Club creditors on concessional terms followed by a stock-of-debt operation after three years of good track records under the IMF arrangements and the rescheduling; agreement by the debtor country to seek at least comparable terms on debt owed to non-Paris Club bilateral and commercial creditors; and new financing on appropriately concessional terms.

Once States qualify for HIPC classification, they must comply with strict macroeconomic requirements prescribed by the IMF, known as Structural Adjustment or Austerity Programs. It often takes years to implement these policies before any debt cancellation is delivered. States must also be in an agreement with the IMF to borrow more money in order to remain eligible for debt relief through HIPC.

When a country meets the requirements to the satisfaction of the World Bank and the IMF, they reach what is called Decision Point. At Decision Point, a State receives interim debt service relief. In other words, what the country pays each year (debt service) is reduced, but the actual amount of debt (debt stock) has yet to be cancelled. Most States begin to benefit from debt service reduction immediately, putting the savings into health, education and other development goals. States must stay "on-track" with implementing the economic policies required by the IMF in order to continue receiving this interim debt relief. In at least nine cases the IMF has suspended debt relief because countries were listed as "off-track" with their IMF program. The World Bank also reserves the right to cut off interim relief to a country if they are not following through with their IMF requirements.

At what is called Completion Point, States exit the HIPC program. Two things are required to reach the HIPC completion point. First, States must remain "on-track" with their IMF economic conditions, even when those policies can be harmful to the domestic industry, the poor, and the environment. Second, States must design and implement for one year a Poverty Reduction Strategy Paper (PRSP) under the guidance of the World Bank and the IMF.

VIII. Conclusion

The legal arrangements between sovereign borrowers and their creditors indicate a growing recognition of a "shared responsibility" in the ongoing crisis management of Third World debt. Despite the strong arguments for unilateral state action by several heavily indebted developing country borrowers, there has been an acceptance of less confrontational means of addressing differing views and approaches. It is thus evident that international actors in the global debt crisis have affirmed in practice an obligation to negotiate instead of exercising unilateral actions. However, as debtor states continue to accept the principle of economic adjustment through IMF surveillance,

it is crucial to emphasize that international creditors should realize that certain provisions of the loan or rescheduling agreements may not be susceptible of strict enforcement. A case in point is the express reference to IMF standby arrangement performance criteria as conditions precedent. This form of linkage now opens a whole range of legal issues particularly in the area of international responsibility.

Appendix

Table A

Low Income Members of the IMF

(As of 2006)

Afghanistan	Armenia
Albania	Azerbaijan
Angola	Bangladesh
Benin	
Bhutan	Liberia
Bolivia	Madagascar
Burkina Faso	Malawi
Burundi	Maldives
Central African Rep.	Mali
Cambodia	Mauritania
Cameroon	Moldova
Cape Verde	Mongolia
Chad	Mozambique
Comoros	Myanmar
Congo, Democratic Rep.	Nepal
Congo, Rep.	Nicaragua
Cote d'Ivoire	Niger
Djibouti	Nigeria
Dominica	Pakistan
Eritrea	Papua New Guinea
Ethiopia	Rwanda
Gambia	Samoa
Georgia	Sao Tome and Principe
Ghana	Senegal
Grenada	Sierra Leone
Guinea	Solomon Islands
Guinea-Bissau	Somalia
Guyana	Sri Lanka
Haiti	St. Lucia
Honduras	St. Vincent
India	Sudan
Kenya	Tajikistan
Kiribati	Tanzania
Kyrgyz Rep.	Timor-Leste
Lao, P.D.R.	Togo
Lesotho	Tonga
	Uganda
	Uzbekistan
	Vanuatu
	Vietnam
	Yemen, Rep.
	Zambia
	Zimbabwe

Table B

Original and Enhanced HIPC Initiative

Element	Original	Enhanced
Stated objectives	To bring the country's debt down to sustainable levels, subject to satisfactory policy performance	Maintains the original focus to remove the debt overhang and provide a permanent exit from rescheduling, plus free up resources for higher social spending aimed at poverty reduction to the extent that cash debt-service payments are reduced.
Qualification criteria	IDA-only countries (poverty) Unsustainable level of debt after full use of traditional mechanisms Strong record of policy performance 41 countries eligible, 29 expected qualify	Same. Applied retroactively to include countries already past decision or completion points under the original framework. 41 eligible in 1999, currently 42, of which 38 are expected to qualify.
Debt sustainability	*Guiding principle.* Target overall debt sustainability to provide a durable exit strategy from the rescheduling process	*Principle for change:* Provide a clear exit from unsustainable debt burden to remove the debt overhang and provide an appropriate cushion against exogenous shocks.
Indicators: Targets	Target range for main indicator: NPV debt-to-exports: 200-250% NPV debt-to-revenue: 280% with export/GDP: 40%; revenue/GDP: 20%	Uniform application of single target: NPV debt-to-exports: 150% NPV debt-to-revenue: 250% with export/GDP: 30%; revenue/GDP: 15%
Calculation of relief	Fixed at completion point, based on projections of debt indicator for completion point	Fixed at decision point, using actual data on NPV debt for year prior to decision point and 3-year average for exports
Time of relief delivery	Completion point (CP), irrevocable commitment	Decision point: on an annual basis, interim relief is bulk of anticipated post-CP relief, it is irrevocable
Forward-locking assessments	Debt sustainability analysis to project profile of key debt indicators	Same
Performance criteria	*Guiding principle.* Action only after the debtor has shown, through a track record, the ability to put to good use whatever relief is provided	*Principle for change:* To strengthen the incentives for debtor countries to adopt strong programs of adjustment and reform
For decision point	3-year track record of macroeconomic stability and policy reform	Same plus interim or full PRSP
For completion point	Further 3-year track record of macroeconomic stability and policy reform	Maintenance of macroeconomic stability Completion of PRSP, plus one-year PRSP implementation for E-HIPC Performance benchmarks for structural and social reforms
Interim period	3 years	Flexible, with the introduction of floating CP
Creditor participation	*Guiding principle:* Comprehensive debt relief action: coordinated among all creditors involved with broad and equitable participation New external finance to be on appropriately concessional terms	*Principle for change.* Same plus debt relief should be additional to reinforce the wider tools of the international community to promote sustainable development and poverty reduction

Source: Gautam, Madhur. Debt Relief for the Poorest: An OED Review of the HIPC Initiative, 2003 THE WORLD BANK, Washington, D.C.

Table C

HIPC Countries, as of May 2006

Completion Point	Decision Point	Pre-Decision Point
Benin	Burundi	Central African Republic
Bolivia	Chad	Comoros
Burkina Faso	Congo, Rep.	Cote d'Ivoire
Cameroon*	DRC	Eritrea
Ethiopia	Gambia	Haiti
Ghana	Guinea	Kyrgyz Republic
Guyana	Guinea-Bissau	Liberia
Honduras	Malawi	Nepal
Madagascar	Sao Tome and Principe	Somalia
Mali	Sierra Leone	Sudan
Mauritania**		Togo
Mozambique		
Nicaragua		
Niger		
Rwanda		
Senegal		
Tanzania		
Uganda		
Zambia		

Source: World Bank

* *Cameroon reached completion point on May 1, 2006.*

** *Mauritania has since been excluded from the MDRI because the IMF determined that macroeconomic management has gone off-track.*

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*The Economic Theory of Globalization**

Victor S. Venida, Ph.D.

The General Agreement on Tariffs and Trade (GATT) always envisioned development as the ultimate goal. To attain this a liberalized but fair trading of goods and services among countries was regarded as a crucial means. This vision has its basis in classical economic theory and has in many ways been verified by the history of developed countries in Western Europe, principally England. As early as 1817, David Ricardo attempted one of the earliest rigorous approaches to economic analysis to justify the abolition of the Corn Laws which restricted the importation of wheat to England and which he regarded as delaying the expansion of employment and investment in England (Blaug 1976). But equally powerful arguments have also been put forth to emphasize the disagreeable aspects of free trade or globalization. Even after the contentious debates regarding the ratification of the GATT, disagreements over the merits of globalization remain, specially with the ongoing regional economic crisis in East Asia.

This article presents a summary of the implicit theories of development underlying globalization, specifically free trade. It focuses not so much on the relationships among nation-states but the social structure within a society and how it changes as the process of economic development proceeds. A special point is on the social classes and how their interaction in the political and economic sphere can determine a country's economic change. The effect of trade on industrial development is then discussed. And the last section attempts to apply these theories

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in analyzing the economic structure of the Philippines and to examine what forces would contend in determining the path of development in the future.

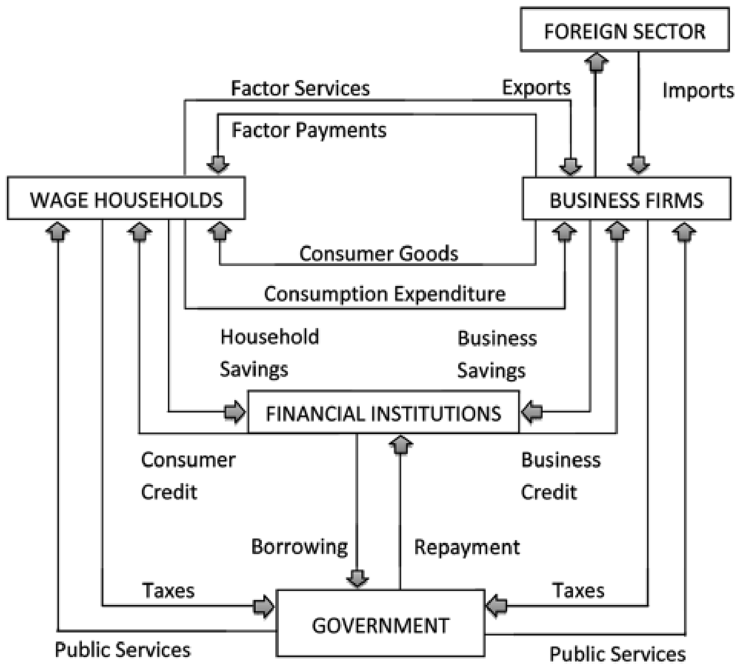
The Dual Economy

Some of the major issues that have emerged in the study of development economics relate to market or structural fragmentation. Developing economies lack a degree of market integration that developed economies take for granted. To be precise, developing economies are said to have a "dualistic" economic system. Dualism here refers to the coexistence of an informal and a modern sector within the structure of the same economy and has become quite popular in the study of the economies of developing countries (Myint 1986; Todaro 1985). From this point of view, development is the process of modernization of a society that starts from a traditional or premodern economy. Thus, developed economies are essentially fully modernized societies while developing economies are still in transition to full modernization. Modernity refers to the high degree of specialization of economic functions, monetization of transactions and homogenization of goods and services prevalent in a society.

The modern sector contains five basic units: the household, the firm, financial institutions, government, and the foreign sector. Households supply firms with labor and capital services in return for factor payments which are then spent on the goods produced by the firms. Both households and firms deposit their savings with financial institutions which then supply finance for both consumption and investment purposes. Households, firms and financial institutions pay taxes to the government which then provides the economy with public goods and services (the government also has credit transactions with the banking system). Finally, firms, households and financial institutions deal with the foreign sector in, respectively, the import and export of goods, supply of factor services for factor incomes, and in capital inflows and outflows (see Figure 1).

Figure 1

A Fully Organized Economy



Source: Hla Myint, "Organizational Dualism and Economic Development," *Asian Development Review*, 2(1), p. 28.

In this stylized picture of the circular flow of income, product, and money, the features of a modern sector emerge. First, the economic units are specialized in their economic functions. Consumption is done by households, production and employment by firms, savings and credit by financial institutions, and peace and order and defense by government. Second, transactions have attained a high degree of monetization because specialization necessitates exchange on a wide scale. Much of the services are already done in exchange for payment. Third, goods and services attain a high degree of homogenization in price and quality throughout the entire modern sector. These include the homogenization of skills and

education required by the entire economic system from among its labor, professional and managerial classes.

This economic structure corresponds to that prevailing among developed economies and the modern sectors of the less developed countries. The costs of transaction and information across borders are quite affordable that they promote a high degree of global economic integration made possible by the availability of infrastructure. Indeed, "infrastructure" (literally beneath the structure) are the systems that make this economic structure function smoothly and efficiently. Five elements comprise the modern infrastructure system: energy, transport, communication, water and sanitation. In fact, the modernized economies of the developed world and the modern sectors in developing countries are closely integrated, made possible by infrastructure linkage. Indeed, nearly all of the transactions within the modern sector of a country are easily and similarly undertaken with the foreign sector.

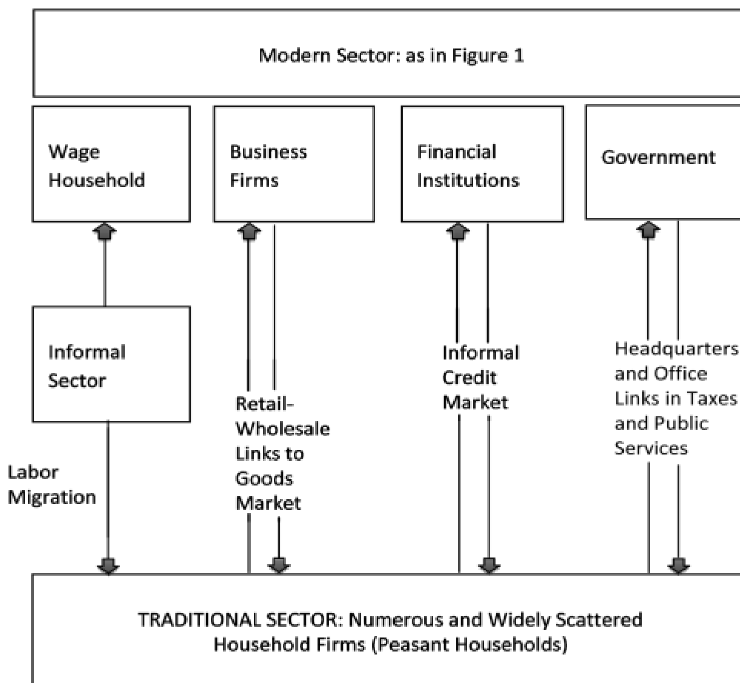
In contrast, the traditional or premodern economy features a low degree of specialization in functions and in integration into the exchange economy. The prevailing economic unit is the peasant household. These undertake subsistence production and possibly production of cash crops and handicrafts and supply of seasonal wage labor, all to earn some money income. In contrast to the modern household which earns money income from its labor to purchase goods and services, the peasant household produces a lot of the goods it consumes and sells some of its produce to earn some money income to purchase some of the goods. There is, moreover, little infrastructure connecting these peasant households which are thus quite isolated from each other. Exchange of goods and services is thus quite minimal. Given this production structure the degree of monetization of transactions and homogenization of goods and services is quite low.

By the theory of dualism, development is the process of modernization, by which a society evolves from the traditional to the modern economic system. A developed economy is one

that is fully modernized. A developing economy is one that is still in transition, with the modern sector and a non-modern sector—called the informal—coexisting, thus a dualistic economy. The informal sector emerges as that which is no longer traditional but is not yet fully integrated with the modern or formal sector. The interaction between the modern and informal sectors is assumed to be tenuous so that the national economy is fragmented (see Figure 2).

Figure 2

Organizational Dualism:
Structure for a Developing Economy



Source: Hla Myint, "Organizational Dualism and Economic Development," *Asian Development Review*, 2(1), p. 29.

Because of an undeveloped transportation and communication system throughout the economy particularly in the informal sector, the overall costs of marketing, information and storage of commodities are quite significant. The markup pricing of middlemen in the distribution system reflect both localized monopolistic control (especially over communities of peasant households without access to other markets) and real resource costs of transactions. As a result, there is a wide differential in the price of farm produce and of manufactured goods between the producer and the retailer. Persistent subsistence production among peasant households is then an economically rational decision given the high prices for goods available in the market and supply uncertainties (Wharton 1969). The domestic market for goods in general in a dualistic economy is indeed quite small. This serves as an effective limit to the growth of enterprises that cater largely to the domestic market. It also predisposes the modern sector to monopolistic or oligopolistic control. These considerations explain, for example, the ambivalence of many firms towards export orientation: on the one hand, the domestic market for wage goods and luxury commodities is easily saturated; on the other, oligopoly profits are more attractive than export earnings and the competition that these earnings entail (deJanvry 1981).

In the labor market, wage differentials across sectors are also significant. An added consideration is that labor itself is no longer homogeneous: raw labor for peasant agriculture is vastly different in minimum skills and work orientation from the unskilled labor of the modern sector. The latter sector generally needs workers with basic skills and availability for regular, long-term, supervised employment—in contrast to the seasonality, muscular energy and manual dexterity sufficient for traditional peasant production. The modern sector wage thus reflects a "quality" premium needed to maintain a relatively stable pool of labor available for wage employment.

In the dual model, employment in the informal labor market involves seasonal labor and rather crude, labor-intensive production in shoemaking, carpentry, other artisan crafts and

food processing. A major portion of the work force involves services such as peddling, domestic work, messengerial, sanitation, garbage recycling and the like. In effect, the informal sector absorbs the seasonal excess labor from the peasant agriculture sector that is unable to obtain wage employment because of lack of sufficient skills and of job availability. Its large pool of labor explains to some extent the cheapness of personal service in developing countries.

Interest rate differentials characterize the capital market (Sicat 1983). The formal banking system incurs higher administrative costs per unit of loan amount if it transacts with the numerous and widely dispersed peasant and urban informal sector households than if it restricts itself to the large modern sector establishments. The latter are either urban manufacturing enterprises or accessible plantations, and these tend to borrow in large amounts to further reduce monitoring and transactions costs. Moreover, these firms have a much lower cost of credit investigation. The interest rate disparity reflects both real costs of administration and differential risk across the sectors (McKinnon 1973).

In the informal credit market, the interest rates are rather higher. This reflects both the local monopoly control of the moneylenders—isolation precludes arbitrage by peasant households across moneylenders—and also there is a genuine capital scarcity in the credit market. The informal sector cannot generate substantial surplus cash, given the prevalence of subsistence production in agriculture and high rates of urban underemployment. And it does not have institutional access to the savings of the organized financial system. Moreover, the informal credit market relies on personalistic (social and economic) relationship among the transacting parties to initiate, consummate and enforce the contractual relationship (Floro 1987; Llanto 1993).

As in the analysis of the labor market, one can see parallels to the role of the informal credit market. Clearly, the latter provides loans needed by the informal sector but one can expect interest rates to be higher, reflecting the real scarcity of funds

in this sector. The supply of funds is limited to whatever surplus the moneylender may have and he would have minimal access to the larger pool of funds within the formal banking system. Secondly, the moneylender can exercise real monopoly power over certain borrowers because of their mutual isolation from other markets. Third, the formal banking system, given the high cost of transportation and information-gathering to determine creditworthiness, may not have an incentive to enter the informal credit market even though interest rates are higher than in the modern (Floro 1987).

Finally the administrative machinery of the government is largely concentrated in the modern sector. The high cost of collecting taxes and providing public services among a vast number of widely dispersed peasant and urban informal sector households ensures this concentration. Besides, the prevalence of subsistence production imposes a limit on monetary revenues that can be generated from within the informal sector. Not surprisingly, the bulk of the modern sector revenue derives from income and corporate taxes, sales taxes, and taxes on imported and exported goods. The tendency is to rely on indirect taxes which, despite equity problems, are relatively efficient and convenient to collect. Again, the small size of the modern sector constrains its revenue-generating capacity even if one assumes an efficient collection machinery and the absence of political pressure by organized unions, capitalists, landowners and middle classes against high taxation. The ability of these social classes to organize as a pressure group, coupled with the administrative costs of delivery of public goods to the informal sector, also explains why public services (such as public or subsidized private education, health services, and infrastructure facilities) are also concentrated in the modern sector. In a nutshell, the tendency for dualistic economies is towards regressivity in tax and expenditure policy, thus towards inequitable distribution of fiscal resources.

From a historical perspective, the modern sector is actually the capitalist mode of production, the traditional as the feudal or precapitalist mode. The process of modernization or of

economic development is the transition from a feudal to a capitalist system. The developed economies therefore are fully capitalistic while the developing are in transition. In a developing economy, capitalism coexists with a mode of production no longer completely feudal but semi-capitalist, or the informal sector (Venida 1996). This approach suggests that feudal practices may persist even though the traditional economic system may have already disintegrated. One can also analyze the political factors that influence the development process itself—in other words, the political economy factors.

Under feudalism, the two main classes were the landlords and the peasants who may be serfs or tenants. The latter are organized into communities over which a particular landlord has a domain. The size of the lord's landholding is variable, its boundaries depending upon relative positioning with other landlords. The lord provides protection to a subject peasantry from outside molestation and guarantees their access to land for subsistence production. In return the landlord has the right to extract the surplus output of the peasantry in cash, in kind, and/or in personal service.

Since the surplus is extracted from the peasantry as a matter of right, the power and wealth of the feudal lord is dependent upon the number of people under his direct control as peasants, retainers or warriors. The collected surplus is spent on his own military for the protection and enlargement of the manor, and for conspicuous consumption. The latter consumption is functional since it reflects and reveals the power of the lord and his serfs and thus serves as an inducement for more peasants to ally with him and request his protection. Moreover, it has a redistributive function to the degree that the peasants participate in the feasting and the entertainment without charge. One can notice this pattern of relationship among many politicians in the Philippines with their large staff of retainers, private army of bodyguards, and the constant entertainment and open house necessary for the hospitality of callers (McCoy 1994).

Under capitalism the two basic classes are the capitalists or bourgeoisie, and the proletariat or formal sector laborers. The former own the means of production while the latter are legally free individuals who provide the labor service necessary for production. This service is exchanged for a wage payment. The capitalist utilizes the profit to invest in equipment, land improvements and machinery to increase production capacity, to reduce the cost of production and thus ensure the viability of the firm. Two factors impose regular pressure on profits. Market forces determine output price while the wage cannot, in the long run, fall below the level necessary for the subsistence of the worker and his or her family. For the competitive capitalist, conspicuous consumption is not a rational choice. The threat of bankruptcy for the one class is as real as the threat of unemployment for the other. Warfare is useless because it destroys capital and reduces the labor supply.

Economists have tended to describe rentiers and landlords as a sterile class because they do not have the incentive to save and invest their earnings in income generating activities. Their earnings tend to go into political activity which by itself does not generate sustained employment and increased production capacity. In contrast, the capitalists are regarded as progressive because by the very nature of their activity, they have to save and invest their earnings in capital, land improvements and skills training because these guarantee their business survival. These also increase employment and production capacity in society (Blaug 1978). The increase in employment is what is necessary to absorb the informal sector labor and the excess labor in agriculture to regular employment and hasten the transition to capitalism.

In a dualistic economic system, the social classes of feudalism and capitalism are all present because the society is still in transition. Elements of either mode of production, specially the peculiar economic behavior of the social classes, persist. The country’s prospects for development will therefore depend on which social class interest dominates, whether that of the feudal landed elite, or that of the capitalist. The role of

international trade and economic relations is also crucial since historically capitalism was brought to the developing economies by colonialism. Thus, the capitalist sectors worldwide are tightly interwoven. Whether an economy develops towards modernity will depend on the type of transactions it engages in the international market.

In addition to the landed elite as a major class component there are also the international capitalist class (the foreign multinational corporations) and the class of local people, the dependent bourgeoisie, who are employed as managers for multinational corporations. The importance of the latter two classes is due indeed to the strategic role that foreign interests play in the domestic economy. Their substantial profits can either be repatriated to the home countries of the multinational corporations or be reinvested in the host countries. As for the landed elite, their profits and rents are directed towards maintaining their position of power, through the establishment of private armies and/or the expenditure in elections to maintain some control over government decision making.

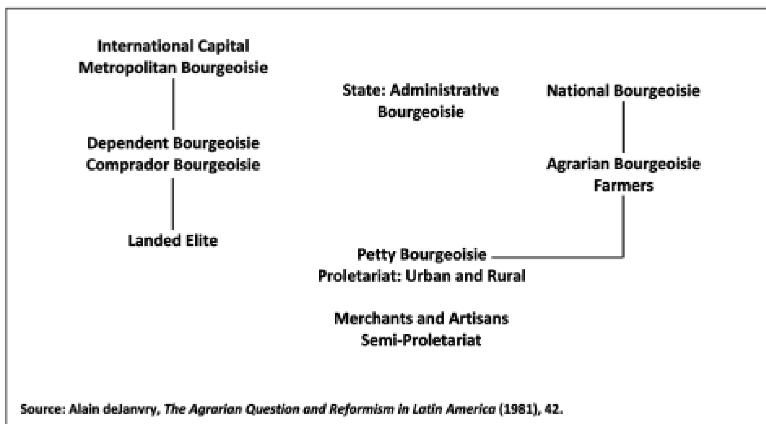
Because some degree of industrialization has been attained in many developing countries, there is a national bourgeoisie, the equivalent of the capitalist bourgeoisie in the capitalist economies. But also important are the agrarian bourgeoisie, who are engaged in agriculture like the landed elite but are more profit-oriented or capitalistic in nature. A large number of the agrarian bourgeoisie may not even be large landowners and they generally do not engage in politics.

The proletariat are present but, in addition, there would also be the informal sector labor, and the peasantry or the traditional sector farm households, and the class of merchants and artisans. Two other important classes are the professionals and students (or the petty bourgeoisie) and the government bureaucrats (or the administrative bourgeoisie).

Given this structure of social classes, the transition to a developed economy may be accelerated when and if dominant social interests happen to be those of the national and agrarian

bourgeoisie in political alliance with the peasantry, proletariat, semiproletariat, merchants and artisans, petty and administrative bourgeoisie. Under this alliance, the taxes and savings of society will be invested in machinery, equipment, infrastructure and education and skills training which can expand employment and production. The bourgeoisie will tend to engage in production for export and joint ventures with foreign capitalists because of the substantial profit opportunities in the international market. Even the international bourgeoisie can be enticed to reinvest their profits in the host country because of the expansion in economic activities and opportunities. However, if the landed elite together with the international and dependent bourgeoisie are the dominant class interest, taxes and savings will tend to be utilized in private armies, politics, and for the international bourgeoisie, repatriation of profits to the home country. The increase in production capacity and employment opportunities will be constrained so that the transition to a developed economy will be delayed (see Figure 3).

Figure 3



Source: Alain deJanvry, *The Agrarian Question and Reformism in Latin America* (1981), 42.

In summary, development is a process of modernization in which a society evolves from a traditional or feudal economic system towards a modern or capitalist economic system. A modern economic system is one with a high degree of

specialization of economic functions, monetization of transactions and homogenization of goods and services. Developing economies are in transition to this so that their economies are dualistic, with modern and informal sectors coexisting. The transition will be accelerated if the class interests of capitalists or bourgeoisie dominate over that of the landed elite because the former tends to direct its savings towards investment in infrastructure, plant, equipment, and skill improvements rather than the latter which tend to engage in politics.

Trade and Development

How international trade contributes to the development is the starting point of understanding the theoretical underpinning of the GATT and globalization. The dualistic approach to the analysis of the development process is generally based on the historical experience of Western European countries. But the modern theories of trade and the process of development tend to be based on the recent history of the East Asian Newly Industrialized Countries (NICs) of Taiwan, South Korea, Hong Kong, and Singapore (World Bank 1993).

"Vent-for-surplus" theory argues that the international market, being far bigger than the domestic market in the number of consumers and total purchasing power, provides an outlet for surplus resources and output of any trading country (Myint 1973). A developing economy can utilize its labor, capital and natural resources to increase the production of goods and services over and above what the domestic market can absorb. The surplus can be sustained and increased over time as these can be sold in the wider market abroad. The expanded production can then help increase domestic employment, income and saving.

As a complement, trade also increases and sharpens the productivity of an economy. Since the international market approximates a perfectly competitive market, production has to be efficient to be profitable and this means the improvement

of labor skills and technical innovation to enhance productivity. This innovation and constant education and training mutually reinforce an atmosphere of economic dynamism that can generate further investment, innovation, efficiency and productivity. This could then redound to sustained increases in domestic production, employment, income and savings. The spur to all these are the competition and opportunity fostered by participation in international economic transactions and not by any form of assistance from government.

Most industrialization programs among developing countries began with import substitution (Balassa 1980). "First stage" import substitution involves the replacement by domestic production of imports of nondurable consumer goods (such as clothing, footwear, processed food and household goods) and of their inputs (textile fabrics, leather, primary goods, among others). "Second stage" import substitution involves the replacement by domestic production of the imports of intermediate goods, producer and consumer durables (such as machinery, equipment and household appliances).

The first stage generally involves production processes that are intensive in unskilled labor with the efficient scale of output at relatively low levels. Costs per unit of output are not substantially high at low output levels, neither is technology sophisticated. And efficient operations do not require a network of suppliers of parts, components and accessories. The second stage is generally capital-intensive and subject to economies of scale. The efficient plant size could well be higher than the domestic requirements of a developing economy. Moreover, costs per unit of output rise rapidly at low levels of output and may increase further with organizational and technical inefficiencies. This may be the usual case given the lack of adequate infrastructure, the lack of sophisticated technology and the absence of a ready network of suppliers of parts, components and accessories. Thus, the first stage is also called the "easy" stage, the second, the "difficult" stage. For the first stage, a measure of tariff and nontariff barriers on imported substitutes can be justified to protect domestic producers since

the domestic production of nondurable consumer goods and inputs encourages the training of large pools of labor, and develops entrepreneurship and the spread of technology (Balassa 1980).

But in the second or the difficult stage, economies of scale is an important consideration. This refers not so much to increasing plant size per se but to increasing horizontal and vertical specialization. Horizontal specialization requires the reduction in product variety which would allow longer production runs and reduce production costs through efficiency, savings on expenses incurred by moving from one operation to another (which would be the case if product variety were high), and the use of special purpose machinery. Vertical specialization involves the manufacture of standardized parts, components and accessories and other vital intermediate inputs on an efficient scale in separate plants. Costs are largely reduced through the subdivision of the production process among plants of efficient size.

The limited size of the domestic market among developing countries constrains the possibilities of both horizontal and vertical specialization. Furthermore, skilled labor and sophisticated technology are not readily available but are necessary for precision required in the production of parts, components, and accessories. A measure of outward- rather than inward-orientation would thus be necessary for efficient second stage industrialization program.

Outward-orientation strategy pertains to policies that provide similar incentives to production for domestic and for export markets. Inward-orientation strategy biased incentives in favor of production for the domestic market rather than for the export markets (Balassa 1980). Among the East Asian NICs—regarded as generally outward-oriented—exporting establishments obtained their inputs from domestic or imported sources, availed of exemptions from indirect taxes on outputs and inputs and from duties on imported inputs, and generally enjoyed the same privileges as the domestic producers of inputs to export production. Furthermore, all

exported goods were extended equal treatment: the same incentives were granted production for export as for import-substitution, agricultural and non-agricultural exports and activities. The incentive system was automatic (i.e., nondiscretionary) and stable over time. The East Asian NICs guaranteed positive real interest rates (which encouraged domestic savings mobilization), realistic pricing for public utilities (which encouraged investments) and minimal differences in incentives across industries.

Countries that pursued outward-oriented industrial development strategies had higher sustained growth rates in export, employment and GNP than those that were inward-oriented. Moreover, countries that shifted to outward-orientation improved on their overall economic performance than those that maintained inward-orientation (Balassa 1980; World Bank 1993). The East Asian NICs began the exportation of nondurable goods soon after the first stage which did not last long among them. Besides not all exported nondurable consumer goods first passed through import substitution: South Korean synthetic textiles, Taiwanese plastic shoes and Singaporean fashion clothing were from the outset produced solely for export.

The private sector played a crucial role. This was specially underscored by the need for flexibility to changes and initiative to the possibilities in international market conditions. But with the incentive system not discriminating against exports, the production of exportable commodities largely corresponded to the countries' respective comparative advantage. Comparative advantage in this case also referred to dynamic changes in the countries' factor resources over time. Thus, Japan started with commodities intensive in unskilled labor, then with those in skilled labor and capital, and is now in technology-intensive commodities. The East Asian NICs have captured Japan's former niche in products that are intensive in skilled labor and capital. Countries at a lower stage of industrial development (such as the majority of the member countries of the Association of Southeast Asian Nations [ASEAN] and China)

have taken over the production of goods intensive in unskilled labor.

For countries that maintained a largely inward-oriented strategy in second-stage import-substitution, their nondurable goods and inputs faced a price disadvantage in the international market because their inputs were largely sourced from the domestic market and were thus high-priced. Moreover, the export of intermediate goods, consumer and producer durables were retarded because the smallness of the domestic markets precluded economies of scale. Small-scale production, inadequate specialization and obsolete machinery and equipment resulted in an internationally obsolete and inert industrial structure as is apparent among the heavy industries of the former Socialist bloc economies.

Thus, for an efficient second-stage import-substitution, special attention has to be focused on the need for economies of scale on the plant level for the production of intermediate goods, horizontal specialization for machinery, and vertical specialization in the production of parts, components and accessories. Furthermore, it would be more efficient to simultaneously undertake the manufacture of intermediate goods, producer and consumer durables for both the domestic and export markets, rather than preceding exportation with an import-substitution phase. No import-substitution preceded the export of South Korean ships, Singaporean photographic equipment, or Taiwanese electronic products.

To summarize the case for free trade and development, a moderate scale of preferential treatment would be needed at the start for manufacturing activities to maintain industrial efficiency and ensure the expansion of agricultural production for both domestic and export markets. Equal treatment in incentives need to be extended to exports and import substitution in manufacturing to ensure resource allocation by comparative advantage and the exploitation of economies of scale. This can also engender efficient production for export and import substitution through vertical and horizontal specialization. Variation in incentives across sectors need to be

minimized so that the private sector can best choose the composition of export goods to respond to international market conditions. The stability and automaticity of the incentive system would minimize uncertainties among manufacturers and allow then flexibility in long-term operations. Finally, export promotion needs to consider dynamic comparative advantage over time.

But even in the last century, a number of political thinkers have expressed reservations regarding the supposed benefits of trade and these were echoed this century by many others (Todaro 1985). In brief, the argument is that trade exposes a country to the inevitable fluctuations of international commodity prices and exchange rates. Thus, the economy is subjected to instability over which it may have little control and is thus diminished in its ability to shape its own destiny. Moreover a young developing economy is at a disadvantage because its newly emerging industries would be subject to unfair and even ruinous competition from the established, more experienced, and consequently more economically powerful industries of the wealthier countries. Several studies have already documented the differential and unsustained impact of international trade on various localities. The thriving textile weaving industry of Iloilo was destroyed by the entry of British cottons in mid-19th century and was replaced by the sugar industry (McCoy 1982). Or hemp exports from Bicol caused income and employment to grow over the 19th century but did not encourage industrial development so that when international demand for natural hemp collapsed after the 1920s, Bicol remained to this day the region with the highest poverty incidence (Owen 1982).

For this reason, many developing countries did embark on an import-substitution industrialization program not long after independence and in many instances resolutely persisted in it (Myint 1973). The entire panoply of controls-tariff and nontariff barriers and other disguised restraints were righteously deployed to protect domestic industries with the valid justification of maintaining national sovereignty and control

over their national destiny. But as noted above, a generally inward-oriented industrialization policy has lost much of its attractiveness given that countries that have pursued this policy have lagged behind the outward-oriented ones in terms of GNP per capita growth, employment and foreign exchange earnings. The pressure to open their economies has been great yet so has the pressure to maintain national sovereignty and specially to protect social programs and other sectors that may be adversely affected—whether in the long-run or the short-run—by trade liberalization and globalization.

The GATT has been an attempt to minimize the disadvantages of free trade by setting standards for fair trading among member-countries and developing a mechanism for adjudicating trade disputes among them. The hope is that these facilities will encourage countries to continue to embark on a generally outward-oriented development program since the GATT mechanisms are available to deal with any form of unfair trading practices or activities that hamper the growth of commerce and industry. Nonetheless, GATT is rather new and its effectiveness still needs to be proved.

Thus, regional economic integration—such as ASEAN and the Asia-Pacific Economic Cooperation (APEC)—remains as an attractive option. Historically, the first successful modern experience is the United States of America and this was a subtle point underlying the US Constitution: the destruction of interstate customs barriers and tariffs eventually paved the way for the emergence of the most powerful economy in the 20th century (Reich 1987). This experience strongly influenced the formation and integration of Western European economies which culminated in the adoption of the Maastricht Treaty that established the European Union or EU (Coppé 1994). Regional integration allows a country a wider market for its goods and services yet reserves a measure of control over elements in the regional market so that a member-country could also manage its own domestic and economic priorities. The costs of industrialization can be reduced by realizing economies of scale

within a larger yet still manageable regional market. As explained by Todaro:

> Third World countries, at relatively equal stages of industrial development, with similar market sizes, and with a strong interest in coordinating and rationalizing their joint industrial growth patterns stand to benefit most from the combined inward/outward trade policies represented by economic integration x x x. [R]egional groupings of small nations x x x can create the economic conditions (mainly in the form of larger internal markets) for accelerating their joint development efforts. Such groupings can also promote long-run development by enabling nations to block certain forms of trade with the more powerful developed nations and perhaps also to restrict or prohibit the deep penetration of multinational corporations into their industrial sectors. (1985, 426)

Thus, regionalism to be successful requires a degree of outward orientation among the member countries. The microeconomic effects can be classified into static and dynamic (Cuyvers, et al. 1994). The static effects include the general reduction in average production costs due to the abolition of trade barriers, to economies of scale resulting from the enlargement of the market, and to the increase in competition in the domestic markets of member-countries. Dynamic effects include the further economies of scale and innovation because of the long-term competition effect resulting from the enlargement of the market. Investment effects, though ambiguous in theory, are also quite attractive. Investment—from within and outside the regional bloc—in import-substituting industries in the second stage could be spurred by locational advantages, uncertainty in trade and investment policies outside the regional bloc, and by efficiency gains and increased demand within the region as a result of dynamic microeconomic effects of regionalization. Investment to the outside world could also be spurred by increased competitiveness of firms from within the region. The macroeconomic effects cover the general weakening in cost-push factors in inflation—mainly the improvement in

infrastructure linkages across the region. This will result in decreases in production cost across the economies, and increases in aggregate demand, capacity utilization and overall and individual GDP. The reduction in cost-push factors will also result in greater competitiveness and improved regional trade balance and reserve position with respect to the rest of the world. These have been experienced by the EU and other regional blocs want to emulate this, like the ASEAN and the APEC.

These are the theoretical benefits that can be derived from outward-oriented industrialization policy. It should also be pointed out though that more than just trade policy, crucial to the success of this trade and industrialization strategy is the stability of macroeconomic policy, mainly the maintenance of low rates of inflation and interest and stable exchange rates (Balassa 1980; Bhattacharya and Linn 1987). It was precisely this macroeconomic stability that allowed the private sector to effectively engage in trade and industrial investment because the stability of these rates reduced the uncertainty in the economic environment and encouraged long-term investment in capital, innovation, training and market development. Governments will thus need to maintain control over the budget deficit by ensuring increasing tax revenue and controlling expenditure. This suggests priority in expenditure towards infrastructure and social services which reduce cost-push factors and therefore enhance a country's competitiveness. Also government will need to control the money supply to control inflation, and liberalize the foreign exchange markets to attract greater foreign exchange deposits to stabilize the supply of foreign exchange.

At this point, it will be worthwhile to consider the implications of outward orientation on a country's social class interaction. It has already been pointed out that historically economic development was spurred by the activities of the capitalist class. For developing economies with a dual economic structure, the transition to modernization will be accelerated if the dominant social class will be that of the capitalist class in

alliance with organized labor, the informal labor sector, the professionals and the bureaucrats. The discussion on outward-oriented industrialization and regional economic integration suggests that these directions in policy favor the economic interest of the capitalist class and undermines that of the landed elite. The next section will sketch the current socio-economic structure of the Philippines and attempts to point out possible directions of interaction among the social classes as far as globalization is concerned.

The Philippine Setting

At independence, sugar, coconut oil, lumber, copper and gold were already the major export commodities. The export of agricultural commodities began as early as the 18th century and created a powerful national elite that would dominate the country's political and economic system. This elite comprised not just the feudal landed elite but the agrarian capitalists, foreign multinational corporation executives (mainly in mining, lumber, banking, and processing of agricultural products) and their local managers, and a capitalist class that initially sourced its wealth from trading before diversifying into landownership (Cullinane 1982; McCoy 1982a, b; Owen 1982).

A certain degree of industrialization was begun on an extensive scale not long afterwards. The underlying philosophy of postwar Philippine industrialization was largely along import substitution (Baldwin 1975; Bautista and Power 1982; Valdepeñas 1970). Industries established during the early 1950s were thus designed to capture the domestic market for manufactured goods away from foreign competitors. Such a program necessarily required a system to protect domestic manufacturers from competition with imports.

The complex foreign exchange control system initiated in 1949 and completely dismantled by 1962 served this purpose effectively at first. The foreign exchange control system was originally intended to ration foreign exchange and stem the

outflow of foreign exchange during the first postwar balance of payments crisis in 1949. It was soon found out to be an effective means of controlling importations, thus, of promoting import-substituting industries as well. With the decontrol of the foreign exchange market beginning in 1960, the task of protection then fell on the tariff and nontariff barriers which were first implemented in 1957. The transition was relatively smooth so that the domestic economy has been effectively officially protected without interruption from the 1950s until the early 1990s (Alburo, et al. 1989; Baldwin 1975; Medalla 1990; Power and Sicat 1971).

The tariff system largely favored the import-substituting manufacturing industries which were generally inward-oriented (Valdepeñas 1970; Power and Sicat 1971; Baldwin 1975; Power and Bautista 1982). This could be readily noted in the steady expansion of the share of manufacturing in Gross Value Added from 13 percent in 1902 to 28 percent in 1961, and the decline of that of agriculture from 55 percent to 34 percent. Services maintained a relatively steady share. The manufacturing sector also experienced the fastest growth rate during the 1950s to early 1960s, the heyday of import substitution. The agricultural sector (which contributed the bulk of export earnings then) continued to survive due to its inherent efficiency and comparative advantage (Bautista and Power 1982).

This pattern of industrialization moreover was largely capital-intensive and increasingly import-dependent specially for intermediate inputs and capital goods. Thus, these industries were largely assembly and packaging operations that relied on imported raw materials and capital equipment which were not imposed any tariff nor nontariff barrier. And they were largely oriented to the domestic market rather than to exports. Their expansion was already retarded by the 1960s because of the slow growth in the domestic market (Bautista and Power 1982; Valdepeñas 1970).

The domestic market could not be expected to grow then as now because of the inequitable distribution of income and the high degree of poverty incidence (see Table 1). The income

distribution profile does not show any significant change from 1961 to 1997. It is interesting to point out, though, that there was a degree of improvement until 1988. The Gini ratio is the standard measure of equity in the distribution of income; a ratio approaching 0 indicates equitable distribution while a ratio approaching 1 indicates inequitable distribution. From 1961 until 1985, the last year of the Marcos administration and a recession year, the distribution was improving and continued in 1988, when the highest growth rate was attained and the Gini ratio was at its lowest in 1988 at 0.445. But the ratio worsened to 0.468 in 1991, when the Aquino administration was at its last year. It worsened further to 0.496 in 1997, the last year of the Ramos administration. It has slightly improved to about 0.4605 in 2003, comparable to the 1991 figure. Inequitable distribution of income is indeed a rather persistent problem.

Table 1

Income Distribution of Families in the Philippines (%)

Decile Grp	1961	1965	1971	1985	1988	1991	1994	1997	2000	2003
First	1.5	1.1	1.2	2.0	2.0	1.8	1.9	1.7	1.7	1.8
Second	2.7	2.4	2.4	3.2	3.2	2.9	3.0	2.7	2.7	2.9
Third	3.4	3.5	3.5	4.1	4.1	3.7	3.9	3.4	3.5	3.8
Fourth	4.5	4.6	4.6	5.0	5.0	4.6	4.9	4.3	4.4	4.7
Fifth	5.5	5.7	5.9	6.0	6.0	5.6	6.0	5.3	5.5	5.8
Sixth	6.6	7.1	7.4	7.3	7.3	6.9	7.4	6.7	6.9	7.2
Seventh	8.3	8.9	9.9	8.9	9.1	8.7	9.1	8.6	8.8	9.1
Eighth	11.0	11.2	11.1	11.4	11.6	11.3	11.8	11.4	11.7	11.9
Ninth	15.5	15.4	16.9	15.7	16.0	16.0	16.4	16.1	16.4	16.6
Tenth	41.0	40.1	37.1	36.4	35.8	38.6	35.5	39.7	38.4	36.6
Gini coefficient				0.447	0.445	0.468	0.451	0.496	0.4822	0.4605

Source: National Statistics Office for the income distribution data and for the Gini coefficients, 2000–2003. For the Gini coefficients of 1985–1991, *Understanding Poverty and Inequality in the Philippines: A Compendium of Policy and Methodological Researches* by Ponciano Intal and Ma. Cynthia Bantilan (Manila: NEDA, 1994).

This confirms certain arguments that a number of policies were pursued at the expense of equity, principally the decision to continue the servicing of the national debt owed to foreign and domestic banks (Intal and Bantilan 1994). Debt servicing accounted for 35–40 percent of the national budget during the entire term of President Aquino. The purpose of this policy was to maintain the country's creditworthiness in the international and domestic capital markets; and the Philippines also happened to be under IMF monitoring since 1983 when the international debt crisis severely affected the Philippines along with many Latin American countries. And because the tax effort did not increase significantly during the 1980s, this debt policy meant reduction in government expenditures on social services. Also the administration did not pursue any policy at promoting employment by encouraging labor-intensive production processes. Thus when the economy entered into a recession in 1990, unemployment increased substantially from 8.4 percent that year to 10.5 percent in 1991 (Intal and Bantilan 1994).

The import-substitution industrialization process was characterized by a high degree of dependence on imported capital which therefore did not significantly contribute to the generation of employment opportunities. This would truly be problematic specially in a labor-surplus economy. The unemployment rate has remained quite high hovering around 10 percent in the 1982–91 period.

A significant measure of the degree of informal sector or semiproletarian activity is the equally high rates of underemployment during the same time period (see Table 2). This averaged about 25 percent, an indicator of the size of the precapitalist sector.

Table 2

Growth Rates of GNP, Rates of Unemployment and Underemployment (%)

Year	GNP	GNP per capita	Unemployment	Underemployment
1973	9.76	6.77	4.9	11.8
1974	4.20	1.39	4.0	9.8
1975	4.88	2.51	3.9	11.2
1976	8.17	4.83	5.2	10.1
1977	5.79	3.01	5.1	18.9
1978	5.46	2.67	4.9	15.2
1979	6.38	3.55	a	a
1980	4.63	1.86	7.9	20.7
1981	3.24	0.70	8.8	22.8
1982	2.84	0.33	9.6	25.8
1983	1.44	-1.06	10.4	29.1
1984	-8.72	-10.92	10.4	30.5
1985	-7.06	-9.31	12.5	20.4
1986	4.15	1.68	11.8	23.0
1987	5.10	2.61	11.2	23.1
1988	7.16	4.67	8.3	23.3
1989	5.73	3.31	8.4	23.3
1990	4.53	2.19	8.1	22.1
1991	0.23	-1.99	9.0	22.1
1992	0.62	-1.54	8.6	19.9
1993	2.12	-0.38	8.9	21.4
1994	5.25	2.74	8.4	20.9
1995	4.88	2.43	8.4	19.8
1996	7.24	4.81	7.4	19.4
1997	5.3	2.97	7.9	20.8
1998	4.1	-1.7	9.6	23.7
1999	3.7	1.5	9.4	22.1
2000	7.1	4.8	10.1	19.9
2001	2.3	-0.01	9.8	16.6
2002	4.2	2.1	10.2	15.3
2003	5.9	3.7	10.2	15.8
2004	6.7	4.6	10.9	16.9
2005	5.6	3.5	7.4	21.2

Unemployment data for 1956–1975 and 1980 onward use "past week" reference period while for 1976–1978 use "past quarter" reference period. Prior to 1987, underemployed was defined as the number of employed persons wanting additional work. From 1987 onwards, the concept was redefined to number of employed persons wanting more hours of work. No labor force survey was conducted in 1979.

Source: National Statistics Office.

The pattern of import substitution industrialization in a small domestic market has resulted in a high degree of concentration of capital or of monopolistic control over markets (Lindsey 1977). Although Lindsey's results apply to 1970 data, there is no reason to believe that there has been a significant change in this pattern of concentration. Moves to liberalize

major sectors of manufacturing and services date only to 1992 with the present administration. Moreover, large-scale industrial concentration and centralization of capital occurred during the subsequent martial law regime of Marcos that began in 1972. This era has not yet been systematically studied but available information (Manapat 1992) suggests a continuation and, in some sectors, an intensification of concentration or monopoly power.

There has yet to be a rather systematic study of class relationships and structure following the class structure of a socially disarticulated economy along the lines of deJanvry (1981). It would be fascinating to identify members of the landed elite who may well be related to the capitalist class either on a familial or business level. It would be interesting to explore this specially since Lindsey's findings showed a high degree of concentration in the manufacturing sector. Also, it would be instructive to identify members of, say, the bureaucrats who happen to have familial or business roots in some other social class, such as the capitalist class or the landed elite.

The informal sector meantime has been thriving. It is formally defined as comprising income, employment and production generated by activities which are officially unrecorded, unregistered, and unregulated (Templo and de Leon 1992). Criminal activities are generally part of this sector in any economy (Quesada 1988) but for developing economies, this sector covers activities which are far from being criminal but cannot simply be registered nor recorded with the government because of the economic structure. Among the activities covered are: small business people engaged in trading and service activities, cottage industry (i.e., production within residential premises) and street and flea market vending and hawking; credit and finance; transportation; household help and domestic service; small-scale utilization of fisheries, mining and logging; and foreign exchange trading. The International Labour Organization defines the informal sector as activities where "free entry exists; enterprises are small, often family-

owned and rely on indigenous resources; workers have limited formal training and markets are highly competitive and unregulated" (Templo and de Leon 1992). From a dualistic perspective, this sector is unregistered, unrecorded and/or unregulated because the lack of infrastructure increases the transactions cost of government.

In general, firms in this sector can be described as having low levels of productivity, employment and fixed assets. Hours of work can be longer than those in the formal or modern sector but most workers in the informal sector perceive their occupation as temporary till a more preferred job is available. Because the sector is precisely unregulated, unregistered and unrecorded, conditions of work and terms of employment can often be more severe than in the formal sector (Templo and de Leon 1992).

Based on a special Labor Force Survey that is still not officially published (Templo and de Leon 1992), the informal sector has comprised a substantial majority of the labor force since 1986 (the earliest for which data are available) as shown in Table 3. The majority of the informal sector labor—consistently above 65 percent—are concentrated in the agricultural sector. This clearly suggests the degree of transition of the economy from the feudal to the fully capitalistic mode of production. From the available data, the actual level of informal sector employment in agriculture has declined from 1986 to 1991 but that in the services sector has increased. This again seems to suggest that given the low level of skills required in either the services sector or the traditional agricultural sector, the informal labor can only be absorbed in either of these.

Table 3

Employment in the Informal Sector
1986–1991 (in thousands)

Sector	1986	1987	1988	1989	1990	1991
Total Employment	18,855	20,050	20,205	21,908	22,211	22,915
Total Informal Employment	11,320	11,001	11,075	11,149	11,387	11,708
Share of Informal in Total (%)	60.00	54.87	54.81	50.89	51.27	51.09
Agriculture	7,837	7,494	7,457	7,275	7,499	7,667
Mining and quarrying	53	30	52	56	49	52
Manufacturing	626	459	625	657	589	617
Construction	49	68	79	97	106	113
Utilities	3	8	0	8	0	8
Services	2,752	2,386	2,862	3,056	3,144	3,251

Source: Templo, Ofelia and de Leon, Teresita, 1992, "The Urban Informal Sector in the Philippines: Recent Developments and Future Policy Directions." Paper presented at the Seminar on Employment Policies for the Urban Sector in East and Southeast Asia, Bangkok, October 12–16.

Moreover, a cursory inspection of the data suggests that the level of employment in the informal sector may be related to the level of overall economic activity as measured by standard measures of national income and output. It must be remembered that in 1986, the Philippines was just recovering from the most severe post-World-War-II recession: real GDP declined by about seven percent in 1984 and in 1985. Unemployment levels went up severely and investment levels declined. The level of informal sector employment declined after 1986 as the economy initially expanded. But it went up even higher than the 1986 level by 1990 on to 1991 when again real GDP declined by 1.5 percent and unemployment surged again due to uncertainties brought about by the Persian Gulf War and the calamities wrought by the eruption of Mount Pinatubo (Templo and de Leon 1992).

The informal sector accounted for about 40 percent of total GDP during the period 1980–90 (see Table 4). In general, the formal sector economic growth is inversely related to that of

the informal sector with the share of the latter increasing during the negative GDP growth years of 1983–1985 and 1990. This suggests that indeed the informal sector absorbs the unemployment and underemployment of the formal sector.

Table 4

Contribution of the Informal Sector (%)

	Average 1980-1985	Average 1986-1990	Average 1980-1990
Growth Rates			
GDP	19.38	12.79	16.45
Formal	14.44	13.26	13.91
Informal	27.47	12.30	20.73
Shares			
GDP	100	100	100
Formal	63	57	60
Informal	37	43	40

Source: Templo and de Leon, p. 7.

By industrial origin, agriculture, fishery, and forestry contributed the biggest share (about 41 percent) of total informal sector output in 1980 but this declined to 30 percent by 1990. The services sector increased its share from 31 percent in 1980 to 47 percent in 1990. The share of manufacturing even declined from 27 percent in 1980 to 23 percent (see Table 5). Again these suggest that some form of transition may be at work with more and more of the peasantry shifting to semiproletariat status given the low level of skills that they possess. Also the declining share of manufacturing may to some extent be explained by the steady expansion of the formal sector manufacturing which requires level of skills higher than what the semiproletariat may possess and levels of technology and efficiency that can successfully compete with those of the informal sector.

Table 5

Share of the Informal Sector in GDP by Industrial Origin, 1980–90 (%)

Sector/Industry	1980	1985	1990
Agriculture, Fishery and Forestry	40.68	31.78	30.27
Industry	27.95	23.01	22.68
Construction	3.35	1.29	1.65
Manufacturing	24.60	20.61	20.54
Mining and Quarrying	0.00	1.11	0.49
Services	31.37	45.21	47.06
Transport, Communication & Storage	5.22	6.57	4.77
Trade	7.21	18.16	21.47
Ownership of Dwellings & Real Estate	12.76	11.37	11.08
Finance	0.26	0.29	0.13
Private Services	5.92	8.82	9.60

Source: Templo and de Leon, p. 8.

In the trade sector, as Table 6 shows, the Philippines has had a chronic balance of trade (BOT) deficit since its independence in 1946. A positive trade balance was attained for 1959, 1973, 1999 and 2000 only. In 1959 the devaluation then caused a severe contraction of imports. In 1973, the value of Philippine exports (then largely raw materials as will be noted below) surged because of a worldwide increase in the prices of raw materials, specially sugar, coconut oil, lumber and copper concentrates—all major Philippine exports. This worldwide price increase has not been repeated since 1999 and 2000 were two years when export demand in the main markets of the Philippines was stronger than the import demand of the domestic market.

Table 6

Historical Trade Statistics
(fob value in USD million)

Year	Exports	% change	Imports	% change	Balance of Trade
1946	64.2	-	295.9	-	-231.7
1947	263.4	310.28	511.1	72.73	-247.7
1948	309.6	17.54	584.9	14.44	-275.3
1949	247.9	-19.93	585.9	0.17	-338.0
1950	331.0	33.52	341.9	-41.65	-10.9
1951	422.4	27.61	489.0	43.02	-66.6
1952	345.7	-18.16	421.4	-13.82	-75.7
1953	398.3	15.22	452.4	7.36	-54.1
1954	400.5	0.55	478.7	5.81	-78.2
1955	400.6	0.02	547.7	14.41	-147.1
1956	453.2	13.13	506.2	-7.58	-53.0
1957	431.0	-4.90	613.2	21.14	-182.2
1958	492.8	14.34	555.7	-9.38	-62.9
1959	529.5	7.45	523.6	-5.78	5.9
1960	560.4	5.84	603.9	15.34	-43.5
1961	499.5	-10.87	611.3	1.23	-111.8
1962	556.0	11.31	586.7	-4.02	-30.7
1963	727.1	30.77	618.2	5.37	108.9
1964	742.0	2.05	780.3	26.22	-38.3
1965	768.5	3.57	807.6	3.50	-39.1
1966	828.2	7.77	852.8	5.60	-24.6
1967	821.4	-0.82	1062.2	24.55	-240.8
1968	857.7	4.42	1150.1	8.28	-292.4
1969	854.3	-0.40	1131.5	-1.62	-277.2
1970	1061.7	24.28	1090.1	-3.66	-28.4
1971	1136.3	7.03	1186.0	8.80	-49.7
1972	1105.5	-2.71	1229.5	3.67	-124.0
1973	1885.5	70.56	1596.6	29.86	288.9
1974	2725.0	44.52	3143.0	96.86	-418.0
1975	2294.0	-15.82	3459.0	10.05	-1165.0
1976	2574.0	12.21	3634.0	5.06	-1060.0
1977	3151.0	22.42	3915.0	7.73	-764.0
1978	3425.0	8.70	4732.0	20.87	-1307.0
1979	4601.0	34.34	6142.0	29.80	-1541.0
1980	5788.0	25.80	7727.0	25.81	-1939.0
1981	5722.0	-1.14	7946.0	2.83	-2224.0
1982	5021.0	-12.25	7667.0	-3.51	-2646.0
1983	5005.0	-0.32	7487.0	-2.35	-2482.0
1984	5391.0	7.71	6070.0	-18.93	-679.0
1985	4629.0	-14.13	5111.0	-15.80	-482.0
1986	4824.0	4.21	5044.0	-1.31	-220.0
1987	5720.0	18.57	6737.0	33.56	-1017.0
1988	7074.0	23.67	8159.0	21.11	-1085.0
1989	7821.0	10.56	10419.0	27.70	-2598.0
1990	8186.0	4.67	12206.2	17.15	-4020.2
1991	8839.5	7.98	12051.4	-1.27	-3211.9
1992	9824.3	11.14	14519.8	20.48	-4695.5
1993	11374.8	15.78	17597.4	21.20	-6222.6
1994	13482.9	18.53	21332.6	21.26	-7849.7
1995	17447.2	29.40	26537.6	24.40	-9090.4
1996	20542.6	17.74	32426.9	22.19	-11884.38
1997	25227.7	22.81	35933.8	10.81	-10706.12
1998	26976.0	6.93	27461.0	-24.46	-485.0
1999	35037.0	29.88	30743	11.95	4294.4
2000	38078	8.68	34491	21.91	3587.38
2001	32150	-15.68	33058	-4.15	-906.96
2002	35208	9.51	39237	18.69	-4028.36
2003	36231	2.91	40471	3.14	-4239.31
2004	39681	9.52	44039	8.82	-4358.69
2005	41255	3.97	47418	7.67	-6163.50

Source: 1946–1973, Central Bank; 1974–2005, National Statistics Office.

Expansion of exports tend to be determined by international market conditions while the movements of imports tend to be determined by domestic market conditions. Imports increase quite fast during periods of sustained increase in GNP and GNP per capita. Imports increased at a high rate from 1973 to 1980 and from 1987 to 1990, both of which were periods of sustained increase in economic activity. Imports declined severely from 1982 to 1986, when the Philippines underwent the most severe recession since 1945.

Eighteen products are regarded as the principal merchandise exports of the Philippines as of 1992. These are classified into traditional and nontraditional:

Traditional	Non-Traditional
Crude coconut oil	Semiconductors, electronic microcircuits
Copper concentrates	Garments
Centrifugal sugar	Iron agglomerates
Lumber	Banana and plantains
Gold from copper ores	Canned pineapple
Dessicated coconut	Prepared tuna
Copra oil, cake and meal	Coffee, not roasted
Plywood, ordinary	Bars, rods of copper
Logs	Shrimps and prawns

The share of nontraditional products has declined steadily since 1970, as Table 7 would show. By 1984, two-thirds of the country's exports were largely nontraditional export commodities, the bulk of which were manufactured goods. And this share has increased even more rapidly since.

Table 7

Export Statistics
(fob value in USD million)

Year	Traditional share		Nontraditional share	
1970	972	91.96	85	8.04
1971	1027	91.13	100	8.87
1972	982	89.19	119	10.81
1973	1606	85.65	269	14.35
1974	2306	85.00	407	15.00
1975	1767	77.81	504	22.19
1976	1773	70.30	749	29.70
1977	2097	67.19	1024	32.81
1978	1985	58.26	1422	41.74
1979	2561	56.15	2000	43.85
1980	3068	53.66	2650	46.34
1981	2742	48.43	2920	51.57
1982	2116	42.60	2851	57.40
1983	2068	42.08	2846	57.92
1984	1828	34.77	3430	65.23
1985	1302	28.45	3275	71.55
1986	1275	27.00	3447	73.00
1987	1367	24.57	4197	75.43
1988	1382	17.66	6442	82.34
1989	1316	16.96	6442	83.04
1990	1157	14.27	6949	85.73
1991	1129	12.77	7711	87.23
1992	1542	15.91	8152	84.09
1993	1395	12.49	9777	87.51
1994	1505	11.38	11723	88.62
1995	1970	11.54	15096	88.46
1996	1831	9.13	18213	90.87
1997	1913	7.83	22514	92.17

Source: For 1970–91, Department of Trade and Industry; for 1992–97, National Statistics Office.

This suggests that the Philippines is no longer a predominantly agricultural country but is already in a transition stage towards industrialization. But of these manufactured goods exports, 35 percent of total export earnings are largely accounted for by garments and semiconductors and electronic microcircuits, products which import the bulk of their intermediate inputs. In fact, their main domestic value-added

is largely labor since these products utilize largely labor-intensive and low-skill-level technology.

As Table 8 shows, the top ten export markets of the Philippines as of 1996 are the USA, Japan, Singapore, Germany, Hong Kong, the United Kingdom, the Netherlands, Taiwan, Thailand and Korea (South). The USA accounts for about 45 percent of the total value of export earnings with Japan, a distant second at about 18 percent of the total. The others account for less than ten percent each so that export market is not widely diversified.

Table 8

Top Ten Export Markets

(Value in USD million)

Country	1994		1996	
	Value	Share (%)	Value	Share (%)
USA	5128	44.9	6655	32.4
Japan	2020	17.7	3671	17.9
Singapore	707	6.2	1224	6.0
The Netherlands	515	4.5	1115	5.4
United Kingdom	637	5.6	936	4.6
Hong Kong	651	5.7	868	4.2
Germany	664	5.8	847	4.1
Thailand	364	3.2	780	3.8
Taiwan	452	4.0	661	3.2
Korea (South)	291	2.5	371	1.8
Total Exports	11429		20543	

Source: Board of Investments

Of the country's imports, consumer goods comprise a minimal share, never more than 9 percent since 1974. As Table 9 shows, the bulk of these consumer goods imports are largely dairy products and cereal and cereal products (mainly wheat-based)—products which the Philippines cannot produce given the country's climate and soil conditions. The rest of the country's imports are largely capital goods, raw materials and intermediate goods, manufactured and semifinished items. The main such imported items are:

Mineral fuels, lubricants, related materials	Textile yarns
Machinery, except electrical	Artificial resins and plastic materials
Base metals	
Electrical machinery, apparatus, appliances	Textile fibers
Transport equipment	Fertilizers (manufactured)
Chemical elements and compounds	Feeding stuff
Manufactured items of metals	Paper products

Table 9

Import Shares
(in percent)

Year	Capital Goods	Raw Materials Intermediate Goods	Manufactured Semi Finished	Consumer Goods
1971	38.4	37.1	11.9	12.1
1972	35.3	38.3	12.1	13.6
1973	30.8	45.4	11.8	11.6
1974	26.2	42.7	20.8	8.9
1975	33.2	33.7	22.3	8.4
1976	31.0	35.0	24.5	7.3
1977	27.5	37.3	25.4	7.8
1978	29.6	39.8	21.8	6.6
1979	29.1	40.3	22.5	5.9
1980	25.7	36.9	29.1	6.0
1981	24.2	36.3	30.9	6.8
1982	23.3	39.7	27.4	8.3
1983	22.7	35.2	28.4	7.2
1984	18.9	43.4	27.2	6.0
1985	15.4	43.0	28.4	8.6
1986	17.1	52.9	17.2	7.9
1987	18.0	50.8	18.5	8.1
1988	20.0	54.1	13.4	7.3
1989	23.0	51.7	13.4	8.6
1990	25.6	47.6	15.1	8.7
1991	24.5	48.6	14.8	8.2
1992	27.7	46.6	14.7	8.5
1993	31.9	44.6	14.7	9.0
1994	32.2	45.0	13.6	9.9
1995	30.4	46.1	13.5	10.5
1996	32.8	44.1	12.4	10.4
1997	39.5	40.2	11.0	8.5

Source: Department of Trade and Industry

The import picture does suggest the same as the export data. The Philippines is already in transition to industrialization since the bulk of its imported items are capital goods, raw materials, intermediate goods, and manufactured and semifinished goods which are necessary for industrialization. As Table 10 shows, of the top 10 import markets as of 1996, seven are also among the top 10 export markets, with the USA and Japan again dominating. The other five are Singapore, Taiwan, South Korea, Hong Kong and Germany. The remaining import markets are Saudi Arabia, Australia and Malaysia. But, in contrast to the export picture, Japan accounts for the biggest share of imports at around 30 percent of the total, with the USA at second with an average share of about 25 percent. The rest account for less than ten percent each. As with the export market, the import sources are also not widely diversified.

Table 10

Top 10 Import Markets
(Value in USD million)

	1994		1996	
Country	Value	Share (%)	Value	Share (%)
Japan	5205	31.2	7129	22.0
USA	3918	23.5	6361	19.6
Singapore	1434	8.6	1740	5.4
Korea (South)	1103	6.6	1673	5.2
Saudi Arabia	945	5.7	1671	5.2
Taiwan	1221	7.3	1598	5.0
Hong Kong	1094	6.6	1360	4.2
Germany	761	4.6	1209	3.7
Australia	581	3.5	808	2.5
Malaysia	429	2.6	801	2.5
Total Imports	16691		32427	

Source: Board of Investments

CONCLUSION

To summarize, the Philippines is definitely in a transition stage towards development or modernization. It already has the unassailable features of an economy beyond the first stage of industrialization. The manufacturing sector has been the major source of employment and output. Manufactured goods dominate the export sector. And the largest portion of imports cover capital and intermediate goods which are necessary for second-stage industrial expansion.

In the absence of comprehensive research on the country's social class configuration, the economic data and historical research suggest that the class configuration of a developing economy may well be persisting. The country has a substantial informal sector labor force. Unemployment and underemployment has persisted and the distribution of income has by and large remained inequitable. The landed elite is a force to reckon with. They may well be engaged in industrial enterprises already. The country's capitalist class emerged also from the inward-oriented import-substituting industrialization program of the postwar era. They have tended to monopolize their markets. And many of these industrial enterprises have had their start-up from foreign investors and multinational corporations. Inward-oriented industrialization has reigned supreme for decades and this has retarded the country's industrial expansion. But outward-oriented policies have begun to be implemented, including the ratification of the GATT. And a capitalist class has already emerged and figures prominently among the export sector. Manufactured goods exports happen to be those in the more competitive markets; and the fact that Philippine exporters are thriving suggest that these enterprises are directed by efficient capitalists.

GATT has been intended as a means to realize the benefits of outward-oriented industrialization for many developing economies. The theoretical underpinning of the GATT and globalization in general has been based upon the proved experience of the EU and then of the East Asian NICs.

Globalization, the continued interaction with the international economy, promoted an efficient and sustainable pattern of industrial and economic development among these countries.

But the theory also suggests that the development process is spurred by domestic circumstances, not just external transactions. The country's social class configuration is a major factor in a country's ability to respond to the challenges of outward-oriented industrial development. Whichever class dominates will determine whether a country's progress towards modernization and industrial development will be accelerated or not.

As pointed out, crucial also to the development process was the maintenance of a favorable macroeconomic environment, of low inflation and interest rates and stable exchange rate. These imply policies such as increasing the efficiency of tax collection, controlling government expenditure with emphasis on infrastructure and basic social services, liberalizing the banking system to attract more savings and foreign exchange deposits. Many of these policies will not sit well with some social classes. The landed elite have traditionally used patronage specially in government appropriations to maintain their position of power. Moreover, they and the bourgeoisie are the one class capable of providing the resources of income taxation. At the same time, many among the low-income classes—whether among the proletariat, semi-proletariat and the farmworkers—do benefit from direct subsidies from government. These will make control of the fiscal process a point of conflict between these classes and those promoting a controlled budget directed towards modernization.

It is worthwhile to remember that among the East Asian NICs, the landed class has ceased to be a major force before their industrialization (King 1977). The landed aristocracy of Japan lost its power after World War II, the Nationalist regime neutralized the native landowning class of Taiwan, and the Japanese occupation of South Korea at the turn of the century destroyed the landed elite of the peninsula. Therefore it was

possible for these countries to embark on a land reform program and a capitalist and bureaucrat class could later emerge and not be encumbered by the interest of a landed elite class.

This is not quite the case in the Philippines. The landed elite has remained a strong even resilient force in government and politics (McCoy 1994). A capitalist class has already emerged and it may be spurred on by the opportunities of a world market. But a substantial segment of the manufacturing and industrial sector remain protected and are loathe to engage in greater competition with the international market. Large numbers of the country's professional and academic class—the petit bourgeoisie—are divided over the merits of globalization. At the same time, the ability of the economy to generate sufficient employment has been unsatisfactory so that large numbers of the informal labor force remain along with substantial unemployment. The attraction to globalization has been severely dented by the recent crisis in the East Asian economies.

Nonetheless, globalization has strong advocates and has been entrenched by the policies of the Aquino and specially the Ramos administrations. A strong class of export-oriented manufacturers and an articulate group of intellectuals have steadily prodded the government and the business classes towards liberalization. The interaction of these contending classes in the country's political arena will certainly determine the response of the Philippines to the opportunities of a global market. The one thing certain is that given the class structure and the current economic structure, the path will be slow and quite tortuous compared to other countries in East Asia.

Summary of Lecture

The main goal of international economic transactions is the achievement of peaceful international relations by the promotion of economic development. The process of economic development is a long-term, complicated process that involves the social and political systems interacting with the economic.

Available theories of economic development suggest that the attainment of a developed economy is inevitable; what differentiates countries is the speed of its evolution. The last two papers identify the main factors that influence the speed of this evolution. Crucial to the process is the bureaucracy of government and its ability to implement long-term infrastructure and social services development programs. Essential to this implementation is the ability to maintain long-term contracts and to resolve and impartially settle disputes and conflicts through the judicial system.

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Law and Economic Development in the Philippines[*]

Victor S. Venida, Ph.D.

I. Introduction

The realm of the social sciences is so broad a scope that the interaction among its specialized fields has never been thoroughly and systematically studied or even appreciated. Of these fields, law and economics suffer a drought of resources, because the interplay between the two has scarcely been explored. But recent events have signaled the importance of such an analysis, particularly, the importance of the rule of law in attracting economic activity and not merely as a result of stable economic policies. In fact, the rule of law is a crucial factor that can either promote or hinder economic development as it seeks to reduce the level of poverty.

This paper attempts to present a general sketch of the economic theory of law, as it tries to identify the precise aspects by which the law directly promotes or hinders particular elements that contribute to economic development. An overview of the economic situation of the Philippines is also discussed to underscore the sheer necessity of encouraging economic development. Finally, the situation of the judiciary and the legal profession is then appraised in terms of their impact on economic development in general.

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II. Traditional Economic Theory of Law

Traditional economic theory regarding the role of law in economic development was formulated by the Economist Adam Smith,[1] who argued that civil government emerged mainly to protect private property. In the absence of property ownership, there is no need to establish any set of rules regarding the relations among human beings. Only when a minority begins to accumulate property does a need for societies to develop rules arise, regarding the acquisition, maintenance, disposition, and inheritance of property. This involves establishing rules to govern the relationships between persons for the protection of possible heirs, vendors, or purchasers of property. A system for the enforcement of these rules and settlement of disputes and conflicts would have to be developed. In our society, we see that this gave rise to the contemporary preoccupation on the importance of the rule of law, and its impact on protection of the rights of investors over property and enforcement of contracts, which served as basis for encouraging investment, thereby stimulating economic growth.[2]

In the long-term process of economic development, Smith proposed the classic argument that government had three basic and specialized functions; external defense, administration of justice, and provision of basic infrastructure.[3] These three are essential and unique functions whose primary goal is the management and reduction of risk and uncertainty in the economy to encourage consumption and investment on a large scale.

The major theory of the determinants of economic development emphasizes the role of consumption, especially investment. Consumption is the expenditure of households on

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1 Adam Smith, *The Wealth of Nations* 232–235 (1967).

2 The World Bank, *From Plan to Market: World Development Report* 86–93 (1996).

3 Smith, *supra* note I, at 208–209.

goods and services, including durable goods such as housing, home furnishings, appliances and the like. Investment is the expenditure of firms on equipment, machinery, buildings, land improvements and the like, all directed towards increasing production for sale, to local consumers or to foreign buyers. Households and firms with surplus earnings can deposit the savings in financial institutions to realize reasonable rates of return on their savings. Financial institutions, on the other hand, earn revenue by providing credit to households and firms with inadequate resources to make purchases. Households normally borrow for major consumer items, usually durable goods, e.g., housing, cars, and home appliances. Firms borrow for short-term working capital requirements, trade credits to facilitate the movement of goods, or for long-term developmental projects, such as construction of a large manufacturing facility like a petrochemical plant or steel mill. Credit decisions are based on the banks' judicious investigation of the applicant's ability to pay. On a social level, financial institutions perform the important task of attracting the savings of society from those with surplus to provide credit to those with deficit in the purchasing power. Those with savings earn interest while those with deficit pay the loan with interest out of future earnings.

Moreover, these initial activities create multiplier effects on the rest of the economy. Consumer spending creates markets for producers and sellers who are then encouraged to increase investments. Investment expenditure creates jobs that create new income, thus encouraging consumer spending. Credit provides added impetus to consumer and investment spending. The availability of savings facilities also acts as an incentive to households and firms to work harder to increase incomes to realize savings and thus build assets. In all, the cycle of consumption and investment spending is accelerated, and economic progress increases.

These economic activities are more intensified when risk and uncertainty are minimized in society. Given such uncertainty such as the current crisis over the possible invasion of Iraq and further terrorist attacks—the desire of consumers

to purchase large items such as durable goods, of firms to invest in huge projects, or of financial institutions to provide credit is severely dampened. Economic activity, then, slows down. Large expenditures take more time to be recovered; for example, it will take longer for a firm to realize income to replace expenditure on a major item, to recover its initial investment, or to repay a huge loan. The absence of uncertainty encourages consumption and investment expenditures and credit, while its presence increases the risk that these expenditures and credit may not be recovered, thereby discouraging them. Any reduction in spending substantially decreases economic growth because of the negative multiplier effect that leads to long periods of stagnation. On the other hand, a steady increase in economic growth over time propels economic development.

The government can substantially manage uncertainty on a social level. External defense acts as a deterrent to external invasion. Invasion by itself destroys lives and property. What is especially problematic to economic development would be the loss of knowledge and skills when lives are lost. But uncertainty is not only a result of actual invasion but likewise, a result of mere threat of invasion. When a government provides a credible external defense capability, any external threat can be perceived by the economy as manageable. This would explain the spectacular long-term development and expansion of South Korea and Taiwan, both facing hostile neighbors but with a strong external defense capability bolstered by the United States of America.

The provision of basic infrastructure—transportation, communication, energy, water and sanitation—substantially reduces the cost of production and transactions throughout the economy. The availability of these facilities again encourages investment in major projects, which in turn encourages financial institutions to provide the necessary credit. This spurs the multiplier effects on consumption and further investment. By the nature of infrastructure, the resources required are huge; as a result, to reduce the cost of production and transactions throughout the economy, facilities need to be provided at

reasonable cost. This is the reason why governments tend to provide facilities, either by direct production as in road construction and installation of flood-control projects or by contracting private investors. Private investors are not only faced with regulation on pricing but also with some incentives for them to gain a reasonable profit as in water distribution in Metro Manila with Maynilad and Manila Water or the franchises for electricity distribution which are local monopolies, most famous being Meralco.

Lastly, the presence of an efficient administration of justice also reduces the uncertainty over conflicts in property. Given that the economy is based on the acceptance and respect for the principle of private ownership of property, society, therefore, needs some form of impartial arbitration to peacefully settle conflicts over property rights. Again, security in property rights encourages the very cycle of consumption, investment, and credit that underlies economic growth. This is the main function of the administration of justice for purposes of long-term economic growth: to act as an impartial arbiter in the peaceful settlement of disputes and in the effective enforcement of laws, rules, regulations, settlements, contracts, and penalties. For as long as the system is regarded as impartial, speedy, efficient, and just, the expenditure and credit activities will be encouraged with the full knowledge that any conflict along the way can be settled quickly and judiciously. Indeed, the World Bank has recognized the pivotal role that the rule of law plays in maintaining stable, strong, and reliable governance both in the public and private sectors.[4] It arguably plays a more powerful stimulus to economic activity than economic policy itself. This was one of the original arguments for maintaining the independence of Hong Kong and its judiciary after the hand-over to China.

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[4] The World Bank, *From Plan to Market supra* note 2, at 142; The World Bank, *The Philippines, Growth With Equity: The Remaining Agenda* 97–100 (2000).

All three functions of government are, therefore, crucial in the attainment of long-term economic development. Although development is a consequence of a steady increase in expenditure by firms and households over time, this is made possible by government efficiently performing these three tasks. In the absence of government, the economy will, therefore, be left in chaos. Stagnation will lead to social disaster. Thus, the function of the government is crucial in the process of economic development.

It is in this crucial function of government that the role of government, in particular the law, is ambiguous. In the process of long-term economic development, aside from savings, three other factors are also crucially important: *capital accumulation*, *labor productivity* and *unproductive labor or activity*.[5] Savings is the portion of national income not spent on consumption. Economic surplus is the difference between a society's gross product and the portion of the product necessary for the subsistence of the productive members. This product is the total product less the amount needed to replace the means of production or the produced inputs used up in a given period. Subsistence refers to a standard of living by which a class of productive members is able to maintain and reproduce itself. It could refer to a level of consumption by which families are able to support and expand their numbers—in other words, a standard of living. Surplus, therefore, covers a larger amount than savings itself. An economy's capability to produce a surplus determines its prospects for long-term growth.

This capability increases as the larger proportion of a society's surplus is utilized in capital accumulation and labor productivity. Capital accumulation translates to greater investments in machinery, equipment, building construction, land improvements, and the provision of infrastructure. Labor productivity increases from the increased expenditure on

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[5] Francois Quesnay, *Economical Table* 12–20 (1968); Edward Wolff, *Growth, Accumulation, and Unproductive Activity: An Analysis of the Postwar U.S. Economy* 1–10 (1987).

education, skills training, health care, and proper housing. Note that all these items require a combination of both private investment and government expenditure. But, the capability to produce a surplus also depends on whether a larger proportion of the labor force is engaged in productive activity.

There is much debate regarding sources of productive activity,[6] but a workable definition of productive activity is that which produces goods and services that satisfy real needs or wants broadly defined. Corollary to this is the notion that productive activity directly increases a society's actual capacity to produce goods and services. Unproductive activity is largely focused on the distribution of the set of rights to the output. Classic examples of unproductive labor are administrators, law enforcers, the religious, trade, advertising, finance and accountancy, historically considered the most prestigious professions. Tables 1 and 2 have a more detailed listing based on the standard industrial and occupational classification. Law and accountancy are included in business service, while the judiciary and penology are part of government administration.

Smith had argued that a higher proportion of labor engaged in unproductive activity reduces the potential productive capacity of a society and thus its capability for sustained long-term growth.[7] Development is accelerated when a larger proportion of the surplus is devoted to capital accumulation and improved labor productivity rather than to unproductive activity.

However, it must still be noted that although law, administration, defense, the judiciary, accountancy, management, trade, finance, real estate and the religious are unproductive, they are all socially necessary. Such social

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6 E.K. Hunt, The Categories of Productive and Unproductive Labor in the Marxist Economic Theory, in *Science and Society* 313–325 (1979); Edward Wolff, *Growth, Accumulation, and Unproductive Activity: An Analysis of the Postwar U.S. Economy* 36–41 (1987).

7 Smith, *supra* note I, at 352–53.

necessity is based on its ability to maintain order, otherwise, the economy and society will be in a state of chaos. It is precisely because they are socially necessary, yet basically unproductive, that they have become the most prestigious professions in most societies and civilizations. Thus, the process of long-term economic development requires that a society devote a sufficient amount of its resources to maintain the necessary level of unproductive activity for the economy to function efficiently and for these resources to be utilized efficiently. The majority of labor and resources will, then, have to be devoted to productive activity and the capital accumulation and productivity improvements that they will require.

Unfortunately, until the economy is centrally planned, there is no straightforward method of determining this allocation. Entry to the professions and occupations will depend on the aptitudes and job requirements of job seekers and the pay offer that the market provides. This will, then, be the key to understanding the impact of a profession on long-term economic development. Wolff noted that Japan and former West Germany had higher rates of capital accumulation and increases in labor productivity, resulting to steadier long-term growth than the United States did in the 1950s–70s. During this period, the United States had a higher proportion of the labor force in the legal profession and a larger portion of government expenditure devoted to the judiciary and military expenditure than did Japan and West Germany.[8] When one applies this lesson on a low income country like the Philippines, the necessity for efficiency in the utilization of resources is, thus, more crucial as a larger proportion of the population is in a state of poverty. The legal profession and the judiciary, thus, need to perform more efficiently.

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[8] Wolff, *supra* note 5, at 174–76.

III. Recent Developments in the Theory of Law and Economic Development

Recent studies have begun to focus on the more immediate impact and effects of the legal and judicial system on poverty and the impoverished sectors. Novel ideas and notions of economic development have begun to go beyond the narrow definition of poverty as a lack of income. Rather, poverty is regarded as the experience of social exclusion and of vulnerability to various forms of stresses and difficulties.[9] Exclusion results not just from the inadequacy of income but from a lack of access to important entitlements, such as health care, education, secured housing, security, and judicial protection. As a result, poverty becomes the means of vulnerability towards calamities, exploitation, displacement (as in warfare or demolition of shanties), and persistent job insecurity.

The correlation of poverty to law have become relevant as more recent studies have focused on the issues of inability of many governments in less developed countries to provide for physical safety, security of property, and quick and reliable settlements of disputes.[10] The said studies specifically mention that the lack of access of low-income households to effective judicial systems results in four types of impoverishment. First, the justice system is unable to protect people from theft, violence, and physical abuse or enforce legitimate entitlements and legal rights, as for example, in wage claims or inheritance. Second, further cost and losses are incurred when low income individuals experience police extortion, unjust imprisonment, and courtroom bribery. Third, as discussed in the previous section, this state of ineffective judicial enforcement can undermine confidence in the future. This discourages large-

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9 Amartya Sen, *Development as Freedom* 3–6 (1999).

10 Institute of Development Studies, *Insights Development Research* 1–2 (2002).

scale consumption, major investments, or risk-taking in credit transactions or new business ventures. And fourth, a substantial portion of incomes—even of low-income households—may be expended on self-protection (such as bribes or weapons). In terms of traditional theory, not only are consumption, investment, and credit discouraged, but a substantial portion of income is set aside for unproductive expenditure. The ability, therefore, of the entire economy to produce a surplus for further capital accumulation is undermined.

Authors Stephen Golub and Kim McQuay reached some rather tentative conclusions about the significant role that legal empowerment plays in alleviating poverty.[11] They studied programs involving the work of non-government organizations and law schools in partnership with poor communities to improve governance and reduce poverty in issues such as human rights, minority and gender rights, environment, agrarian reform, and labor. They have concluded that legal empowerment can enhance the material conditions and resources of low-income groups and reduce poverty in the sense of increasing their participation in decision making, thus minimizing the degree of their social exclusion. The poor are, thus, able to understand how government operations and regulations influence policies regarding them. Golub and McQuay argue that legal empowerment is as much a crucial element in strengthening the rule of law for development because empowerment directly addresses the immediate legal needs of the poor.[12] Legal empowerment, therefore, needs to be integrated in the mainstream socio-economic development projects. This will be especially fruitful in areas such as women and children’s health, rural development, land tenure, decentralization and other poverty reduction programs. For efficiency-given limited resources, Golub and McQuay suggest that legal empowerment should involve not just lawyers and

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[11] Stephen Golub and Kim McQuay, Legal Empowerment: Advancing Good Governance and Poverty Reduction in *Law and Policy Reform at the Asian Development Bank* 159–60 (2001) .

[12] *Id.* at 159–61.

judges but also law students, paralegals, and development workers.

Nevertheless, the traditional justice system itself requires improvement in efficiency. Scholars have studied the Mexican system and found that the poor face a number of barriers in dealing with the formal judicial system. Courts were often located in urban areas far away from many of the rural folk.[13] Even when free legal assistance was available, the poor still had to spend on attorney's fees, documents, "grease" money, bribes, transportation, and time. Moreover, the justice system seemed foreign to the poor, both in terms of concept and even the language used; legal Spanish was not widely understood among the mainly Nahuatl-speaking rural poor of Mexico. Lastly, because of judicial prejudice against poor and ill-educated people and a general feeling of distrust in formal authority, the poor tended to avoid dealings with the justice system. In the course of the study, a number of strategies were experimented on to improve the access of the poor to judicial and justice services. Interestingly, initial results from a number of Latin American countries suggest that increased efficiency of the traditional justice system benefits traditional clients among the poor, but specialized services along legal empowerment lines more effectively reach excluded groups such as cultural and ethnic minorities and poor women and children.

In sum, these studies suggest that justice and legal services designed for specially vulnerable groups and legal empowerment programs, usually undertaken by law schools and NGOs, can have significant impact in improving the general condition of the poor. These services aid in integrating them to the broader society and its norms, rules, and conduct, including notions of justice, judicial settlement, and agreements. Since programs that focus on job creation to increase the incomes of

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[13] Linn Hammergren, Ana Laura Magaloni, Layda Negrete, Alfredo Ramirez and Rosario Tellez, The Juicio Ejécutivo Mercantil in Federal District Courts of Mexico–A Study of the Uses and Users of Justice and Their Implications in Judicial Reform in *World Bank Report 22635-ME* 3–4 (2002).

the poor can take some time and require investment by the business sector, the justice system can still alleviate poverty directly by targeting vulnerable groups and by minimizing the degree of social exclusion and vulnerability that poor communities experience.

To summarize, economic theory recognizes the importance of the rule of law in creating the stable atmosphere of clear and consistent rules on property, enforcement of contracts, impartial and expeditious settlement of disputes, and imposition of sanctions if necessary. This stability encourages consumption, investment, saving, and credit which generates jobs and income thus propelling economic growth. If sustained over a sufficiently long period of time, this process can generate the necessary social changes that characterize economic and social development. This will be a major precondition for the reduction of poverty. However, even within this process, programs can already be designed to provide legal and judicial assistance to the poor and vulnerable groups as part of direct community development efforts of non-government organizations and law schools. Poverty is not simply the lack of income but also the experience of social exclusion and vulnerability to social changes. Direct assistance to the poor, particularly legal empowerment, can help improve the general condition of the poor and vulnerable groups. But above all, the processes underlying the legal and judicial systems and legal empowerment programs need to be undertaken efficiently because while the law itself is socially necessary, it is basically unproductive. Though development requires a larger portion of resources and labor dedicated to productive activities, law and justice, being socially necessary should be implemented efficiently. Otherwise, the law itself can be a hindrance to development.

IV. The Philippine Economy

Two salient characteristics of the Philippine economy are the inequitable distribution of income and the high degree of

poverty incidence (Tables 3 and 4). The income distribution profile does not show any significant change from 1961 to 1997. However, it is interesting to point out that there was a degree of improvement until 1988. The *Gini* ratio is the standard measure of equity in the distribution of income; a ratio approaching zero indicates equitable distribution while a ratio approaching one indicates inequitable distribution. From 1961 until 1985, during the last year of the Marcos administration and a recession year, the distribution was improving. This continued until 1988, when the highest growth rate was attained and the *Gini* ratio was at its lowest in 1988 at 0.445. But the ratio worsened to 0.468 in 1991, when the administration of Pres. Corazon Aquino was in its last year. It further worsened to 0.496 in 1997, the last year of the administration of Pres. Fidel Ramos. Inequitable distribution of income is indeed a persistent problem.

This confirms certain arguments that a number of policies were pursued at the expense of equity, principally the decision to continue the servicing of the national debt owed to foreign and domestic banks.[14] Debt servicing accounted for 35–40 percent of the national budget during the entire term of President Aquino. The purpose of this policy was to maintain the country's creditworthiness in the international and domestic capital markets. Furthermore, the Philippines has been under International Monetary Fund monitoring since 1983 when the international debt crisis severely affected the Philippines along with many Latin American countries. Since the tax effort did not increase significantly during the 1980s, this debt policy meant reduction in government expenditures on social services. In addition, the administration did not pursue any policy at promoting employment by encouraging labor-intensive production processes. Thus, when the economy entered into a recession in 1990, unemployment increased

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[14] Ma. Cynthia Bantilan and Ponciano Intal, *Understanding Poverty and Inequality in the Philippines: A Compendium of Policy and Methodological Researches* 5–20 (1994).

[15] *Id*.

substantially from 8.4 percent that year to 10.5 percent in 1991.[15] A belated effort by the Ramos administration to launch the Social Agenda was derailed by the subsequent Asian Financial Crisis and the abbreviated Estrada administration.

The unemployment rate has remained quite high, hovering around 10 percent in the 1982–1991 period. Equally high rates of under-employment that averaged about 25 percent were recorded during the same time period (Table 5). The growth rate of the Gross National Product (GNP) and GNP per capita has not been as high compared to the rates that have been attained by the neighboring newly industrialized countries and China. The high growth rates sustained over a long period of time are necessary for long-term economic development. The high growth would suggest increased incomes, therefore, increased savings and tax collections. Savings can, then, be channeled to investment, and tax revenues could mean more funds for infrastructure and social services. In other words, higher growth would mean more resources that can be devoted to productive activity. This would be truly pivotal in a country with a substantial incidence of poverty and a rather inequitable distribution of income. It is the investment in productive activity and government expenditure on infrastructure and social services that create jobs and provide the necessary social services that improve the standard of living of the majority.

V. The Law in the Philippines

As suggested, the Philippines would need to devote a sufficient amount of resources directed towards judicial administration in order to be able to provide the necessary service to the economy. This would cover not just the traditional system of legal adjudication, judicial, and penal systems but special programs to provide service in the interest of justice and legal assistance to vulnerable groups and poor communities. This area of study is still exploratory so that one will have to rely on anecdotal evidence, case studies, and the application of conclusions of studies of other countries.

Available data suggest that the numbers of clients of the Public Attorney's Office (PAO) have increased steadily from 1995 to 1999 (Table 6). Rather encouragingly, there has been an increase in the number of clients for all types of legal services provided. The bulk of assistance tended to be devoted to non-legal services like legal documentation, legal counseling, and administration of oaths. However, quite a number also involved actual court cases where more than half were criminal cases and jail visitation.

Available data from the Supreme Court showed that the number of newly filed cases increased steadily by an average of 6.98 percent *per annum* from 1993 to 1999, but the number of cases decided or resolved increased during the same period by an average of only 6.08 percent *per annum*. Indeed, the number of pending cases increased by 14.26 percent *per annum* during that same period and the trend has continued well into 2005 (Table 6). The rate of court-case disposition overall has been quite low at about 0.8 percent by 2005 (Table 7). Moreover, a substantial number of vacancies exist, about 32 percent of total positions as of 2001, the latest for which data was supplied by the *NEDA Statistical Yearbook*.

The Shari'a Courts, the Sandiganbayan, and the Court of Tax Appeals have the highest rates of disposition. Thus, they have the lowest shares in the total number of pending cases. But, they also have the smallest number of cases handled. The Sandiganbayan and the Court of Tax Appeals did not have any vacancy during the time period, but the two Shari'a Courts have the highest rates of vacancies. The Metropolitan Trial Courts had the lowest rate of court disposition and the second highest number of cases filed and cases pending. They also have a high rate of vacancies. The Regional Trial Courts handle the largest number of cases and have the highest number of judicial positions, but also, a substantial rate of vacancy at 20 percent in 2001. Furthermore, women comprise 20 percent of the total number of judges.

Initial assessment would suggest that the formal, traditional justice system has been expanding its service to the poor and

needy as evidenced by the increase in the number of cases attended to by the PAO. Moreover, a substantial number of these cases involve criminal cases, which involve jail visitation, assistance and/or counsel to prisoners, and basic non-legal service. These are significant when one considers the widespread perception that the poor, particularly those in prison, do not have the essential resources to deal with the necessary legal service in cases and other legal documentation. However, the data does not consider the many cases and situations in which potential litigants simply avoid the justice system, since they regard the system as too expensive, corrupt, or ineffective.

Moreover, the rate of disposition of actual cases is alarmingly low. No data is available on the average length of time for a dispute to be settled with finality. However, one may assume that this is lengthy when one considers, for example, the vast number of cases filed by the Presidential Commission on Good Government (PCGG) that have yet to be completely and finally settled nearly 16 years since these were first filed. Furthermore, the author is aware of a series of cases involving intestate proceedings, which were first filed in 1968, and finally resolved by the Supreme Court only in 1988. The issues involved included the removal of a judge for perceived bias and extortion, arguments over who the rightful heirs are, and new disputes over the management of the property which has been taken over by illegal settlers. To this day, the property in such intestate proceedings has yet to be partitioned among the heirs because of the prolonged dispute over the appointment of an estate administrator.

In addition, a substantial number of vacancies, about 32 percent, remain in the courts. When one considers the low rate of disposition of cases and the length of time involved in the final resolution of a case, one begins to appreciate the massive delays in the delivery of justice in the society, particularly in the economy. As a result, in an economy anchored on private property, capitalism, and liberal external transactions, these massive delays hinder the country’s progress.

On its face, the reason for the failure of the judiciary in the Philippines to perform its basic function of delivery of justice is that it does not have the minimum necessary resources to complete its ranks, filling in the vacancies for judges. On the other hand, one may argue the same for other affiliated law enforcement and judicial agencies, such as the police, prosecutors and judicial personnel, thereby hampering the judiciary from effectively enforcing justice. This inadequacy can very well be a major reason behind the rather low rate of disposition of cases and the arguably long delay in the resolution of cases. This clearly is a major problem with the rule of law in the Philippines.

In addition, the legal system may also be dealing with a wealth of laws, jurisprudence, and procedures that may also delay or confound the efficient delivery of justice. The judiciary has shown that it can modify established policies and even contracts that have made investors uncertain about the general direction of economic policy. Examples include the re-bidding of Manila Hotel that denied the original winning bidder, a Malaysian firm, the right to manage the enterprise,[16] and the ruling in 1997 that the law liberalizing the petroleum industry was unconstitutional.[17] A more common practice is the issuance of temporary restraining orders that cause delays in various projects or in the implementation of existing contracts. These delays increase the cost of investment and create the climate of uncertainty that unsettle investors and creditors. Perhaps a situation of this sort requires a clarification of laws and jurisprudence that may have created conflicting decisions, interpretations, and rulings.

Legal procedures may also be contributing to the inefficiency in the delivery of justice. Examples include the practice of "forum shopping," the often liberal attitude towards motions for reconsideration, the lack of night courts and courts

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16 *Manila Prince Hotel v. Government Service Insurance System*, 267 SCRA 408 (1997).

17 *Tatad v. Secretary of Finance*, 281 SCRA 330 (1997).

during weekends and holidays, and the requirement for decisions to be read in full.[18] The requirement for decisions to be read in full, for instance, may take almost a whole day—especially, when one considers decisions that reach more than 200 pages. This implies that a substantial number of pending cases are not heard for one day.

However, there has been an encouraging growth in the number of non-governmental organizations that provide direct assistance and community development efforts for poor and vulnerable groups. A substantial number includes organizations of lawyers, law students, and paralegals. Moreover, several laws and international instruments passed during the years since the demise of the Marcos dictatorship were focused on the condition of the poor and vulnerable, such as the Comprehensive Agrarian Reform Law,[19] Indigenous Peoples' Rights Act,[20] and the Convention on the Rights of the Child. Indeed, there has been a more intense awareness of rights and obligations and of the importance of legal documentation among sectors, such as urban poor groups, labor groups, women and children's advocates, rural communities, and indigenous communities. Thus, this is a truly encouraging sign of greater citizen participation in the legal and judicial processes that are integral to a civil government and society—in contrast to the attraction that rebellion and subversion offered as means of redress during the 1970s and 1980s.

These, however, all the more underscore the necessity for the justice system to efficiently deliver on its functions. Many laws and jurisprudence might require codification and simplification, such as the need for a simplified tax code and stronger laws on bankruptcy and financial regulation.

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[18] Only decisions on criminal cases of Regional Trial Courts are read in full, as required by The Rules on Criminal Procedure Rule 120, Sec. 6 (2000).

[19] RA No. 6657, as amended (1988).

[20] RA No. 8371 (1997).

Procedures, also, need to be reviewed and possibly modified to encourage speedier resolution of cases in view of the fact that resources are insufficient. These involve the decrease of vacancies, the creation of new courts to deal with the case backlog, and a greater logistical support to prosecutors, police, and penal establishments.

VI. Conclusion

The rule of law is a powerful social mechanism to promote sustained economic growth and development. This is a serious consideration in the Philippines with its substantial rates of poverty and relatively inequitable distribution of income. With the rule of law, contracts can be enforced, disputes can be arbitrated speedily and impartially, and sanctions are imposed as a discouragement to irregularities and illegal activities. The rule of law is thus a necessary tool in creating the stable atmosphere that encourages consumption, investment, and credit. But poverty is more than the inadequacy of income. It is also the experience of social exclusion and vulnerability. Legal assistance to the poor and marginalized can, thus, also enhance their well-being.

But since the legal profession by itself is unproductive but socially necessary, it has to deliver justice efficiently, especially in a resource-poor economy. Available data and case studies suggest that the justice system of the Philippines is still inefficient. Nearly a third of judicial positions are vacant and the rate of case disposition is low. In spite of increasing numbers of assistance by the PAO, it is possible that a substantial number of disputes may not even be settled within the legal system itself. The average length of the final resolution of a case is also unknown.

Thus, to strengthen the rule of law, resources need to be devoted to the Judiciary, prosecution, police, and penal institutions. But, the laws and jurisprudence also need to be codified and simplified to minimize possible legal difficulties that may face investors, creditors, and households in their

business and economic decisions and activities. Legal procedures may also need to be reviewed to expedite the resolution of cases.

In a country that highly regards the legal profession, this may well be the profession's own obligation to assist in the process of social and economic development.

TABLES

Table 1

Productive and Unproductive Sectors (USA)

Productive	*Unproductive*
Agriculture	Wholesale and retail trade
Mining	Finance and insurance
Construction	Real estate rentals
Manufacturing	Business service
Transportation and warehousing	Government: defense and general administration
Communications	
Broadcasting	
Utilities	
Hotels, personal/repair service	
Research and development	
Automotive repairs	
Amusement	
Medical/educational service	
Non-profit institutions	
Federal government enterprises	
State/local government enterprises	
Allocated imports	
Business travel	
Scrap	
Government: non-defense, non-administration	
Household industry	

Source: Edward Wolff, *Growth, Accumulation, and Unproductive Activity: An Analysis of the Postwar U.S. Economy* 43 (Cambridge: Cambridge University Press, 1987).

Table 2

Selected Productive and Unproductive Occupations (USA)

Productive	*Unproductive*
1) Professional and technical	1) Professional and technical
Architects	Accounting and auditors
Computer specialists	Lawyers and judges
Engineers	College deans and presidents
Farm management advisors	Personnel and labor relations workers
Foresters and conservationists	Religious workers
Librarians, archivists, curators writers	Public relations personnel and publicity
Mathematical specialists	
Life and physical scientists	
Physicians, dentists, nurses, health specialists, health technicians	
Social scientists	
Social and recreation workers	
Teachers	
Engineering, science and other technicians	
Writers, artists, athletes, entertainers	
All other professional, technical and kindred workers (except unproductive)	
2) Clerical	2) Clerical
Vehicle dispatchers and starters	Bank tellers
Expediters and production controllers	Billing clerks
Library attendants and assistants	Bookkeepers
Mail carriers and handlers	Cashiers
Home management advisors	Vocational counselors
Office machine operators (except bookkeeping and billing machine operators)	Bill and account collectors
Proofreaders	Counter clerks
Medical secretaries	File clerks
Statistical clerks	Insurance adjusters, examiners, investigators
Teacher aides	Messengers and office boys
Telegraph and telephone operators	Meter readers
	Bookkeeping and billing machine operators
	Payroll and timekeeping clerks
	Postal clerks
	Real estate appraisers
	Receptionists, secretaries (except medical), stenographers, typists
	Shipping and receiving clerks
	Stock clerks and storekeepers
	Ticket, station, express agents
	Weighers
	All other clerical workers (except productive)
3) Craftsmen and kindred workers	3) Managers and administrators (except farm)
4) Operatives	4) Sales workers
5) Service workers, including firemen and excluding all other protective service workers	5) Protective service workers
6) Non-farm laborers	Guards and watchmen
7) Farmers and farm managers	Marshals and constables
8) Farm laborers and farm foremen	Policemen, detectives, sheriffs, bailiffs

Source: Edward Wolff, *Growth, Accumulation, and Unproductive Activity: An Analysis of the Postwar U.S. Economy* 51–53 (Cambridge: Cambridge University Press, 1987).

Table 3
Income Distribution of Families in the Philippines (%)

Decile Grp	1961	1965	1971	1985	1988	1991	1994	1997	2000	2003
First	1.5	1.1	1.2	2.0	2.0	1.8	1.9	1.7	1.7	1.8
Second	2.7	2.4	2.4	3.2	3.2	2.9	3.0	2.7	2.7	2.9
Third	3.4	3.5	3.5	4.1	4.1	3.7	3.9	3.4	3.5	3.8
Fourth	4.5	4.6	4.6	5.0	5.0	4.6	4.9	4.3	4.4	4.7
Fifth	5.5	5.7	5.9	6.0	6.0	5.6	6.0	5.3	5.5	5.8
Sixth	6.6	7.1	7.4	7.3	7.3	6.9	7.4	6.7	6.9	7.2
Seventh	8.3	8.9	9.9	8.9	9.1	8.7	9.1	8.6	8.8	9.1
Eighth	11.0	11.2	11.1	11.4	11.6	11.3	11.8	11.4	11.7	11.9
Ninth	15.5	15.4	16.9	15.7	16.0	16.0	16.4	16.1	16.4	16.6
Tenth	41.0	40.1	37.1	36.4	35.8	38.6	35.5	39.7	38.4	36.6
Gini coefficient				0.447	0.445	0.468	0.451	0.496	0.4822	0.4605

Source: National Statistics Office for the income distribution data and for the Gini coefficients, 2000–2003. For the Gini coefficients of 1985–91, *Understanding Poverty and Inequality in the Philippines: A Compendium of Policy and Methodological Researches*, by Ponciano Intal and Ma. Cynthia Bantilan (Manila: NEDA, 1994).

Table 4

Growth Rates of GNP, Rates of Unemployment and Underemployment (%)

Year	GNP	GNP per capita	Unemployment	Underemployment
1973	9.76	6.77	4.9	11.8
1974	4.20	1.39	4.0	9.8
1975	4.88	2.51	3.9	11.2
1976	8.17	4.83	5.2	10.1
1977	5.79	3.01	5.1	18.9
1978	5.46	2.67	4.9	15.2
1979	6.38	3.55	a	a
1980	4.63	1.86	7.9	20.7
1981	3.24	0.70	8.8	22.8
1982	2.84	0.33	9.6	25.8
1983	1.44	-1.06	10.4	29.1
1984	-8.72	-10.92	10.4	30.5
1985	-7.06	-9.31	12.5	20.4
1986	4.15	1.68	11.8	23.0
1987	5.10	2.61	11.2	23.1
1988	7.16	4.67	8.3	23.3
1989	5.73	3.31	8.4	23.3
1990	4.53	2.19	8.1	22.1
1991	0.23	-1.99	9.0	22.1
1992	0.62	-1.54	8.6	19.9
1993	2.12	-0.38	8.9	21.4
1994	5.25	2.74	8.4	20.9
1995	4.88	2.43	8.4	19.8
1996	7.24	4.81	7.4	19.4
1997	5.3	2.97	7.9	20.8
1998	4.1	-1.7	9.6	23.7
1999	3.7	1.5	9.4	22.1
2000	7.1	4.8	10.1	19.9
2001	2.3	-0.01	9.8	16.6
2002	4.2	2.1	10.2	15.3
2003	5.9	3.7	10.2	15.8
2004	6.7	4.6	10.9	16.9
2005	5.6	3.5	7.4	21.2

Source: National Statistics Office. Unemployment data for 1956–1975 and 1980 onward use "past week" reference period while for 1976–1978 use "past quarter" reference period. Prior to 1987, underemployed was defined as the number of employed persons wanting additional work. From 1987 onwards, the concept was redefined to number of employed persons wanting more hours of work. No labor force survey was conducted in 1979.

Table 5

Clientele Assisted by the Public Attorney's Office

Type of Service	2001	2002	2003	2004	2005
Indigent Persons Served	5,404,490	5,596,338	5,598,471	5,324,487	4,495,534
Judicial Cases Handled	410,919	437,735	534,893	539,319	545,613
Quasi-Judicial Cases Handled	60,533	68,303	69,779	60,136	55,916
Limited Services	641,918	661,174	715,084	677,023	654,709
Non-Judicial Services	3,199,824	3,290,372	2,981,643	2,846,384	2,200,634
Outreach Activities	159,255	162,440	192,268	182,555	163,544
Jail Visitation Program	386,537	389,875	444,768	418,657	446,924

Source of Basic Data: Philippine Statistical Yearbook 17.17 (2006).

Table 6

Case Outflow and Inflow and Pending Cases

Year	Inflow	Outflow	Pending
1993	414,813	257,629	370,473
1994	469,586	308,785	460,510
1995	472,302	289,986	498,094
1996	553,899	289,225	629,729
1997	697,249	353,827	769,190
1998	607,246	346,816	795,892
1999	621,887	367,071	824,360
2000	686,244	686,818	834,221
2001	564,271	583,702	815,740
2002	544,441	544,001	816,380
2003	589,131	595,663	824,057
2004	507,217	514,162	808,488
2005	456,651	488,601	769,656

Source of Basic Data: Philippine Statistical Yearbook 17.19–23 (2000, 2006).

Table 7

Rate of Court Case Disposition (In Percent)

Court	2000	2001	2002	2003	2004	2005
Total	0.63	0.69	0.70	0.70	0.74	0.83
Supreme Court	1.10	1.10	1.00	0.97	0.97	N.A.
Court of Appeals	0.87	0.99	0.93	1.00	0.96	1.04
Sandiganbayan	1.46	1.48	1.28	3.08	1.98	0.97
Court of Tax Appeals	0.78	1.10	0.84	0.81	0.73	0.71
Regional Trial Court	0.71	0.72	0.68	0.64	0.69	0.79
Metropolitan Trial Court	0.45	0.49	0.59	0.59	0.68	0.75
Municipal Trial Court in Cities	0.64	0.73	0.79	0.78	0.87	0.83
Municipal Trial Court	0.62	0.80	0.72	0.77	0.77	0.90
Municipal Circuit Trial Court	0.67	0.73	0.75	0.80	0.76	0.96
Shari'a District Court	1.03	0.78	0.81	2.33	1.50	1.17
Shari'a Circuit Court	0.90	0.98	0.93	0.71	0.89	0.90

Source: Philippine Statistical Yearbook 17–19 (2000).

Table 8

Number of Judges by Type of Court and by Gender, 2001

Court	Men	Women	Incumbents	Vacancies	Total Positions
Total	1,169	318	1,487	727	2,214
Supreme Court	13	2	15	_	15
Court of Appeals	32	13	45	6	51
Sandiganbayan	11	3	14	1	15
Court of Tax Appeals	3	_	3	_	3
Regional Trial Court	632	146	778	172	950
Metropolitan Trial Court	32	28	60	22	82
Municipal Trial Court in Cities	84	29	113	40	153
Municipal Trial Court	174	58	232	182	414
Municipal Circuit Trial Court	168	39	207	268	475
Shari'a District Court	1	_	1	4	5
Shari'a Circuit Court	19	_	19	32	51

Source: Philippine Statistical Yearbook (2000) 17–20.

World Trade Organization Appellate Body

Brazil – Measures Affecting Dessicated Coconut

Philippines, *Appellant/Appellee*
Brazil, *Appellant/Appellee*

European Communities, *Third Participant*
United States, *Third Participant*

Present:

El-Naggar, *Presiding Member*
Ehlermann, *Member*
Lacarte-Muró, *Member*

I. Introduction

The Philippines and Brazil appeal from certain issues of law and legal interpretations in the Panel Report, *Brazil—Measures Affecting Desiccated Coconut*[1] (the "Panel Report"). That Panel was established to consider a complaint by the Philippines against Brazil relating to the countervailing duties imposed by Brazil on imports of desiccated coconut from the Philippines pursuant to Interministerial Ordinance No. 11 (the "Ordinance") on August 18, 1995.

The application for initiation of the countervailing duty investigation was filed with the Brazilian authorities on January 17, 1994. The investigation was initiated on June 21, 1994; provisional countervailing duties were imposed on March 23, 1995; and definitive countervailing duties were imposed on August 18, 1995. The *Marrakesh Agreement Establishing the*

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1 WT/DS22/R, October 17, 1996.

World Trade Organization[2] (the "WTO Agreement") entered into force for both parties to this dispute, Brazil and the Philippines, on January 1, 1995, that is, after the application for, and the initiation of the investigation and prior to the imposition of the provisional and definitive countervailing duties.

The Panel Report was circulated to Members of the World Trade Organization (WTO) on October 17, 1996. It contains the following conclusions:

a. Article VI of GATT 1994 does not constitute applicable law for the purposes of this dispute. As a result, the substance of the Philippines' claims under that Article, and of its claims under Articles I and II of GATT 1994 which derive from their claims of inconsistency with Article VI of GATT 1994, cannot be considered by this Panel.

b. The Agreement on Agriculture does not constitute applicable law for the purposes of this dispute. As a result, the substance of the Philippines' claims under that Agreement cannot be considered by this Panel.

c. The Philippines' claim regarding Brazil's failure to consult is not within the terms of reference of this Panel and therefore its substance cannot be considered.[3]

The Panel made the following recommendation:

> The Panel, having concluded that the substance of the Philippines' claims are not properly before it, recommends that the Dispute Settlement Body make such a ruling.[4]

On December 16, 1996, the Philippines notified the Dispute Settlement Body[5] (DSB) of its intention to appeal certain issues

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[2] Done at Marrakesh, Morocco, April 15, 1994.

[3] Panel Report, ¶ 294.

[4] Panel Report, ¶ 295.

[5] WT/DS22/8, December 18, 1996.

of law covered in the Panel Report and legal interpretations developed by the Panel, pursuant to paragraph 4 of Article 16 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU") and filed a Notice of Appeal with the Appellate Body, pursuant to Rule 20 of the *Working Procedures for Appellate Review* (the "Working Procedures").

On January 9, 1997, the Philippines filed an appellant's submission.[6] On January 14, 1997, Brazil filed an appellant's submission pursuant to Rule 23(1) of the Working Procedures. On January 24, 1997, Brazil filed an appellee's submission pursuant to Rule 22 of the Working Procedures and the Philippines filed an appellee's submission pursuant to Rule 23(3) of the Working Procedures. That same day, the European Communities and the United States submitted third participants' submissions pursuant to Rule 24 of the Working Procedures.

The oral hearing provided for in Rule 27 of the Working Procedures was held on January 30, 1997. The participants and third participants presented their arguments and answered questions from the Division of the Appellate Body hearing the appeal.

II. Arguments of Participants and Third Participants

A. The Philippines

The Philippines appeals from certain of the Panel's legal findings and conclusions, as well as from certain legal interpretations developed by the Panel. The Philippines submits that the Panel erred in concluding that Article VI of the *General Agreement on Tariffs and Trade 1994* (the "GATT 1994") cannot be independently applied in transitional situations where the *Agreement on Subsidies and Countervailing Measures* (the "SCM Agreement") is not applicable pursuant to Article 32.3 of the SCM Agreement, and that the inapplicability of Article

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6 Pursuant to Rule 21(1) of the Working Procedures.

VI of the GATT 1994 renders Articles I and II of the GATT 1994 inapplicable. In the Philippines' view, the Panel erroneously treated the Philippines' reliance on Articles I and II of the GATT 1994 as one that "derive[s] from" the Philippines' invocation of Article VI of the GATT 1994.

According to the Philippines, the Panel's analysis is flawed by its failure to address this dispute in accordance with the proper relationship between Articles I, II, and VI of the GATT 1994 and Article 32.3 of the SCM Agreement. The Panel erred in starting and focusing its analysis on Article 32.3 of the SCM Agreement, which the Philippines did not invoke. The Panel should have first evaluated whether the disputed measure is inconsistent with Articles I and II of the GATT 1994, and if it was found to be inconsistent, then the Panel should have examined whether the measure could be justified under Article VI of the GATT 1994. Moreover, because Brazil's defence is predicated on an exception (Article 32.3 of the SCM Agreement) to yet another exception (Article VI of the GATT 1994) to the general rule (Articles I and II of the GATT 1994), the Panel should have narrowly interpreted Article 32.3 of the SCM Agreement.

The Philippines argues that, when the WTO Agreement entered into force for both Brazil and the Philippines on January 1, 1995, the Philippines became entitled to invoke its rights under Articles I and II of the GATT 1994, and its rights arising under Article VI of the GATT 1994, in regard to any countervailing measure imposed against the Philippines by any WTO Member, including Brazil, after the WTO Agreement's entry into force. Article 32.3 of the SCM Agreement, at most, precludes the application of the SCM Agreement to WTO-era measures applied for before the entry into force of the WTO Agreement due to the differences between the SCM Agreement and the *Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade* (the "Tokyo Round SCM Code"); but such a transitional rule does not affect the applicability of Articles I, II, and VI of the GATT 1994, whose texts are exactly identical to their counterpart provisions in the *General Agreement on Tariffs and Trade 1947* (the "GATT 1947").

The Philippines asserts that international law principles as codified in the *Vienna Convention on the Law of Treaties* (the "Vienna Convention")[7] ensure the non-retroactive application of treaties. Article 28 of the Vienna Convention insulates an act that took place before the new treaty's entry into force from the obligations of that treaty. As the substance and conclusion of the investigation leading to the imposition by Brazil of the countervailing measure at issue in this dispute occurred after the entry into force of the WTO Agreement, Articles I, II, and VI of the GATT 1994 constitute the law applicable to the measure in dispute, and such applicability does not involve retroactivity. The Philippines challenges the Panel's finding that the application of Article VI of the GATT 1994 to the countervailing duty measure in dispute leads to a "manifestly absurd or unreasonable" result. In the Philippines' view, application of Article VI of the GATT 1994 to a definitive countervailing duty is no less fair than applying WTO norms to other pre-WTO measures, such as occurred in *United States–Standards for Reformulated and Conventional Gasoline*[8] ("United States–Gasoline").

In the Philippines' view, the Panel improperly disregarded the Philippines' argument that the transitional decisions[9]

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7 May 23, 1969, 1155 *U.N.T.S.* 331; 8 *International Legal Materials* 679.

8 WT/DS2/9, adopted May 20, 1996.

9 By "transitional decisions," we refer to the Decision on Transitional Co-Existence of the GATT 1947 and the WTO Agreement, PC/12-L/7583, December 13, 1994; the Decision on Transitional Co-Existence of the Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade and the Marrakesh Agreement Establishing the World Trade Organization (the "Decision on Transitional Co-existence of the Tokyo Round SCM Code and the WTO Agreement"), SCM/186, December 16, 1994; and the Decision on Consequences of Withdrawal from or Termination of the Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade (the "Decision on Consequences of Withdrawal from or Termination of the Tokyo Round SCM Code"), SCM/187, December 16, 1994.

recognize the right of WTO Members to invoke WTO norms even in situations involving elements that occurred prior to the entry into force of the WTO Agreement. The Decision on Transitional Co-Existence of the Tokyo Round SCM Code and the WTO Agreement expressly recognizes the availability of WTO dispute resolution not only as an option, but as an immediate pre-emptive choice in matters also covered by the Tokyo Round SCM Code. The Decision on Consequences of Withdrawal from or Termination of the Tokyo Round SCM Code is permissive, expressly recognizing the right of a signatory to the Tokyo Round SCM Code, that is also a WTO Member, to choose under which regime it will vindicate its rights. The Philippines contends that it has the procedural right to resort to the DSU to enforce its substantive WTO rights.

While Article 28 of the Vienna Convention recognizes that its limitations on non-retroactivity may be qualified where "a different intention appears from the treaty or is otherwise established," the Philippines argues that no such intention is indisputably established by Article 32.3 of the SCM Agreement and the other provisions upon which the Panel relied. It was wrong for the Panel Report to vary the plain meaning of the term, "this Agreement," in Article 32.3 of the SCM Agreement so as to refer also to the GATT 1994.

In the Philippines' view, the context of Article 32.3 of the SCM Agreement does not warrant inferring a reference to Article VI of the GATT 1994. Article 32.1 of the SCM Agreement confirms that the reference in Article 32.3 of the SCM Agreement to "this Agreement" means only the SCM Agreement. The omission in the SCM Agreement of note 2 to the preamble of the Tokyo Round SCM Code does not support, and in fact undercuts, the Panel's non-separability finding. The presence of cross-references from Articles 10 and 32.1 of the SCM Agreement to Article VI of the GATT 1994 does not make Article VI of the GATT 1994 so inseparable from the SCM Agreement as to negate the rights of WTO Members to invoke Article VI of the GATT 1994 independently. Such a right to choose existed under the pre-WTO regime despite similar cross-references in the Tokyo

Round SCM Code to Article VI of the GATT 1947. Furthermore, it was improper for the Panel to support its non-separability finding with the broad argument that Article 7.1 of the DSU fosters an "integrated" dispute settlement framework that "allows a panel to interpret provisions of covered agreements in the light of the WTO Agreement as a whole."[10]

According to the Philippines, the object and purpose of Article 32.3 of the SCM Agreement and the WTO Agreement also do not warrant interpreting the phrase "this Agreement" in Article 32.3 of the SCM Agreement to include Article VI of the GATT 1994.

In the Philippines' view, the panel report in *United States–Countervailing Duties on Fresh, Chilled, and Frozen Pork from Canada*[11] ("United States–Pork") offers persuasive guidance on the separate applicability of Article VI of the GATT 1994. The panel in *European Economic Community–Payments and Subsidies Paid to Processors and Producers of Oilseeds and Related Animal-Feed Proteins*[12] ("EEC–Oilseeds") in effect addressed the separability issue and resolved it in favor of applying GATT 1947 separately from the Tokyo Round SCM Code. In addition, the Panel Report failed to give due weight to the *United States–Gasoline* case as evidence that a complaining WTO Member is not required to invoke all agreements that are potentially relevant to a dispute.

In the view of the Philippines, the unavailability of the SCM Agreement's definitions, or the possibility of interpretations inconsistent therewith, when Article VI of the GATT 1994 is interpreted independently, do not negate the right of WTO Members to invoke Article VI of the GATT 1994 independently in transitional situations where the SCM Agreement is inapplicable. In addition, when independently applied, Article

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[10] Panel Report, ¶ 242.

[11] BISD 38S/30, adopted July 11, 1991.

[12] BISD 37S/86, adopted January 25, 1990.

VI of the GATT 1994 can be properly interpreted in the light of practice under Article VI of the GATT 1947 that antedated, and/ or was not dependent on the Tokyo Round SCM Code.

The Philippines further argues that it was not the intent of the original WTO Members to allow prospective new WTO Members to use applications for investigations filed prior to their accession to the WTO Agreement as a basis for insulating from the GATT 1994 any countervailing measures that such prospective WTO Members may impose after their admission into the WTO. In addition, the Panel's ruling could leave some WTO Members without any remedy for at least five years, until such time as the "sunset" review provision in Article 21.3 of the SCM Agreement becomes effective.

If the Appellate Body reverses the Panel's conclusions that Articles I, II, and VI of the GATT 1994 are inapplicable to this dispute, the Philippines requests that the Appellate Body adopt a procedure for this appeal under Rule 16(1) of the Working Procedures for the resolution of the substantive merits of the Philippines' claims. The Philippines incorporates its arguments made before the Panel and submits that the subsidy and injury determinations of the Ordinance, and the countervailing measure based thereon, are inconsistent with Articles I and II of the GATT 1994, and not justified by Articles VI:3 and VI:6(a) of the GATT 1994.

With respect to the point of appeal raised in Brazil's appellant's submission, the Philippines argues that Brazil did not ask the Panel to refrain from considering whether or not Articles I and II of the GATT 1994 are applicable to this dispute. On the contrary, Brazil requested the Panel to consider the issue of the applicability or inapplicability of the GATT 1994. In any event, Articles I and II of the GATT 1994 are covered by the terms of reference because they are "relevant provisions" within the agreement "cited" by the Philippines.

B. Brazil

Brazil generally agrees with the Panel's findings and conclusions concerning the law applicable to this dispute, but nevertheless appeals on one issue. Brazil claims that the issue of the applicability of Articles I and II of the GATT 1994 was not within the terms of reference of the Panel in this dispute and should not have been addressed by the Panel.

With respect to the points of appeal raised in the Philippines' appellant's submission, Brazil considers it appropriate, and in accordance with principles of international law, that the Panel first determined whether it had jurisdiction to consider the dispute before considering the substantive merits of the Philippines' claims. The question of whether the WTO Agreement applies to the substance of the dispute is not merely a "defence" as claimed by the Philippines, but a fundamental jurisdictional issue. While Brazil does not contest that the Philippines has the procedural right to resort to the DSU to enforce its substantive WTO rights, Brazil asserts that the Panel properly found that this dispute did not involve any substantive WTO rights. The Panel's conclusion that it did not have jurisdiction is correct, and the Tokyo Round SCM Code constitutes the law applicable to this dispute.

In Brazil's view, the Panel properly applied the customary rules of interpretation of public international law as set out in Articles 31 and 32 of the Vienna Convention to conclude that the WTO Agreement did not apply to this dispute. The plain language of Article 32.3 of the SCM Agreement prohibits the application of at least the SCM Agreement to this dispute, and the context of the WTO Agreement indicates that Article 32.3 of the SCM Agreement prevents the application of any portion of the WTO Agreement to this dispute. There are numerous indicia that the WTO Agreement and its Multilateral Trade Agreements were intended to apply as a whole. Article II:2 of the WTO Agreement states that the agreements and associated legal instruments included in Annexes 1, 2, and 3—encompassing both the GATT 1994 and the SCM Agreement—

are "integral parts" of the Agreement. There is a unified dispute settlement mechanism that applies to disputes raised under the WTO Agreement, the GATT 1994 and the other covered agreements. The general interpretative note to Annex 1A of the WTO Agreement indicates that the GATT 1994 and the other agreements are to be considered together. Article 10 of the SCM Agreement indicates that countervailing duties may only be imposed in accordance with the provisions of Article VI of the GATT 1994 and the terms of the SCM Agreement. As the Panel noted, several of the provisions of the SCM Agreement seek to interpret or provide guidance on terms used in Article VI. As the Panel further observed, applying Article VI of the GATT 1994 separately from Article VI of the GATT 1994 and the SCM Agreement could lead to differing interpretations of the benefits and obligations conferred by Article VI of the GATT 1994 as between the same Members.

In Brazil's view, *United States–Gasoline* does not support the application of Article VI of the GATT 1994 without reference to the SCM Agreement. The Agreement on Technical Barriers to Trade, invoked in *United States–Gasoline*, does not purport to interpret any articles of GATT 1994, nor does it contain any language similar to that of Article 10 of the SCM Agreement linking it to specific articles of the GATT 1994.

Brazil asserts that the Panel's consideration of the Decision on Consequences of Withdrawal from or Termination of the Tokyo Round SCM Code was consistent with the reference to a "subsequent agreement" within the meaning of Article 31(3)(a) of the Vienna Convention. To the extent that "subsequent practice" within the meaning of Article 31(3)(b) of the Vienna Convention has developed, it supports the Panel's conclusion that Article VI of the GATT 1994 does not apply to this dispute. Brazil further asserts that Article 28 of the Vienna Convention, as a "relevant rule of international law applicable in the relations between the parties" referred to in Article 31(3)(c) of the Vienna Convention, supports the Panel's conclusions on the law applicable to this dispute.

Brazil contends that the panel reports in *United States–Pork* and *EEC–Oilseeds*, invoked by the Philippines, provide no guidance for this dispute. As the issue of applicable law was never raised in *United States–Pork*, it therefore gives no indication of past practice on this issue. Moreover, because the structure of the various agreements in this case differs from the structure of the agreements in *EEC–Oilseeds*, that panel report provides no guidance on the interpretation of the WTO Agreement.

Should the Appellate Body find that the WTO Agreement applies, Brazil argues that it is not appropriate for the Appellate Body to rule on the substantive issues in this dispute. The Appellate Body's authority is limited by paragraphs 6 and 13 of Article 17 of the DSU. Brazil further argues that *United States–Gasoline* does not support the examination by the Appellate Body of these issues. If, however, the Appellate Body considers it appropriate to address the substantive issues, Brazil incorporates by reference all its submissions, both oral and written, to the Panel concerning those issues. If the Appellate Body decides that Article VI of the GATT 1994 applies, it must be interpreted on its own without reference to the Tokyo Round SCM Code or the SCM Agreement.

C. European Communities

The European Communities support the legal findings and conclusions of the Panel. The European Communities assert that the Panel correctly concluded that Article VI of the GATT 1994 is inapplicable to the measure in dispute and that the inapplicability of Article VI of the GATT 1994 also renders Articles I and II of the GATT 1994 inapplicable.

In the European Communities' view, the Panel's findings are in conformity with the principles of customary international law regarding the temporal application of treaty obligations, contained in Article 28 of the Vienna Convention, which apply "[u]nless a different intention appears from the treaty or is otherwise established." The Panel correctly considered the text

of the relevant provisions in the light of their context, and of the object and purpose of the WTO Agreement, to reach its legal conclusion that Article VI of the GATT 1994 cannot be applied independently. It was, therefore, no longer necessary for the Panel to resort to the subsidiary rule contained in Article 28 of the *Vienna Convention*. In any case, the application of this subsidiary rule would also lead to the conclusion that Article VI of the GATT 1994 does not apply in the present dispute.

According to the European Communities, the *United States–Pork* and *EEC–Oilseeds* panel reports invoked by the Philippines are not relevant to this dispute, as the relationship of the GATT 1947 to the Tokyo Round SCM Code is different from the relationship of the SCM Agreement to the GATT 1994. The transitional decisions do not support the independent application of Article VI of the GATT 1994. Moreover, the independent application of Article III:4 of the GATT 1994 in *United States–Gasoline* does not support the independent application of Article VI of the GATT 1994, as the relationship between Article III of the GATT 1994 and the *Agreement on Technical Barriers to Trade* is different from the relationship between Article VI of the GATT 1994 and the SCM Agreement.

D. United States

The United States disagrees with certain of the legal findings and conclusions of the Panel, and requests that the Appellate Body take into consideration its arguments before the Panel as described in paragraphs 211–224 of the Panel Report. The United States asserts that Article VI of the GATT 1994 is applicable to Brazil's countervailing duty measure and that, as of January 1, 1995, Brazil was bound to levy countervailing duties consistently with the provisions of the GATT 1994. If the Appellate Body considers the substantive merits of this dispute, it must do so under Article VI of the GATT 1994 alone, without reference to the Tokyo Round SCM Code. The United States submits that the panel report in *EEC–Oilseeds* is instructive in this regard.

III. Issues Raised in this Appeal

The Philippines appeals from two legal findings and conclusions of the Panel. First, the Philippines submits that the Panel erred in concluding that Article VI of the GATT 1994 cannot be applied independently in transitional situations where the SCM Agreement is not applicable pursuant to Article 32.3 of the SCM Agreement. Second, the Philippines claims that the Panel erred in finding that the inapplicability of Article VI of the GATT 1994 also renders Articles I and II of the GATT 1994 inapplicable. Brazil appeals from the Panel's legal findings and conclusions concerning Articles I and II of the GATT 1994. Brazil argues that the issue of the consistency of Brazil's countervailing duty measure with its obligations under Articles I and II of the GATT 1994 was not within the terms of reference of the Panel.

On the basis of the written submissions and oral statements made by the participants and third participants, this appeal raises the following issues:

1. Whether Article VI of the GATT 1994 applies, independently of the SCM Agreement, to a countervailing duty measure imposed as a result of an investigation initiated pursuant to an application made before the entry into force of the WTO Agreement;
2. Whether a finding with respect to the applicability of Article VI of the GATT 1994 determines the applicability of Articles I and II of the GATT 1994; and
3. Whether the Philippines' claims under Articles I and II of the GATT 1994 were within the terms of reference of the Panel.

IV. Applicability of Article VI of the GATT 1994

A. Background

This appeal deals with a countervailing duty investigation which was initiated pursuant to an application filed with the Brazilian authorities on January 17, 1994. The investigation was initiated on June 21, 1994; provisional countervailing duties were imposed on March 23, 1995; and definitive countervailing duties were imposed on imports of desiccated coconut from the Philippines on August 18, 1995. The WTO Agreement entered into force for both parties to this dispute, Brazil and the Philippines, on January 1, 1995.

With respect to the measure at issue in this appeal, we see a decision to impose a definitive countervailing duty as the culminating act of a domestic legal process which starts with the filing of an application by the domestic industry, includes the initiation and conduct of an investigation by an investigating authority, and normally leads to a preliminary determination and a final determination. A positive final determination that subsidized imports are causing injury to a domestic industry authorizes the domestic authorities to impose a definitive countervailing duty on subsidized imports.

B. WTO Agreement: An Integrated System

The WTO Agreement is fundamentally different from the GATT system which preceded it. The previous system was made up of several agreements, understandings and legal instruments, the most significant of which were the GATT 1947 and the nine Tokyo Round Agreements, including the Tokyo Round SCM Code. Each of these major agreements was a treaty with different membership, an independent governing body, and a separate dispute settlement mechanism.[13] The GATT 1947 was

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[13] *Agreement on Technical Barriers to Trade*, BISD 26S/8; *Agreement on Implementation of Article VII of the GATT — Protocol to the Agreement on Implementation of Article VII of the GATT,* BISD 26S/116, 151; *Agreement on Implementation of Article VI of the GATT* (the "*Tokyo*

administered by the CONTRACTING PARTIES, whereas the Tokyo Round SCM Code was administered by the Tokyo Round Committee on Subsidies and Countervailing Duty Measures comprised of the signatories to that *Code*.[14] With respect to disputes brought under Article XXIII of the GATT 1947, the CONTRACTING PARTIES were responsible for dispute settlement, including establishment of panels, adoption of panel reports, surveillance of implementation of rulings and recommendations, and authorization of suspension of concessions or other obligations. The Tokyo Round Committee on Subsidies and Countervailing Measures was responsible for administering and monitoring dispute settlement under Articles 12, 13, 17 and 18 of the Tokyo Round SCM Code.

As a result of the separate legal identity of the GATT 1947 and the Tokyo Round SCM Code, a complaining party either had to bring a dispute under Article VI of the GATT 1947, in which case it would invoke the dispute settlement provisions of Article XXIII of the GATT 1947, or alternatively, under the provisions of the Tokyo Round SCM Code, in which case it would commence consultations under that Code. Most disputes involving countervailing duty measures between 1979 and 1994 were

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Round Anti-dumping Code"), BISD 26S/171; *Agreement on Interpretation and Application of Articles VI, XVI, and XXIII of the General Agreement on Tariffs and Trade* (the "*Tokyo Round SCM Code*"), BISD 26S/56; *Agreement on Import Licensing Procedures*, BISD 26S/154; *Agreement on Government Procurement*, BISD 26S/33; *Agreement on Trade in Civil Aircraft*, BISD 26S/162; *Arrangement Regarding Bovine Meat*, BISD 26S/84; and *International Dairy Arrangement*, BISD 26S/91. The *Agreement on Import Licensing Procedures and the Agreement on Trade in Civil Aircraft* made reference to Articles XXII and XXIII of the GATT 1947 for dispute settlement. The *Arrangement Regarding Bovine Meat* and the *International Dairy Arrangement* did not explicitly provide for dispute settlement.

[14] By the end of 1994, the GATT 1947 had 128 contracting parties, whereas the *Tokyo Round SCM Code* had 24 signatories.

brought under the Tokyo Round SCM Code.[15] In the *United States–Pork* case, notwithstanding that both Canada and the United States were signatories to the Tokyo Round SCM Code, Canada chose to bring the matter under the dispute settlement provisions of Article XXIII of the GATT 1947, relying solely on its claims under Article VI of the GATT 1947.

Unlike the previous GATT system, the WTO Agreement is a single treaty instrument which was accepted by the WTO Members as a "single undertaking." Article II:2 of the WTO Agreement provides that the Multilateral Trade Agreements, in Annexes 1, 2 and 3 are "integral parts" of the WTO Agreement, binding on all Members. Annex 1A contains 13 multilateral agreements relating to trade in goods, including the GATT 1994 which was incorporated by reference into that Annex. A general interpretative note was included in Annex 1A in order to clarify the legal relationship of the GATT 1994 with the other agreements in Annex 1A. It provides that in the event of a

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[15] *Canadian Countervailing Duties on Grain Corn from the United States*, BISD 39S/411, adopted March 26, 1992; *United States–Definition of Industry Concerning Wine and Grape Products*, BISD 39S/436, adopted 28 April 1992; *United States–Measures Affecting Imports of Softwood Lumber from Canada*, SCM/162, adopted October 27, 1993; *Brazil–Imposition of Provisional and Definitive Countervailing Duties on Milk Powder and Certain Types of Milk from the European Economic Community*, SCM/179, adopted April 28, 1994; *United States–Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway*, SCM/153, adopted April 28, 1994; *United States–Countervailing Duties on Non-Rubber Footwear from Brazil*, SCM/94, adopted June 13, 1995; *EEC–Subsidies on Exports of Wheat Flour*, SCM/42, March 21, 1983, unadopted; *EEC–Subsidies on Exports of Pasta Products*, SCM/43, May 19, 1983, unadopted; *Canada–Imposition of Countervailing Duties on Imports of Boneless Manufacturing Beef from the EEC*, SCM/85, October 13, 1987, unadopted; *German Exchange Rate Scheme for Deutsche Airbus*, SCM/142, March 4, 1992, unadopted; *United States–Imposition of Countervailing Duties on Certain Hot-Rolled Lead and Bismuth Carbon Steel Products Originating in France, Germany and the United Kingdom*, SCM/185, November 15, 1994, unadopted.

conflict between a provision of the GATT 1994 and a provision of another agreement in Annex 1A, the latter shall prevail to the extent of the conflict. Article II:4 of the WTO Agreement provides that the GATT 1994 "as specified in Annex 1A x x x is legally distinct from the General Agreement on Tariffs and Trade, dated October 30, 1947 x x x."

The single undertaking is further reflected in the provisions of the WTO Agreement dealing with original membership, accession, non-application of the Multilateral Trade Agreements between particular Members, acceptance of the WTO Agreement, and withdrawal from it.[16] Within this framework, all WTO Members are bound by all the rights and obligations in the WTO Agreement and its Annexes 1, 2, and 3.

The DSU provides an integrated dispute settlement mechanism applicable to disputes arising under any of the "covered agreements." Article 2 of the DSU provides that the DSB has the "authority to establish panels, adopt panel and Appellate Body Reports, maintain surveillance and implementation of rulings and recommendations, and authorize suspension of concessions and other obligations under the covered agreements." The "covered agreements" include the WTO Agreement, the Agreements in Annexes 1 and 2, as well as any Plurilateral Trade Agreement in Annex 4 where its Committee of signatories has taken a decision to apply the DSU.[17] In a dispute brought to the DSB, a panel may deal with all the relevant provisions of the covered agreements cited by the parties to the dispute in one proceeding.[18]

C. GATT 1994 within the WTO Agreement

The WTO Agreement is a successor treaty to the GATT 1947, the Tokyo Round SCM Code and the other agreements and understandings which formed the previous GATT system.

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16 *WTO Agreement*, Articles XI, XII, XIII, XIV, and XV, respectively.

17 *DSU*, Article 1 and Appendix 1.

18 *DSU*, Article 7.

Although it is a new treaty which the WTO Members accepted definitively, Article XVI:1 of the WTO Agreement provides as follows:

> Except as otherwise provided under this Agreement or the Multilateral Trade Agreements, the WTO shall be guided by the decisions, procedures and customary practices followed by the CONTRACTING PARTIES to GATT 1947 and the bodies established in the framework of GATT 1947.

The GATT 1994 was incorporated by reference into Annex 1A of the WTO Agreement. The reference language includes the provisions of the GATT 1947, as rectified, amended or modified before the entry into force of the WTO Agreement; the provisions of legal instruments that entered into force under the GATT 1947 prior to the entry into force of the WTO Agreement, such as protocols and certifications relating to tariff concessions, protocols of accession (excluding the provisions concerning provisional application and "grandfather rights"), decisions on waivers granted under Article XXV of the GATT 1947 and other decisions of the CONTRACTING PARTIES to the GATT 1947; as well as the Understandings which amended specific articles of the GATT 1947 as a result of the Uruguay Round Multilateral Trade Negotiations. In many ways, therefore, the provisions of the GATT 1994 differ from the provisions of the GATT 1947.

The relationship between the GATT 1994 and the other goods agreements in Annex 1A is complex and must be examined on a case-by-case basis. Although the provisions of the GATT 1947 were incorporated into, and became a part of the GATT 1994, they are not the sum total of the rights and obligations of WTO Members concerning a particular matter. For example, with respect to subsidies on agricultural products, Articles II, VI, and XVI of the GATT 1994 alone do not represent the total rights and obligations of WTO Members. The Agreement on Agriculture and the SCM Agreement reflect the latest statement of WTO Members as to their rights and obligations concerning agricultural subsidies. The general interpretative note to Annex 1A was added to reflect that the other goods agreements in

Annex 1A, in many ways, represent a substantial elaboration of the provisions of the GATT 1994, and to the extent that the provisions of the other goods agreements conflict with the provisions of the GATT 1994, the provisions of the other goods agreements prevail. This does not mean, however, that the other goods agreements in Annex 1A, such as the SCM Agreement, supersede the GATT 1994. As the Panel has said:

> x x x the question for consideration is not whether the SCM Agreement supersedes Article VI of GATT 1994. Rather, it is whether Article VI creates rules which are separate and distinct from those of the SCM Agreement, and which can be applied without reference to that Agreement, or whether Article VI of GATT 1994 and the SCM Agreement represent an inseparable package of rights and disciplines that must be considered in conjunction.[19]

D. Principle of Non-Retroactivity of Treaties

The fundamental question in this case is one of the temporal application of one set of international legal norms, or the successor set of norms, to a particular measure taken during the period of co-existence of the GATT 1947 and the Tokyo Round SCM Code with the WTO Agreement. Article 28 of the Vienna Convention contains a general principle of international law concerning the non-retroactivity of treaties. It provides as follows:

> Unless a different intention appears from the treaty or is otherwise established, its provisions do not bind a party in relation to any act or fact which took place or any situation which ceased to exist before the date of the entry into force of the treaty with respect to that party.

Article 28 states the general principle that a treaty shall not be applied retroactively "unless a different intention appears from the treaty or is otherwise established." Absent a contrary intention, a treaty cannot apply to acts or facts which took place,

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[19] Panel Report, ¶ 227.

or situations which ceased to exist, before the date of its entry into force. Article 32.3 of the SCM Agreement is an express statement of intention which we will now examine.

E. Interpretation of Article 32.3 of the SCM Agreement

1. Text

Article 32.3 of the SCM Agreement reads as follows:

> x x x the provisions of this Agreement shall apply to investigations, and reviews of existing measures, initiated pursuant to applications which have been made on or after the date of entry into force for a Member of the WTO Agreement.

Examination of the ordinary meaning of this provision alone could lead us to the conclusion that the term, "this Agreement," in Article 32.3 means the SCM Agreement. However, it is necessary also to consider this provision in its context and in light of the object and purpose of the WTO Agreement.

2. Context

The relationship between the SCM Agreement and Article VI of the GATT 1994 is set out in Articles 10 and 32.1 of the SCM Agreement. Article 10 reads as follows:

> *Application of Article VI of GATT 1994*
>
> Members shall take all necessary steps to ensure that the imposition of a countervailing duty[36] on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture.

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[36] The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994.

Article 32.1 reads as follows:

> No specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement.[56]
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> [56] This paragraph is not intended to preclude action under other relevant provisions of GATT 1994, where appropriate.

From reading Article 10, it is clear that countervailing duties may only be imposed in accordance with Article VI of the GATT 1994 and the SCM Agreement. A countervailing duty being a specific action against a subsidy of another WTO Member, pursuant to Article 32.1, it can only be imposed "in accordance with the provisions of GATT 1994, as interpreted by this Agreement." The ordinary meaning of these provisions taken in their context leads us to the conclusion that the negotiators of the SCM Agreement clearly intended that, under the integrated WTO Agreement, countervailing duties may only be imposed in accordance with the provisions of Part V of the SCM Agreement and Article VI of the GATT 1994, taken together. If there is a conflict between the provisions of the SCM Agreement and Article VI of the GATT 1994, furthermore, the provisions of the SCM Agreement would prevail as a result of the general interpretative note to Annex 1A.

We turn to the omission of note 2 to the preamble of the Tokyo Round SCM Code from the SCM Agreement. That note reads:

> Wherever in this Agreement there is reference to "the terms of this Agreement" or the "articles" or "provisions of this Agreement" it shall be taken to mean, as the context requires, the provisions of the General Agreement as interpreted and applied by this Agreement.

This note related to a provision in the preamble to the Tokyo Round SCM Code which demonstrated the Tokyo Round signatories' desire "to apply fully and to interpret the provisions of Articles VI, XVI, and XXIII" of the GATT 1947. The preamble

was not retained in the new text of the SCM Agreement. Consequently, the note also disappeared. The SCM Agreement contains a set of rights and obligations that go well beyond merely applying and interpreting Articles VI, XVI and XXIII of the GATT 1947. The title to the SCM Agreement was also modified in this respect. Like the Panel, "we do not consider that the exclusion of this provision from the SCM Agreement sheds much light on the question before us."[20]

If Article 32.3 is read in conjunction with Articles 10 and 32.1 of the SCM Agreement, it becomes clear that the term "this Agreement" in Article 32.3 means "this Agreement and Article VI of the GATT 1994." We agree with the Panel that:

> Article VI of GATT 1947 and the Tokyo Round SCM Code represent, as among Code signatories, a package of rights and obligations regarding the use of countervailing measures, and Article VI of GATT 1994 and the SCM Agreement represent a new and different package of rights and obligations, as among WTO Members, regarding the use of countervailing duties. Thus, Article VI and the respective SCM Agreements impose obligations on a potential user of countervailing duties, in the form of conditions that have to be fulfilled in order to impose a duty, but they also confer the right to impose a countervailing duty when those conditions are satisfied. The SCM Agreements do not merely impose additional substantive and procedural obligations on a potential user of countervailing measures. Rather, the SCM Agreements and Article VI together define, clarify and in some cases modify the whole package of rights and obligations of a potential user of countervailing measures.[21]

3. *Object and Purpose of the WTO Agreement*

The fact that Article VI of the GATT 1947 could be invoked independently of the Tokyo Round SCM Code under the

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[20] Panel Report, ¶ 236, note 62.

[21] Panel Report, ¶ 246; we understand the Panel's reference to "*SCM Agreements*" in this paragraph to mean the *SCM Agreement* and the *Tokyo Round SCM Code*.

previous GATT system[22] does not mean that Article VI of GATT 1994 can be applied independently of the SCM Agreement in the context of the WTO. The authors of the new WTO regime intended to put an end to the fragmentation that had characterized the previous system. This can be seen from the preamble to the WTO Agreement which states, in pertinent part:

> *Resolved*, therefore, to develop an integrated, more viable and durable multilateral trading system encompassing the General Agreement on Tariffs and Trade, the results of past trade liberalization efforts, and all of the results of the Uruguay Round of Multilateral Trade Negotiations.

Article II:2 of the WTO Agreement also provides that the Multilateral Trade Agreements are "integral parts" of the WTO Agreement, "binding on all Members." The single undertaking is further reflected in the articles of the WTO Agreement on original membership, accession, non-application, acceptance and withdrawal. Furthermore, the DSU establishes an integrated dispute settlement system which applies to all the "covered agreements," allowing all the provisions of the WTO Agreement relevant to a particular dispute to be examined in one proceeding.

The Appellate Body sees Article 32.3 of the SCM Agreement as a clear statement that for countervailing duty investigations or reviews, the dividing line between the application of the GATT 1947 system of agreements and the WTO Agreement is to be determined by the date on which the application was made for the countervailing duty investigation or review. Article 32.3 has limited application only in specific circumstances where a countervailing duty proceeding, either an investigation or a review, was underway at the time of entry into force of the WTO Agreement. This does not mean that the WTO Agreement does not apply as of January 1, 1995 to all other acts, facts and situations which come within the provisions of the SCM Agreement and Article VI of the GATT 1994. However, the

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22 As demonstrated by the *United States–Pork* panel.

Uruguay Round negotiators expressed an explicit intention to draw the line of application of the new WTO Agreement to countervailing duty investigations and reviews[23] at a different point in time from that for other general measures.[24] Because a countervailing duty is imposed only as a result of a sequence of acts, a line had to be drawn, and drawn sharply, to avoid uncertainty, unpredictability and unfairness concerning the rights of states and private parties under the domestic laws in force when the WTO Agreement came into effect.

We agree with the Philippines that the transitional decisions approved by the Tokyo Round Subsidies and Countervailing Measures Committee and the CONTRACTING PARTIES[25] do not

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[23] There is an identical provision to Article 32.3 of the *SCM Agreement* contained in Article 18.3 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (the *Anti-dumping Agreement*). Similarly, there are mirror transitional decisions approved by the Tokyo Round Committee on Anti-dumping Measures, in the Decision on Transitional Co-Existence of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade and the Marrakesh Agreement Establishing the World Trade Organization, ADP/131, December 16, 1994; and the Decision on Consequences of Withdrawal from or Termination of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade, ADP/132, December 16, 1994.

[24] In its appellant's submission dated January 9, 1997, at p. 37, ¶ 59, the Philippines argues that in *United States—Gasoline*, both the panel and the Appellate Body assessed the pre-WTO domestic regulatory process that led to the imposition of the United States' environmental measure at issue in that dispute. We note that, in that case, there was no issue with respect to the temporal application of the measure in dispute, nor did the panel or the Appellate Body examine the applicability of the *Agreement on Technical Barriers to Trade*.

[25] The Decision on Transitional Co-Existence of the GATT 1947 and the WTO Agreement (PC/12-L/7583, December 13, 1994) was adopted by the CONTRACTING PARTIES to the GATT 1947 (6SS/SR/1); the Decision on Transitional Co-Existence of the Tokyo Round SCM Code and the WTO Agreement (SCM/186, December 16, 1994) was

modify the scope of rights and obligations under the WTO Agreement. We believe, however, that they contribute to understanding the significance of Article 32.3 of the SCM Agreement as a transitional rule. The Decision on Transitional Co-Existence of the GATT 1947 and the WTO Agreement and the Decision on Transitional Co-Existence of the Tokyo Round SCM Code and the WTO Agreement provide for the legal termination of the GATT 1947 and the Tokyo Round SCM Code one year after the date of entry into force of the *WTO Agreement*, i.e. by December 31, 1995. They also permit WTO Members, during the period of co-existence of the GATT 1947 and the Tokyo Round SCM Code with the WTO Agreement, to bring their disputes under the *DSU* where the measure in issue is one to which the WTO Agreement applies.

The Decision on Consequences of Withdrawal from or Termination of the Tokyo Round SCM Code, adopted by the Tokyo Round Subsidies and Countervailing Measures Committee, extended dispute settlement under the Tokyo Round SCM Code for two years, one year beyond the legal termination of the Tokyo Round SCM Code. The Tokyo Round Committee on Subsidies and Countervailing Measures was to remain in operation by agreement of the signatories to the Tokyo Round SCM Code until December 31, 1996, to deal with disputes arising out of countervailing duty investigations or reviews initiated pursuant to applications made prior to January 1, 1995. Signatories to the Tokyo Round SCM Code agreed to make their best efforts to expedite domestic investigations and dispute settlement procedures to permit the Tokyo Round Subsidies

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adopted by the Tokyo Round Committee on Subsidies and Countervailing Measures and noted by the CONTRACTING PARTIES (6SS/SR/1) and the WTO Committee on Subsidies and Countervailing Measures (G/SCM/M/1). The Decision on Consequences of Withdrawal from or Termination of the Tokyo Round SCM Code (SCM/187, December 16, 1994) was adopted by the Tokyo Round Committee on Subsidies and Countervailing Measures and noted by the CONTRACTING PARTIES (6SS/SR/1) and the WTO Committee on Subsidies and Countervailing Measures (G/SCM/M/1).

and Countervailing Measures Committee to consider covered disputes within this two-year period. This Decision avoided the application of Article 70 of the Vienna Convention, which provides that the termination of a treaty releases the parties from any obligation further to perform the treaty.

Like the Panel, "we are hesitant, in interpreting the WTO Agreement, to give great weight to the effect of decisions that had not yet been taken at the time the WTO Agreement was signed."[26] We agree with the Panel's statement that:

> The availability of Article VI of GATT 1994 as applicable law in this dispute is a matter to be determined on the basis of the WTO Agreement, rather than on the basis of a subsequent decision by the signatories of the Tokyo Round SCM Code taken at the invitation of the Preparatory Committee.[27]

While we agree with the Panel that these transitional decisions are of limited relevance in determining whether Article VI of the GATT 1994 can be applied independently of the SCM Agreement, they reflect the intention of the Tokyo Round SCM Code signatories to provide a forum for dispute settlement arising out of disputes under the Tokyo Round SCM Code for one year after its legal termination date. At the time the Tokyo Round SCM Code signatories agreed to these decisions, they were fully cognizant of the implications of the operation of Article 32.3 of the SCM Agreement.

We agree with the Panel that the complaining party in this dispute, the Philippines, had legal options available to it, and, therefore, was not left without a right of action as a result of the operation of Article 32.3 of the SCM Agreement. Until December 31, 1995, the GATT 1947 continued to co-exist with the WTO Agreement, and dispute settlement was available to the Philippines pursuant to Articles VI and XXIII of the GATT 1947. Until December 31, 1996, as a result of the Decision on Consequences of Withdrawal from or Termination of the Tokyo

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[26] Panel Report, ¶ 270.

[27] Panel Report, ¶ 272.

Round SCM Code approved by its signatories, dispute settlement was available under the provisions of the Tokyo Round SCM Code. Within a reasonable period of time after the definitive countervailing duty was imposed, the Philippines had the right to request a review pursuant to Article 21.2 of the SCM Agreement—a right which remains available to the Philippines today.

Any WTO Member, which was not a signatory to the Tokyo Round SCM Code, had a right of action under Articles VI and XXIII of the GATT 1947 until December 31, 1995, and, like the Philippines, has a continuing right to request a review under Article 21.2 of the SCM Agreement.

We believe that the situation of a prospective Member of the WTO, which accedes under the provisions of Article XII of the WTO Agreement, is different from that of former contracting parties to the GATT 1947 or signatories to the Tokyo Round SCM Code because those agreements did not apply previously to its trading relations with other states. Article XII:1 of the WTO Agreement provides, furthermore, that a state may accede "on terms to be agreed between it and the WTO."

In light of the above, we believe that it is not necessary to determine whether applying Article VI of the GATT 1994 independently of the SCM Agreement would be more onerous than applying them together.

V. Applicability of Articles I and II of the GATT 1994

We have concluded that, as a result of the integrated nature of the WTO Agreement and the specific language in Articles 10 and 32.1 of the SCM Agreement, the provisions of the SCM Agreement relating to countervailing duty investigations are not separable from the rights and obligations of the GATT 1994 or the WTO Agreement taken as a whole. We find, therefore, that the Panel did not err in concluding at paragraphs 280 and 281 of the Panel Report that the applicability of Article VI of the GATT 1994 to the countervailing duty investigation which is the

subject of this dispute, also determines the applicability of Articles I and II of the GATT 1994 to that investigation. In the same manner as the Panel found that "the measures are neither "consistent" nor "inconsistent" with Article VI of GATT 1994; rather, they are simply not subject to that Article,"[28] we believe that the measures here are neither "consistent" nor "inconsistent" with Articles I and II of the GATT 1994, because those Articles are also not applicable law for the purposes of this dispute.

VI. Terms of Reference

Brazil argues in its appellant's submission that the issue of consistency of its countervailing duty measures with Articles I and II of the GATT 1994 is not within the terms of reference of the Panel, and, therefore, should not have been addressed by the Panel.[29] In this appeal, the parties to the dispute, the Philippines and Brazil, agreed on the following special terms of reference pursuant to Article 7.3 of the DSU:

> To examine, in the light of the relevant provisions in GATT 1994 and the Agreement on Agriculture, the matter referred to the DSB by the Philippines in document WT/DS22/5, taking into account the submission made by Brazil in document WT/DS22/3 and the record of discussions at the meeting of the DSB on February 21, 1996, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements.[30]

A panel's terms of reference are important for two reasons. First, terms of reference fulfil an important due process objective—they give the parties and third parties sufficient information concerning the claims at issue in the dispute in order to allow them an opportunity to respond to the

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28 Panel Report, ¶ 280, note 71.

29 Brazil's appellant's submission, dated January 14, 1997, p. 1, ¶ 2.

30 WT/DS22/6, April 18, 1996.

complainant's case. Second, they establish the jurisdiction of the panel by defining the precise claims at issue in the dispute.

We agree, furthermore, with the conclusions expressed by previous panels under the GATT 1947, as well as under the Tokyo Round SCM Code and the Tokyo Round Anti-dumping Code, that the "matter" referred to a panel for consideration consists of the specific claims stated by the parties to the dispute in the relevant documents specified in the terms of reference.[31] We agree with the approach taken in previous adopted panel reports that a matter, which includes the claims composing that matter, does not fall within a panel's terms of reference unless the claims are identified in the documents referred to or contained in the terms of reference.

In the present case, because we agree with the conclusions of the Panel concerning applicable law, we believe it is not necessary to determine whether the Philippines' claims under Articles I and II of the GATT 1994 were within the Panel's terms of reference.

VII. Findings and Conclusions

For the reasons set out in this Report, the Appellate Body upholds the legal findings and conclusions of the Panel.

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[31] *United States – Denial of Most-Favoured-Nation Treatment* as to *Non-Rubber Footwear from Brazil*, BISD 39S/128, adopted June 19, 1992, ¶ 6.2; EC – *Imposition of Anti-dumping Duties on Imports of Cotton Yarn from Brazil*, ADP/137, adopted October 30, 1995, ¶ 456; *United States – Imposition of Countervailing Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway*, SCM/153, adopted April 28, 1994, ¶ 212; *United States – Imposition of Anti-Dumping Duties on Imports of Fresh and Chilled Atlantic Salmon from Norway*, ADP/87, adopted April 26–27, 1994, ¶ 336.

The Appellate Body *recommends* that the Dispute Settlement Body make a ruling consistent with the legal findings and conclusions in the Panel Report and this Report.

Signed in the original at Geneva this 14th day of February 1997 by:

Said El-Naggar
Presiding Member

Claus-Dieter Ehlermann
Member

Julio Lacarte-Muró
Member