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Achieving the ASEAN Economic Community 2015: Challenges for the Philippines

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

Achieving the ASEAN Economic Community 2015: Challenges for the Philippines

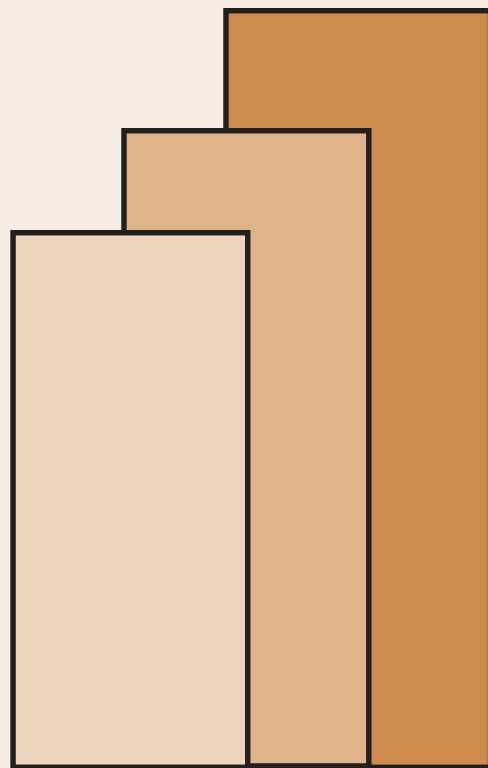
Jenny D. Balboa et al.

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Achieving the ASEAN Economic Community 2015: Challenges for the Philippines

Jenny D. Balboa, Fatima Lourdes E. Del Prado and Josef T. Yap

ASEAN member countries are moving towards achieving the ASEAN Economic Community with the timeline set at 2015. It is therefore important for policymakers in the region to sustain the momentum—or perhaps even accelerate the pace—towards establishing the AEC. Policy measures are being implemented based on the AEC Blueprint agreed upon in 2007. However, progress among the ASEAN member countries in meeting their commitments has been uneven. This paper reviews the progress of the Philippines in meeting its commitments on the AEC and comparing it with achievements of other ASEAN countries. The paper also discusses some of the problems and constraints that may prevent the Philippines from benefitting from the AEC.

Keywords: ASEAN, Regional Integration, ASEAN Economic Community

Achieving the ASEAN Economic Community 2015: Challenges for the Philippines

Jenny D. Balboa, Fatima Lourdes E. Del Prado and Josef T. Yap¹

Introduction

ASEAN member countries are moving towards achieving the ASEAN Economic Community with the timeline set at 2015. Recent studies have shown the benefits of the AEC. For example, the study edited by Plummer and Chia (2009) presents estimates that ASEAN economic welfare will rise by 5.3 percent or \$69 billion relative to the baseline. It is therefore important for policymakers in the region to sustain the momentum—or perhaps even accelerate the pace—towards establishing the AEC.

Policy measures are being implemented based on the AEC Blueprint agreed upon in 2007. However, progress among the ASEAN member countries in meeting their commitments has been uneven. Moreover, many difficult regional issues have not yet been resolved. Among these are wide development gaps, entrenched domestic interests, and the slow pace of Myanmar in implementing fundamental economic and political reforms.² Hence, achieving the AEC in 2015 may be on the optimistic side. The theme of this year's ASEAN Summit, "From Vision to Action", is therefore quite appropriate.

This paper reviews the progress of the Philippines in meeting its commitments. The progress is largely reflected in the AEC Scorecard, an analytical tool in tracking the achievements of member countries which was developed by ASEAN for this purpose. The framework of the AEC Blueprint and mechanics of the ASEAN Scorecard are described in Appendix 1. As of this writing, only the Philippine scorecard for the first batch of priority actions was available. The official data is supplemented by a study conducted by the Economic Research Institute for ASEAN and East Asia (Corbett and Umezaki 2009).

In the next section, the current Philippine economic situation is described by comparing it with other economies in terms of indicators of competitiveness. Many of the latter are components of the AEC Blueprint. This is followed by a section where the Philippine performance in terms of the ASEAN Scorecard is presented and discussed. As mentioned earlier the official data will be supplemented by results from ERIA studies. The penultimate section attempts to explain the progress of the Philippines in meeting its AEC commitments, particularly vis-à-vis the more developed ASEAN countries. The last section looks at structural problems in the Philippines that may prevent it from benefiting

¹ Supervising Research Specialist, Research Specialist, and President, Philippine Institute for Development Studies (PIDS) respectively. The authors would like to acknowledge the valuable inputs of Dr. Rafaelita M. Aldaba and Dr. Erlinda M. Medalla. The excellent research assistance of Ms. Susan Pizarro is also acknowledged. The usual disclaimer applies.

² For example, see "Regional bloc's 2015 deadline a 'stretch goal'?", *Business World*, 5 April 2010, page 1.

from the AEC. These problems also explain the relatively poor performance of the Philippines in terms of competitiveness.

Competitiveness of the Philippine Economy

The AEC blueprint calls for creating a single market and production base which will improve the competitiveness of the region. In this context, the Philippines stands to benefit a great deal since its level of competitiveness lags those of many economies including its ASEAN neighbors. For example, the World Bank’s Ease of Doing Business Report showed a deteriorating performance for the Philippines in its latest survey. The country fell by three notches, from its rank of 141th in 2009 to its 2010 rank of 144th. The same survey also showed the country’s global ranking weakening in all areas of doing business, particularly in the areas of ease of paying taxes, starting a business, dealing with construction permits and protecting investors (Table 1).

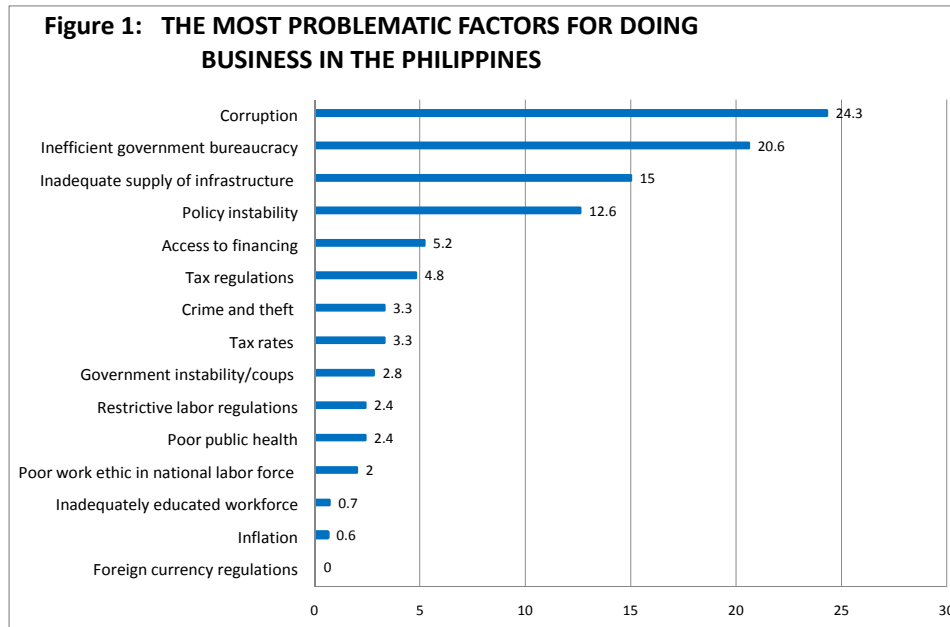
Table 1: EASE OF DOING BUSINESS IN THE PHILIPPINES

	Doing Business 2010 rank	Doing Business 2009 rank	Change in rank
Starting a Business	162	155	-7
Dealing with Construction Permits	111	106	-5
Employing Workers	115	114	-1
Registering Property	102	101	-1
Getting Credit	127	125	-2
Protecting Investors	132	127	-5
Paying Taxes	135	126	-9
Trading Across Borders	68	66	-2
Enforcing Contracts	118	116	-2
Closing a Business	153	153	0
Doing Business Report Rank	144	141	-3

Source: Doing Business Report (<http://Doing Business in Philippines - Doing Business - The World Bank Group.htm> accessed 10 April 2010)

Factors that can explain this poor performance are shown in Figure 1. Latest surveys showed that corruption, inefficient government and inadequate supply of infrastructure remain to be the main obstacles for doing business in the Philippines.

The Philippine situation highlights two key issues related to the AEC and economic integration in general. First, the factors that hamper the progress towards implementing the country’s commitments have to be explained. Some of these factors may overlap with a second category: factors that prevent the Philippines from benefiting fully from implementation of these commitments, in particular, and previous policies under the banner of liberalization, privatization, and deregulation, in general. These factors will be discussed in turn in the last two sections of the paper.



Source: Global Competitiveness Report, 2009-2010

Progress of the Philippines with its AEC Commitments

The AEC Scorecard

To monitor the timely implementation of the AEC Blueprint, an AEC Scorecard was developed to serve as a tool to keep track of the progress of member states in implementing the commitments. The Scorecard has two major goals: a) *to provide qualitative and quantitative indications of the ratification, adoption and transposition into domestic laws, regulations and administrative procedures of agreed obligations, and commitments within the prescribed timeframes as specified in the AEC Blueprint; and b) track implementation of agreements/commitments and achievement of milestones in the AEC Strategic Schedule.*

The Scorecard monitors the timely implementation of the Priority Actions based on the AEC Blueprint. The Priority Actions are derived from the four primary objectives and seventeen core elements of the AEC. The four primary objectives are: **1) a single market and production base; b) a highly competitive region; c) a region of equitable economic development; d) a region fully integrated into the global economy.**

The **ASEAN Single Market and Production Base** has seven core elements 1) Free flow of goods, 2) Free flow of services, 3) Free flow of investment, 4) Freer flow of

capital, 5) Free flow of skilled labour, 6) Priority Integration Sectors, and 7) Food, Agriculture and Forestry.

With respect to creating a **Competitive Economic Region**, six core elements are included, namely: 1) Competition Policy, 2) Consumer Protection, 3) Intellectual Property Rights, 4) Infrastructure Development, 5) Taxation, and 6) E-Commerce.

Two core elements are included in the **Equitable Economic Development** objective, as follows: 1) SME Development and 2) Initiative for ASEAN Integration (IAI).

Finally, in creating a **Region Fully Integrated into the Global Economy**, ASEAN is aware that it needs to take into account external rules and regulations. In this regard, two elements are included in this objective: 1) Developing a coherent approach towards external economic relations, 2) enhanced participation in global supply networks.

Priority actions under these core elements are to be undertaken within four implementation periods, beginning from 2008-2009, 2010-2011, 2012-2013, and 2014-2015.

The ASEAN Secretariat keeps track, evaluates, and rates the performance of member countries. While the Scorecard can benefit from further refinement, the current format gives a picture of the achievement of ASEAN member states in incorporating the Strategic Actions of the AEC Blueprint.

The Philippine Scorecard: Tentative Results

Preliminary estimates showed that the Philippines generated a score of 45.71%, indicating 32 measures implemented out of 72 for the first set of priority actions. The score can still improve as several commitments under Transport (9/25) were complied but not yet implemented. At least eleven Protocols from the Transport sector are pending for Executive Ratification as of this period.

Highlights of Results of AEC Scorecard for the Philippines (Tentative Results)³

Listed below are the highlight of AEC Scorecard Results of the Philippines as of May 2010:

Implemented Measures

- A. Single Market and Production Base
 1. Free Flow of Goods
 - CEPT-AFTA- full implementation of the AFTA CEPT Scheme
 - Tariff Liberalization, except for the end rate for Highly Sensitive Product (rice)
 - Rules of Origin – Approved revised CEPT ROO Scheme had been reviewed and implemented

³ Preliminary draft provided by the Bureau of International Trade Relations-Department of Trade and Industry. Updated commitments are still under embargo as of this writing.

- ASEAN Trade Facilitation Work Program – Comprehensive Work Programme on Trade Facilitation had been finalized
- ASEAN Single Window (Bureau of Customs) – the National Single Window was launched recently and included standardized data elements for digitalized processing and exchange. However, it is still to be fully operationalized
- Standards and Conformance (Bureau of Product Standards) – ASEAN Reference Laboratories had been established and the ASEAN Cosmetic Drive had been implemented. The Bureau still has not implemented the following: a) ASEAN Common Technical Dossier and ASEAN Harmonized Common Technical Requirement; 2) Signing of ASEAN Sectoral MRA on GMP of Inspection of Manufacturers of Medicinal Products.

2. Free Flow of Services

- Schedule maximum of 3 types of non-equity market access (MA) limitations for 12 sub-sectors under the Other Sectors area
- Schedule “none” for modes 1 and 2 MA and national treatment (NT), with exceptions due to bonafide regulatory reasons
- Complete compilation of inventory of barriers to services
- Completed negotiations and signed MRA on accountancy services
- Completed negotiations and signed MRA on medical practitioners
- Completed negotiations and signed MRA on dental practitioners

3. Free Flow of Investment

- Discuss, draft, negotiate and sign the new ASEAN Comprehensive Investment Agreement (ACIA)
- Publication of ASEAN Investment Report
- Publication of Statistics of FDI in ASEAN
- Commence Phase 1 of progressive reduction/elimination of investment restrictions and impediments

4. Priority Integration Measures

- Automotive- a regional strategy study on automotive industry is being developed; other measures such as ASEAN database on automotive products as well as an ASEAN portal for ASEAN automotive components are also being developed.
- Textile/Apparel- Initiative a study to assess the impact of Multi-Fibre Agreement expiry on ASEAN textile industry and a studied the impact in ASEAN of China’s export of textiles and apparel products in Asia

B. Creating a Competitive Region

- Competition Policy – Carrying out a foundation-laying study, review of study findings and recommendations, and convening a regional meeting on study findings and recommendations; Establishment of the ASEAN Expert Group on Competition
- Consumer Protection – Establishment of the ASEAN Coordinating Committee on Consumer Protection

- Infrastructure – Several Protocols and initiatives under the Transport Sector

C. Equitable Economic Development

- Initiative for ASEAN Integration (IAI) – endorsement of the IAI Strategic Framework and Work Plan 2

Priority Actions Pending for Implementation

A. Single Market and Production Base

1. Free Flow of Goods

Tariff Liberalization

- End rate for HSL products (rice)
- ASEAN Single Window (to be fully operationalized)
- Standards and Conformance – Implementation of ASEAN Common Technical Dossier and ASEAN Harmonized Common Technical Requirement; Signing of ASEAN Sectoral MRA on GMP of Inspection of Manufacturers of Medicinal Products

2. Free Flow of Services

- Schedule of 10 new subsectors
- Schedule at least 51% of foreign equity allowed in the priority services sector
- Schedule at least 49% of foreign equity allowed in logistics services and other sectors
- Schedule a maximum of 2 types non-equity MA limitations for all 29 subsectors of the four priority services sector
- Schedule maximum 3 types of non-equity MA limitations for all logistics services subsectors

3. Free Flow of Capital (DOF)

- Assess and identify top 5 rules for liberalization, listing of existing rules and measures on FDI, and review, evaluate and assess existing rules and measures

4. Priority Integration Measures

- E-ASEAN (DOLE/NEDA) – Facilitate MRAs for qualifications in IT professionals
- Electronics (BOI) - Institutionalize Rosettanet compatibility in ASEAN for exchange of trade documents; Implement 24/7 customs operations, as may be applicable or deemed necessary, through operationalization of systems of electronic processing and those similar on the basis of the ASEAN Cargo Processing Model
- Healthcare (DOH) – Set up “one stop centre” in each ASEAN country responsible for facilitating investments including healthcare projects
- Food, Agriculture and Forestry – Define legality standards of timber (elements and indicators for legal timber)

B. Creating a Competitive Region

- Consumer Protection – Terms of Reference and Work Programme for development of a rapid alert system and information exchange

- Transport – 11 Protocols covering issues on trade facilitation pending for ratification
- Energy – Ratify MOU on ASEAN Power Grid

C. Initiative for ASEAN Integration

- Conduct study to determine the impact of accelerating AEC from 2020 to 2015 on CLMV

Recent Achievements: The National Single Window Project

An important strategic action under the AEC Blueprint is the international Single Window Project. The project is part of the initiative to improve import/export and customs operations in ASEAN. The main idea of this project is to have a single customs portal for ASEAN by interconnecting the Single Window of member economies for easier and more efficient import and export processing in the region. The ASEAN Single Window Project is due to be completed by 2012.

Recently, the Philippines had the soft launching of the National Electronic Single Window. Planning and implementation of the project is overseen by a steering committee led by the Department of Finance and composed of agencies linked to the Bureau of Customs (BOC). The National Single Window project is expected to substantially speed up customs processing for importers and exporters and enhance transparency and efficiency in transactions with BOC.

Results of Selected ERIA Studies

To complement the ASEAN Scorecard, the Economic Research Institute for ASEAN and East Asia (ERIA) has embarked on a series of studies under the banner “Deepening East Asian Economic Integration”. The initial set of studies (Corbett and Umezaki, 2009) was focused on developing quantitative measures to “provide several snapshots of the progress in selected key policy pillars in the AEC Blueprint...The quantitative measures were designed (1) to visualize the process of policy reforms consistent with the AEC Blueprint, (2) to provide a framework under which milestones and end goals for each element can be defined, and (3) to evaluate the current status and the progress towards the milestones and end goals.”

Urata and Ando (2009) conducted a study to examine and evaluate the restrictiveness/openness of the FDI policy regime and environment for ASEAN countries. They examined FDI policies which are found in legal documents related to six aspects: market access or right of establishment, national treatment, screening and approval of procedure, restrictions on boards of directors as well as foreign investors, and performance requirement.

Since it is common in developing countries that the existence of a law does not necessarily imply its implementation, Urata and Ando used information on barriers to FDI from the survey compiled by the Japan Machinery Center for Trade and Investment (JMC). The survey looked into the obstacles faced by Japanese firms operating in ASEAN countries.

The scoring system used shows a high score for a relatively open FDI regime and the various factors are given different weights. The results of their evaluation, which are

shown in Table 2, indicate that the FDI policy regime in Singapore is very open and those in the Philippines, Thailand, Indonesia, and Cambodia are relatively open, while those in Myanmar, Malaysia, Brunei, and Lao PDR are relatively closed. The said study ranks the Philippines as the second-most open economy in ASEAN.

Table 2: Assessment of FDI Policy Regimes of ASEAN Countries

	Market Access	National Treatment	Screening & Appraisal	Board of Directors	Movement of investors	Performance Requirement	Total Score
Weight	0.40	0.20	0.10	0.10	0.10	0.10	1.00
Brunei	0.76	0.20	0.57	0.41	0.82	0.82	0.61
Cambodia	0.86	0.60	0.25	1.00	0.25	0.88	0.70
Indonesia	0.69	0.95	0.24	0.95	0.48	0.95	0.73
Lao PDR	0.60	0.70	0.34	0.67	0.54	0.79	0.61
Malaysia	0.59	0.17	0.76	0.62	0.89	0.91	0.59
Myanmar	0.55	0.61	0.30	0.61	0.24	0.61	0.52
Philippines	0.74	0.81	0.89	0.48	0.96	0.89	0.78
Singapore	0.83	0.95	0.86	0.75	0.95	0.95	0.88
Thailand	0.58	1.00	0.91	0.98	0.37	0.90	0.75
Vietnam	0.66	0.74	0.64	0.71	0.53	0.85	0.69
Average	0.69	0.67	0.58	0.72	0.60	0.85	0.69
Standard deviation	0.11	0.29	0.28	0.20	0.28	0.10	0.11

Source: Lifted from Table 3.2 of Urata and Ando (2009)

A study conducted by Urata, Ando and Ito (2007), which is related to the aforementioned JMC survey, showed that FDI performance in a country is not only determined by liberalization policies, but also facilitation issues. Ten 10 major categories of issues were identified, with four issues relevant to FDI liberalization and six issues relevant to facilitation, thus:

FDI Liberalization:

1. Restrictions on foreign entry
2. Performance requirements
3. Restrictions on overseas remittances and controls on foreign currency transactions
4. Restrictions on the movement of people and employment requirements

FDI Facilitation

5. Lack of transparency in policies and regulations concerning investment (institutional problems)
6. Complicated and/or delayed procedures with respect to investment-related regulations (implementation problems)
7. Insufficient protection of intellectual property rights
8. Labor regulations and related practices excessively favorable to workers
9. Underdeveloped infrastructure, shortages of human resources, and insufficient investment
10. Restricted competition and price controls

The survey conducted in 2008 showed that FDI liberalization policies in the Philippines, as perceived by Japanese firms, on average is at par, or even better than other ASEAN countries. However, it is in FDI facilitation measures that the Philippines is outperformed by other ASEAN countries. Comparing the results of the survey to 2005 figures showed that the number of adverse incidents pertaining to FDI facilitation in the Philippines even increased sharply (Table 3). This was attributed to a growing number of issues related to implementation problems for investment-related policies and regulations and a perceived labor regulation excessively favorable to workers (Urata and Ando 2009).

Table 3: Investment Climate in the Philippines: 2005, 2008

	Philippines	
	2005	2008
(a) The number of Japanese affiliates in each country		419
(b) Issues to be solved for FDI liberalization and facilitation		
FDI liberalization	11	9
i) Restrictions on foreign entry	6	6
ii) Performance requirements	2	0
iii) Restrictions on overseas remittances and controls on foreign currency transactions	1	2
iv) Restrictions on the movement of people and employment requirements	2	1
FDI facilitation	37	48
v) Lack of transparency in policies and regulations concerning investment (institutional problems)	10	11
vi) Complicated and/or delayed procedures with respect to investment-related regulations (implementation problems)	12	16
vii) Insufficient protection of intellectual property rights	1	3
viii) Labor regulations and related practices excessively favorable to workers	6	10
ix) Underdeveloped infrastructure, shortages of human resources, and insufficient investment incentives	8	8
x) Restricted competition and price controls	0	0
Total	48	57

Source: Lifted from Tables 4.2 and 4.3 of Urata and Ando (2009)

Meanwhile, the survey of Findlay (2009) on trade facilitation showed that there are large differences in the regulatory environment for logistics of the ASEAN+6 economies. Both the domestic measures that apply to all entrants and measures that apply only to foreign providers were evaluated. Citing a study of Hollweg and Wong (2009), Findlay reports that Viet Nam, Lao PDR, India, and the Philippines have relatively high scores—i.e. relatively restrictive regimes—on the domestic index. The countries with high scores for the foreign index are Indonesia, Philippines, China, and Malaysia. Only the Philippines appears in both lists.

Explaining the Progress with AEC Commitments

Trends in the Philippines

The Philippine AEC Scorecard reveals that the Philippines is committed to be part of the ASEAN Economic Community and to contribute to regional integration goals. It showed positive results in trade liberalization, with the CEPT-AFTA in full implementation and tariff barriers reduced or eliminated, allowing free flow of goods in the country. The Philippines' commitment to free trade is more or less reflective of the general pattern of trade liberalization in the region. Table 4 shows tariff and non tariff barriers in ASEAN and other East Asian countries. Average tariff rates had been either removed for some member countries or lowered to .1. Average tariff weight for non-agricultural products is likewise brought down to the same level. Tariff rates for agricultural products are higher,

but had been generally brought down to 0-.5, with the Philippines having a small .1 average tariff rate.

However, Non-tariff Barriers (NTBs) remain high in the region, with Japan having the most number of NTBs at 65.4, and the Philippines closely following at 64.5. Non-tariff measures (NTMs) was also observed to be significantly increasing in the Philippines in the past decade, with more Technical Barriers to Trade (TBTs) being imposed (Basu, 2010). One of the reasons cited for the increase in NTMs is that with the reduction or removal of tariffs, NTMs have been resorted to in order to provide some protection to local industries to help them survive competition against imports. Nonetheless, based on its AEC commitment, Philippine NTBs will be reduced by 2012. Compliance to this commitment will address the issue of rising NTMs.

Table 4: Tariff and Non Tariff Barriers Indicators

Country	Trade weighted average tariff rate	Trade weighted average tariff rate for non-agricultural products	Trade weighted average tariff rate for agricultural products	Non-tariff barriers
Australia	0.1	0.1	0.0	20.2
Brunei				
Cambodia	0.1	0.1	0.2	4.2
China/PRC	0.1	0.1	0.2	22.6
Hong Kong	0.0	0.0	0.0	n/a
Indonesia	0.1	0.1	0.1	45.0
Japan	0.0	0.0	0.2	65.4
Korea (Rep. of)	0.1	0.1	0.5	n/a
Lao PDR				
Malaysia	0.1	0.1	0.2	17.1
Myanmar				
New Zealand	0.0	0.0	0.0	23.7
Philippines	0.0	0.0	0.1	64.5
Singapore	0.0	0.0	0.0	23.8
Taiwan	0.1	0.0	0.2	23.0
Thailand	0.1	0.1	0.3	26.9
Vietnam	0.1	0.1	0.4	34.9

Source: Global Competitiveness Report, 2010

With tariffs removed and the remaining ones gradually reduced and removed, and with efforts towards eliminating non-tariff barriers, ASEAN and East Asia will be creating a huge open market as the economies move closer to its target date of creating an ASEAN Economic Community in 2015. The next step would be how to create an open business environment that would facilitate free flow of trade and accelerate transactions between and among economies. As discussed in the earlier section, the Philippines has

a lot of catching up to do in improving its competitiveness and in making the country an attractive trade and investment destination.

For the Philippines, an important area that it has to address is Customs Procedure. Based on latest survey conducted by the World Economic Forum, the Philippines is perceived to be the most inefficient, corrupt and costly (by middle income country standards) customs service in East Asia (Table 5). Full operation of BOC's National Single Window could potentially be the solution to this problem. Reducing human interface in Customs transactions could reduce the agency's vulnerability to corrupt practices and also substantially reduce transaction costs.

The Philippine AEC Scorecard likewise reflected the country's weakness in the area of Free Flow of Investment and Freer Flow of Capital. This is consistent with the study of Urata and Ando discussed earlier. Inadequate government policies to facilitate these two key areas resulted to smaller investment and capital flows in the country relative to other middle income economies in ASEAN. A recent survey showed that the Philippines is perceived to be the least open in foreign participation in the region (Table 6). The government is bounded by Constitutional restrictions to legislate policies that will facilitate foreign investment in certain areas. The Foreign Investment Negative List (FINL) (RA 8179, as amended) enlists the areas restricted to Filipinos and areas opened to foreigners, and the corresponding investment equity restrictions. The FINL includes, among others restrictions on the use, management and ownership of certain utilities and infrastructure (e.g. the cabotage law in shipping), and imposes foreign equity restriction of up to 40% in BOT projects and Government Procurement. In retail trade, a minimum of US\$7.5 million equity is required which is much higher than the requirement of Thailand (at US\$250,000). Meanwhile, Singapore and Hong Kong have no such requirement.

In terms of Creating a Competitive Region, the Philippines need to strengthen efforts in this area. Amidst fear of market domination of large foreign companies with a more liberalized investment regime, developing an effective Competition Policy aligned with regional guidelines has even become more expedient. This is an area that needs urgent attention and which for a long time now, the government has failed to come up with decisive actions due to strong private sector lobby. Also in relation to creating a Competitive Region, the government needs to enact better policies in protecting Intellectual Property Rights and improve tax regulation policies in the country.

The Philippines is also sorely lagging in infrastructure and logistics and need to catch up with the other East Asian economies (Table7). This is an important area since infrastructure and logistics affects the country's attractiveness as an investment destination.

The Philippine AEC Scorecard did not include actions to strengthen SMEs to make it at par with best practice in SMEs in East Asia. As the biggest employer in the country and source of employment of the poor, SME is a critical sector for growth and development and therefore needs full support in terms access to financing and product and skills development to enable them to compete with domestic and international players. SME development should be considered a top priority and its progress should be closely tracked at both the domestic and regional levels. The Department of Trade and Industry, through the Bureau of Micro, Small and Medium Enterprise Development (BMSMED), is

in charge of this sector. BSMED has launched several initiatives to spur MSME growth in the country.

Finally, the Philippine AEC Scorecard did not explicitly include a strategy on external economic relations under the Priority Action on Full Integration in the Global Economy. The Philippines is an active participant in FTAs both at the bilateral and plurilateral levels (as part of its commitment with ASEAN). However, the country still needs to improve its technical and administrative capacity in implementing the various FTAs.

Political Economy Considerations

The slow pace in ASEAN economic integration have been attributed to a number of factors that relate mostly to imperfect market conditions, non-binding regional trade arrangement and the futility of state-led growth. Existing literature however failed to understand that economic policies may be pursued at variance with the official commitment to regional economic integration (Tantikulananta, undated).

Under the guise of 'national interest', domestic politics and dominant interest groups seek to maintain trade barriers and economic restrictions. Tantikulananta further maintains that these protection measures by individual countries serve to obstruct ASEAN economic integration. The recent calls of Indonesia for renegotiation at the onset of the ASEAN-China pact and the Philippines' appeal for deferment of tariff cuts on sugar to give the domestic sugar industry more time to adjust to liberalized trade under AFTA, are manifestations of what Ravenhill (2008) called 'negotiated protectionism'. In the Philippines, this trade distorting practice takes many forms and persists in highly sensitive sectors.

A case in point is the Philippine aviation industry. While the adoption of open sky policy may be well on track, new entrants have to contend with the uneven playing field in Philippine aviation market, which is largely dominated by the Philippine Airlines (PAL). PAL still receives the fiscal incentives and other unconditional guarantees it once enjoyed as a government corporation (Aldaba, 2008). Furthermore, terminal space and landing slots are dominated by PAL, which managed to secure sole ownership of an airport terminal originally intended to serve as the country's domestic terminal. Allegation of institutional weakness and regulatory capture is also observed in the failure of Civil Aeronautics Board (CAB) to collect from the Philippine Airlines (PAL) the mandated regulatory fees. CAB, a government regulatory agency charged with the supervision and regulation of air carriers, has likewise been accused of interfering in favor of PAL in bilateral air rights negotiations.⁴

By allegedly controlling the country's 'gateways' through CAB (and its 'zero sum' policy), PAL has not only ignored the needs of millions of Overseas Filipino Workers (OFWs) for frequent, cheaper and shorter flights, but has shunned inconceivable economic

⁴ Rimando, L 2008 'PAL controls gateways through CAB, say experts' *ABS-CBN News*, 02 March 2008, viewed 10 April 2010, <<http://www.abs-cbnnews.com/03/02/08/pal-controls-gateways-through-cab-say-experts>>.

opportunities and benefits for the Philippines from potential tourists, and trade and business linkages.⁵

Another example of institutional weakness is in the Philippine power sector. Despite the moves to deregulate the country's energy sector through the passage of the Electric Power Industry Reform Act of 2001 (EPIRA), there remains a cap on foreign ownership and cross ownership, and the congressional franchise requirement on energy transmission and distribution. This casts doubt not only on the effectiveness of EPIRA and but also on the capability Energy Regulatory Board (ERB) to regulate the market and apprehend erring agents. Already a large private electricity distributor has been accused of favoring allied companies essentially subsidizing costly and inefficient firms with consumers ending up paying higher energy prices (SEPO 2009).

The Philippines may have made significant strides in deregulating the telecommunications industry but cases of abuse of power by a dominant player are well-documented. The Philippine Long Distance Company (PLDT), owns the backbone facility, and has the most number of fixed line subscribers. PLDT has been accused by other carriers of exploiting its market power by allegedly delaying interconnection, granting unequal access and predatory pricing.

In addition to these, latest government pronouncements like the passage of Executive Order No. 261 and 264, grant protection and safeguard measure on ad hoc basis to selected manufacturing industries, particularly cement, ceramic tile, clear float glass, and related sectors where charges of cartel-like practices abound. The apparent reversal to traditional protectionist practices can effectively turn off investors, as this not only implies unfair and uneven playing field, but is also reflective of the unreliability and unpredictability of government statutes and institutional weakness in enforcing rules and regulations (Aldaba 2008).

⁵ Ibid

Table 5. Customs Procedures

Country	Burden of Customs procedures ^{1/}		Time for Import	Documents for Import	Cost to Import	Time for export	Documents for export	Cost to export	Trading across borders
	How would you rate the level of efficiency of customs procedures (related to the entry and exit of merchandise) in your country? (1 = extremely inefficient; 7 = extremely efficient) 2008-2009 weighted average								
	Score	Rank (out of 133 Countries)	Number of days required to import/2009	Number of documents required to import/2009	(US\$ per container)	Number of days required to export/2009	Number of documents required to export/2009	(US\$ per container)	Rank out of 183 countries, 2009
Australia	4.9	24.0	8.0	5.0	1119.0	9.0	6.0	1060.0	27.0
Brunei	4.6	36.0	19.0	6.0	708.0	28.0	6.0	630.0	48.0
Cambodia			30.0	11.0	872.0	22.0	11.0	732.0	127.0
China/PRC	4.6	41.0	24.0	5.0	545.0	21.0	7.0	500.0	44.0
Hong Kong	6.1	2.0	5.0	4.0	583.0	6.0	4.0	625.0	2.0
Indonesia	3.7	83.0	27.0	6.0	660.0	21.0	5.0	704.0	45.0
Japan	4.4	49.0	11.0	5.0	1047.0	10.0	4.0	989.0	17.0
Korea (Rep. of)	4.6	42.0	8.0	3.0	742.0	8.0	3.0	742.0	8.0
Lao PDR			50.0	10.0	2040.0	50.0	9.0	1860.0	168.0
Malaysia	4.8	28.0	14.0	7.0	450.0	18.0	7.0	450.0	35.0
Myanmar									
New Zealand	5.9	4.0	9.0	5.0	850.0	10.0	7.0	868.0	26.0
Philippines	3.0	117.0	16.0	8.0	819.0	16.0	8.0	816.0	68.0
Singapore	6.4	1.0	3.0	4.0	439.0	5.0	4.0	456.0	1.0
Taiwan	5.0	23.0	12.0	7.0	732.0	13.0	7.0	720.0	33.0
Thailand	4.1	60.0	13.0	3.0	795.0	14.0	4.0	625.0	12.0
Vietnam	3.6	91.0	21.0	8.0	940.0	22.0	6.0	756.0	74.0

Source: World Bank, Doing Business Report: 2009

^{1/} World Economic Forum, World Competitiveness Report: 2009

Table 6. Openness to Foreign Participation

Country	Openness to Foreign Participation	Ease of hiring foreign labor	Prevalence of foreign ownership ^{1/}		Business impact of rules on FDI ^{1/}	
	This variable is calculated as the average of four variables: Ease of hiring foreign labor, Prevalence of foreign ownership, Business Impact of rules on FDI, & Capital controls./ 2007, 2008 (1=least open, 7=most open)	Labor regulation in your country (1=prevents your company from employing foreign labor, 7=does not prevent your company from employing foreign labor) 2007, 2008	How prevalent is foreign ownership of companies in your country? (1 = very rare; 7 = highly prevalent) 2008–2009 weighted average		To what extent do rules governing foreign direct investment (FDI) encourage or discourage it? (1 = strongly discourage FDI; 7 = strongly encourage FDI) 2008–2009 weighted average	
			Score	Rank (out of 133 countries)	Score	Rank (out of 133 countries)
Australia	5.2	4.5	5.6	26.0	5.1	55.0
Brunei			4.2	108.0	4.8	78.0
Cambodia	5.0	4.6	4.9	77.0	5.2	47.0
China/PRC	4.5	5.1	4.4	98.0	5.6	23.0
Hong Kong	6.3	5.4	6.6	1.0	6.5	3.0
Indonesia	5.5	5.3	5.3	41.0	5.3	41.0
Japan	4.6	4.0	4.4	93.0	4.5	98.0
Korea (Rep. of)	5.2	4.9	5.1	62.0	4.9	65.0
Lao PDR						
Malaysia	5.1	4.9	5.0	68.0	5.3	43.0
Myanmar						
New Zealand	5.5	4.8	5.9	14.0	5.0	61.0
Philippines	4.5	4.0	4.3	102.0	4.5	97.0
Singapore	6.3	5.9	6.4	3.0	6.7	1.0
Taiwan	4.8	4.2	5.3	51.0	5.4	39.0
Thailand	4.6	4.3	4.8	80.0	5.3	44.0
Vietnam	4.8	4.8	4.2	107.0	5.5	27.0

Source: World Economic Forum, Executive Opinion Survey 2007, 2008

^{1/} World Economic Forum, World Competitiveness Report: 2009

Table 7. Infrastructure

Country	Paved Roads ^{1/}	Road congestion ^{1/}	Quality of port infrastructure		Quality of air transport infrastructure		Quality of railroad infrastructure		Quality of roads		Quality of Overall Infrastructure	
			Score	Rank (Out of 133 Countries)	Score	Rank (Out of 133 Countries)	Score	Rank (Out of 114 Countries)	Score	Rank (Out of 133 Countries)	Score	Rank (Out of 133 Countries)
	(Paved roads as percentage of total roads/2005)	Motor vehicles per km of road/2005	How would you assess port facilities in your country? (1 = extremely underdeveloped; 7 = well developed and efficient by international standards) 2008-2009 weighted average		How would you assess passenger air transport infrastructure in your country? (1 = extremely underdeveloped; 7 = extensive and efficient by international standards) 2008-2009 weighted average		How would you assess the railroad system in your country? (1 = extremely underdeveloped; 7 = extensive and efficient by international standards) 2008-2009 weighted average		How would you assess roads in your country? (1 = extremely underdeveloped; 7 = extensive and efficient by international standards) 2008-2009 weighted average		How would you assess general infrastructure (e.g., transport, telephony, and energy) in your country? (1 = extremely underdeveloped; 7 = extensive and efficient by international standards) 2008-2009 weighted average	
Australia	38.7	17.0	4.6	50.0	5.8	28.0	4.1	29.0	5.0	37.0	5.0	38.0
Brunei			4.8	42.0	5.2	47.0			5.2	29.0		
Cambodia	6.3	37.0	3.5	89.0	4.1	88.0	1.6	94.0	3.3	77.0	3.4	82.0
China/PRC	81.6	16.0	4.3	61.0	4.3	80.0	4.1	27.0	4.2	50.0	4.0	66.0
Hong Kong	100.0	254.0	6.8	2.0	6.9	2.0	6.5	3.0	6.6	3.0	6.7	3.0
Indonesia	55.3	62.0	3.4	95.0	4.7	68.0	2.8	60.0	2.9	94.0	3.1	96.0
Japan	77.7	63.0	5.2	34.0	5.1	53.0	6.6	2.0	5.6	22.0	5.8	17.0
Korea (Rep. of)	76.8	151.0	5.1	36.0	6.0	21.0	5.7	8.0	5.8	14.0	5.8	20.0
Lao PDR												
Malaysia	81.3	72.0	5.5	19.0	5.8	27.0	4.8	19.0	5.5	24.0	5.4	27.0
Myanmar												
New Zealand	64.9	32.0	5.5	22.0	6.1	17.0	3.7	37.0	4.6	43.0	4.7	45.0
Philippines	9.9	14.0	3.0	112.0	3.7	100.0	1.7	92.0	2.8	104.0	3.1	98.0
Singapore	100.0	183.0	6.8	1.0	6.9	1.0	5.7	9.0	6.7	1.0	6.7	2.0
Taiwan	n/a	n/a	5.6	16.0	5.5	41.0	5.8	7.0	5.8	18.0	5.8	19.0
Thailand	98.5	n/a	4.7	47.0	5.9	26.0	3.0	52.0	5.0	35.0	4.8	41.0
Vietnam	25.1	n/a	3.3	99.0	4.1	84.0	2.8	58.0	2.8	102.0	2.8	111.0

Source: World Economic Forum, World Competitiveness Report: 2009

^{1/} World Economic Forum, Executive Opinion Survey 2007, 2008

Structural Problems in the Philippines

The discussion in the last section, particularly on political economy considerations, only highlights the structural problems that continue to plague the Philippine economy. These were discussed extensively by Balboa, et al (2007). The major factors that have prevented the Philippines from maximizing its gains from globalization can be traced to policy shortcomings, and can be summarized as follows:⁶

1. *Low investments in infrastructure.* According to World Bank estimates, a middle income country in East Asia will need to spend at least 5 percent of GDP on infrastructure to meet their needs in the next 10 years. Infrastructure expenditure in the Philippines is far below this benchmark as it only accounts for 2.8 percent of GDP. In addition, resources allotted for infrastructure development are spent inefficiently. Infrastructure upgrading is necessary to improve economic performance of the country as it would help attract more investments and reduce production costs. The lack of infrastructure program is largely related to the fragile fiscal situation of the government.

2. *Lack of political will to implement a sustained and credible fiscal reform program.* Weak fiscal institutions created policies that increased the debt burden and inherently put bias towards deficit-spending. They are also responsible for the fiscal blunders created such as politicized spending and delayed fiscal consolidation during crises—as epitomized during the aftermath of the 2008 global financial crisis. To be effective, fiscal reforms, should aim at creating stronger fiscal institutions that adhere to rules and do not easily give in to populist demands. Reforms should also create accountable and more transparent institutions that will implement the revenue generation programs and include capability enhancement measures to reinforce technical capacity of these institutions to fully mobilize revenues for the country's needs.

3. *High Transaction Costs.* Transaction costs refer to market-related infrastructure, facilities and services needed to conduct business, including logistics. It also includes costs in acquiring and exchanging information in transactions and contract enforcement. If transaction costs are high, these become a disincentive to producers to participate in any market exchange. It has been argued that the relatively poor performance of Philippine exports may be explained by high transaction costs in the country rather than market access issues. Logistical cost disadvantages—as pointed out earlier in this paper— have hindered domestic industries from benefiting fully from the effects of trade liberalization and have discouraged foreign investors from considering the Philippines in their production and logistical networks.

4. *Lack of a coherent industrial policy.* This is an area that has been overlooked because of the controversy it generates. However, recent work has attempted to provide a pragmatic approach that eschews ideological prescriptions and instead looks more closely at historical experience. The basic argument is that industrial policy is as much about eliciting information from the private sector on significant externalities—primarily information and coordination externalities—and their remedies as it is about implementing appropriate policies. However, the capacity to apply industrial policy is also important, which leads to the importance of governance and institutions. Since 1972, Philippine economic managers followed a program that largely mimicked the

⁶ Balboa, et al. (2007), pages 133-134.

Washington Consensus and did not allow for strategic intervention on the part of the government.

There were also gaps in the implementation of reforms and this is related to failure to address issues in good governance. This focuses on anti-corruption initiatives and institutionalization of corporate governance practices. The Philippines has always been cited as a country whose potential for growth has been eroded by corrupt institutions. According to World Bank figures, 20 percent of annual government budget is lost to corruption.

It is of utmost importance that measures to curb corruption are undertaken. Anti-corruption strategy should be reinforced by a committed leadership and able management skills to implement the programs and sustain the progress made. Continued re-engineering of the bureaucracy is necessary, with reforms focused not only on achieving efficiency and effectiveness, but also instilling a culture of adherence to rules (Balboa and Medalla 2006).

The Philippines has to work on addressing governance issues that hinder the country to take advantage of opportunities from regional integration. A committed leadership that has the political will to pursue genuine reforms would be critical. The Philippine experience has shown that elite groups, at their will, could impede implementation of reforms. Hence, mechanisms toward reducing opportunities for monopoly of power that undermine reform efforts should be installed.

Concluding Remarks

The economic reform process in the Philippines can be depicted in Figure 2. Political economy factors largely explain the slow progress in implementing economic reforms, including AEC commitments. These factors include the need to adhere to the democratic process and the presence of entrenched domestic interests.

Meanwhile, even if reforms are implemented, economic agents—especially private firms—are unable to take advantage of the opportunities presented. This can be explained by structural factors including supply-side constraints. Poor infrastructure and the absence of a strategic and effective industrial policy are the main elements of supply-side constraints.

The intersection of these two sets of factors are aspects related to poor governance and weak institutions. Unfortunately, economists do not have the ready answer to the question of how to strengthen institutions. This would require a multi-disciplinary approach. But definitely credible and visionary leadership is an important consideration.

Factors Related to AEC Commitments, Liberalization and other Reforms

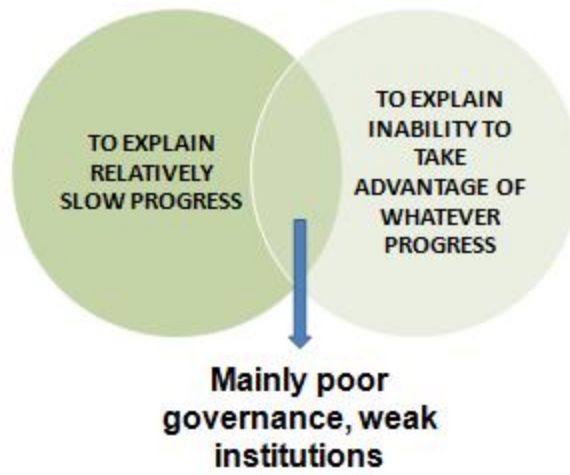


Figure 2: Depiction of Reform Process in the Philippines

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Appendix 1: ASEAN Economic Community Blueprint (Highlights)

Strategic Approach	Some of the Major Priority Actions
A. Towards a Single Market and Production Base	
A1. Free Flows of Goods	
	Enhancement of Common Effective Preferential Tariffs-ASEAN Free Trade Area (CEPT-AFTA)
	Tariff Reduction - complete the tariff reduction schedule to 0-5% for IL products CLM countries
	Elimination of Tariffs
	Elimination of Non-Tariff Barriers
	Rules of Origin - Continuously reform, enhance and simply CEPT ROO and its operational procedures
	Trade Facilitation Work Programme
	Customs integration - ensure customs development; operationalise ASEAN Single Window
	Standards and Conformance - implement a Single Regulatory Scheme for Cosmetic; ensure effective implementation of the ASEAN Sectoral MRA on Electrical and Electronic Equipment; Implement ASEAN Common Technical Dossiers for Pharmaceutical and Medical Device
A2. Free Flows of Services	
	Services Liberalisation under AFAS
	Mutual Recognition Arrangements (MRAs)

	Financial Services Sector
A3. Free Flows of Investment	ASEAN Investment Agreement (AIA)
A4. Free Flows of Capital	Strengthening ASEAN Capital Market Development and Integration Liberalisation of Foreign Direct Investment flows including portfolio and other investments flows
A5. Free Flows of Skilled Labour	Complete MRAs for major professional services Develop core competencies for job/occupational skills required in priority services sector
A6. Priority Integration Sectors	Conduct a bi-annual review to monitoring the status, progress and effectiveness of PIS roadmaps Identify sector-specific projects or initiatives with Country Coordinators
A7. Food, Agriculture and Forestry	Enhance extra-ASEAN trade and long-term competitiveness of ASEAN's food, agriculture and forestry products Promote cooperation, joint approaches and technology transfer with the private sector and international organizations Promote ASEAN agricultural cooperatives

B. Towards a Highly Competitive Economic Region	
B1. Competition Policy	Building capacity and introduction/adoption of best practices for introducing competition policy
B3. Intellectual Property Rights	Intellectual Property Rights Action Plan
B4. Infrastructure Development	Transport Action Plan ASEAN Framework Agreement on Multimodal Transport ASEAN Framework Agreement on the Facilitation of Goods in Transit ASEAN Framework Agreement on Facilitation of Inter-State Transport Roadmaps for Integration of Air Travel Sector Information Structure Energy Cooperation (i.e. ASEAN Power Grid)
B5. Taxation	Complete the network of bilateral agreements on avoidance of double taxation among members
B6. E-Commerce	Enactment of E-Commerce Law
C. Towards a Region of Equitable Economic Development	

C1. SME Development	ASEAN Policy Blueprint for SME Development
C2. Initiatives for ASEAN Integration (IAI)	Conduct periodic socio-economic studies to monitor impact of economic integration
D. Towards Full Integration into the Global Economy	
D1. Coherent approach towards External Economic Relations and Enhanced Participation in Global Supply Networks	Review FTA/CEP commitments vis-à-vis ASEAN's internal integration commitments Identification of technical assistance to develop and upgrade industrial capabilities and productivity of ASEAN member countries

Source: ASEAN Website