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## Gearing the Philippines for ASEAN economic community

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### **Gearing the Philippines for ASEAN Economic Community**

by

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## **Gearing the Philippines for ASEAN Economic Community**

*Florian A. Alburo*

### **Abstract**

This paper argues that the way for the Philippines to the ASEAN Economic Community (AEC) is not through ASEAN but through the world. Being good neighbors will define the AEC and how the Philippines fits into it—not necessarily in the way it was planned. Of the 4 pillars underlying the AEC, the paper focuses on Pillar 1—Single Market and Production Base—and within this, trade in goods. During the period of AFTA implementation the Philippines did not only aggressively pursue a program of preferential tariff reduction but a concomitant reduction of MFN tariff rates. Between 1993 and 1999 the margins between Philippine AFTA rates and its MFN rates sharply declined, so that the initial preferential bias in terms of both exports to and imports from ASEAN diminished and trade shares with the region remained stable. In a sense the country's readiness for AEC was already laid down at the start of AFTA and fortified when it unilaterally liberalized on an MFN basis. But this is only one, albeit critical, part, of the AEC package. The other pillars and the other parts of Pillar 1 are still beset by barriers to effective regional trade – mostly homegrown and putting the domestic house in order is necessary not only for the AEC but for firmer integration with the world economy. Even with the current progress in trade-in-goods, sustaining this requires a readiness that needs to be attended—with or without the AEC. Of the original 5 ASEAN members, most have successfully overcome barriers to integration into the regional and global trade and investment systems. Thus, for some of these countries, aggressive pursuit of the AEC is marginal and a by-product of global readiness. Their institutional machineries have been built around the global trading arena, their economic actors exploit their borders' opportunities, their governments bold in forging agreements that open markets. The Philippines has yet to fully be ready for the global markets, its economic actors still have to appreciate borders and their potential for expanding markets, and its government carries out audacious reforms that realize its nearby neighbors can be exploited as part of the larger world economy.

JEL Codes: F13, F15

Key Words: AEC, Regional and World Trade

## Gearing the Philippines for ASEAN Economic Community

*Florian A. Alburo*

### 1. Introduction

This paper argues that the way for the Philippines to the ASEAN Economic Community (AEC) is not through ASEAN but through the world. Being good neighbors will define the AEC and how the Philippines fits into it—not necessarily in the way it was planned. The Philippines has always been an ardent subscriber to ASEAN throughout its evolution. In the economic sphere the Philippines has always adhered to all economic cooperation modalities (at times even aggressively), participated in various ASEAN projects, and contributed to regional gatherings that examine and plot ASEAN's course. Yet the Philippines' "ASEAN-ness" has hardly been evident in terms of its trade with other ASEAN members.<sup>1</sup>

Circumstances have changed dramatically since ASEAN was founded; many of these circumstances have shaped the region and influenced how it may eventually evolve as a community. At the ASEAN Summit of December 1997, ASEAN adopted *Vision 2020* which sees "...a stable, prosperous, and highly competitive ASEAN economic region in which there is a free flow of goods, services, investment, and freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities..." by 2020. Subsequently, the ASEAN Leaders signed the Bali Concord II in October 2003 for the AEC as the goal of economic integration. The ASEAN Summit of December 2005 considered accelerating the AEC from 2020 to 2015 and requested concerned Ministers to examine the possibility. The ASEAN Secretariat

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<sup>1</sup> Over many decades ASEAN's share of Philippine trade hardly reached more than 15 percent (although the same can be said of ASEAN as a whole)

was asked to develop a single and coherent blueprint for advancing the AEC from 2020 to 2015, with clear targets and timelines. The Ministers recommended the acceleration of the AEC and proposed it to the ASEAN Summit in January 2007. This 12<sup>th</sup> Summit approved the acceleration of the AEC and in the 13<sup>th</sup> Summit the Leaders adopted the AEC Blueprint. If we trace the evolution of this “marching order” for ASEAN (which also defines how the Philippines fits), a distinct break is evident.

A number of studies list the different ASEAN economic agreements that are supposed to contribute to trade among the Member States and further integration of their economies (Chia, 2004; Cuyvers and others, 2005; Nandan, 2006). These studies often classify the agreements according to the members that participate, their status, or according to the kind of agreement (e.g. goods, services, investment, etc.). A more comprehensive list can be found at the ASEAN Secretariat, which lists more than 325 ASEAN treatises and agreements since its founding in 1967. Some 50 of these are in the form of economic agreements that seek to promote greater trade within ASEAN.<sup>2</sup> While there are others which could also be considered as economic agreements, these do not really address a change in the economic environment in which traders, producers, and consumers alter their behavior, e.g. agreements to establish an ASEAN center, undertake cooperation (agriculture cooperatives, environment, energy), ASEAN declarations and some memoranda. In fact, such list includes many which do not require ratification by the Member States.<sup>3</sup>

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<sup>2</sup> This number is purely arbitrary and based on a simple cursory review of all the treatises and agreements which have been catalogued in ASEAN.

<sup>3</sup> Strictly speaking, if we go by definition of an agreement as requiring ratification, then such listing would be more accurate.

What may be useful is to understand the character of these agreements as they have evolved over time. The original rationale for the establishment of ASEAN was security alliance; moving into the economic field, and a more regional development direction, was obviously not a usual fare to the Members. In fact, the language of the Treaty of Amity and Cooperation in Southeast Asia remained couched in terms of regional peace and stability, even if the economic provisions alluded to promoting economic growth in the region, expansion of trade, and improvement of economic infrastructure (e.g. Article 6 of the Treaty, 1976). The Bali Accord of 1976, though clearly indicating the importance of industrial and trade cooperation, remained focused on stability and the elimination of threats posed by subversion to its stability. Note, however, that even then the Accord was already urging Member States to develop awareness of regional identity and create a strong ASEAN community (Bali Accord, 1976 Declaration No. 8).

First of all, the evolution of ASEAN economic agreements may be characterized as country-centered. The identification of regional industrial projects, the ASEAN Industrial Complementation, ASEAN Industrial Joint Venture, Preferential Trading Arrangement, and even the initial listing for the ASEAN Common Effective Preferential Tariff Scheme (CEPT) all began at the country levels. This is not to suggest that they should not have begun at the country-level. However, many of these agreements did not really have regional reference points. As late as the CEPT, each country simply determined what products it identified in its inclusion list; in earlier agreements the countries identified their own regional industrial projects or industrial complementation. This was understandable since without a notion of regional markets or regional integration, the second-best option was a country-level determination (done mostly by bureaucrats).

Second, and related to the first character, the content of the agreements were selective or fragmented. Especially in the early part of the evolution, the choices of products or sectors for liberalization or promotion were somewhat arbitrary. Those that fell under the inclusion list, exclusion list, or exception list were selective. In short, the selective nature of the content of the agreements appears to have been based on criteria which did not directly impact on regional or intra-ASEAN economic transactions. This character is prominent in the agreements relating to early areas of economic cooperation during the eighties.

Third, many of the recent economic agreements reflect deliberate responses to changing global environment of ASEAN. In particular, the lack of success in getting the Doha Round completed has driven the region to seek more regional and intra-regional trade and other economic cooperation arrangements. This is reflected in the quickening pace of specific agreements. For instance, the ASEAN Framework Agreement on Services (AFAS) agreed on 3 rounds (the 5<sup>th</sup> to the 7<sup>th</sup>) in 3 years, whereas it took 7 years between the first and the third rounds. Similarly, many free-trade agreements were initiated in a shorter span of time. In contrast, ASEAN took its time in responding to global changes in the early part of the evolution of its economic agreements, e.g. it took 15 years before the original Preferential Trading Arrangement (PTA) was abandoned for the ASEAN Free Trade Area (AFTA) at a time when globalization was starting to pick up, multinational firms were breaking production into different locations, and foreign investors were seeking active hosts to foreign capital. Indeed, many of the ASEAN Member States may have missed significant opportunities for global economic participation by hinging their international participation through the ASEAN. While the delay in response can be explained (e.g. lingering import-substitution policies of some members), its muted impact on the region in terms of expanded intra-ASEAN trade was evident.

Finally, the increasing complexity, substantive content, and technical nature of the agreements have significantly benefitted from improvements in the institutional capacity of the ASEAN Secretariat, which was reorganized under a 1992 amendment to the agreement establishing it. The formal recognition of the stature of the Secretary-General (as Minister on par with the other ministers of ASEAN), the professionalization of the staff, and increased knowledge within the organization have all been instrumental in improving the caliber of the agreements. This is evident in a cursory reading of the agreements as they have evolved over time. Indeed, the AEC Blueprint is a product of the Secretariat.

Table 1 shows a listing of the various general and specific agreements entered into by ASEAN that relate to the economy. Table 2 shows a time grouping of the various economic agreements in ASEAN. Table 1 reveals that most of the economic areas are covered by the agreements – trade in goods, services, and investment, among others. However, Table 2 reveals that timeline of the evolution of the agreements has been somewhat arbitrary. Notice the increasing sophistication of the agreements beginning in 2001, with more focus on their regional aspects or their implications on intra-ASEAN trade. The agreements in eighties were more bureaucratic-driven agreements, confined mostly to the development of the PTA as the initial means of economic cooperation and the pursuit of regional development. Table 3 focuses on the components of the economic agreements to the AEC and the dates of some.

**Table 1**  
**Key ASEAN Agreements on Economic Integration**

**General**

The ASEAN Declaration (Bangkok Declaration) Bangkok, 8 August 1967

Declaration of the ASEAN Concord, Bali, 24 February 1976

Protocol to Amend the Framework Agreement on Enhancing ASEAN Economic Cooperation, Thailand, 15 December 1995

ASEAN Vision 2020, Kuala Lumpur, 15 December 1997

Hanoi Plan of Action, Hanoi, 15 December 1998

Hanoi Declaration on Narrowing the Development Gap for Closer ASEAN Integration, Hanoi, Vietnam, 23 July 2001

Declaration of ASEAN Concord II (Bali Concord II), Bali, 7 October 2003

Vientiane Action Program 2004 -10, Vientiane, 29 November 2004

**Goods**

Agreement on the ASEAN Preferential Trading Arrangement (1977)

Customs Code of Conduct (1983)

Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area (1992)

Customs Code of Conduct (1995)

ASEAN Agreement on Customs (1997)

ASEAN Customs Vision 2020 (1997)

ASEAN Framework Agreement on the Facilitation of Goods in Transit (1998)

ASEAN Framework Agreement on Mutual Recognition Arrangements (1998)

Guidelines for Mutual Assistance to Combat Customs Fraud and Smuggling (1998)

Protocol on the Special Arrangement for Sensitive and Highly Sensitive Products (1999)

ASEAN Customs Policy Implementation and Work Programme (1999)

Understanding on the Criteria for Classification in the ASEAN Harmonised Tariff Nomenclature (2003)

### **Services**

ASEAN Framework Agreement on Services (1995)

Protocol to Amend the ASEAN Framework Agreement on Services (2003)

### **Investment**

Framework Agreement on the ASEAN Investment Area (1998)

Protocol to Amend the Framework Agreement on the ASEAN Investment Area (2001)

### **Dispute settlement**

Protocol on Dispute Settlement Mechanism (1996)

ASEAN Protocol on Enhanced Dispute Settlement Mechanism (2004)

Source: Nandan, 2006

**Table 2**  
**Agreements and Timelines**

***1980 – 1991***

AIP, AIC, AIJV

Brand to Brand, PTA,

Enhanced PTA,

Customs Code of Conduct

***1992 – 2000***

CEPT, AFAS, MRA, AIA

Agreement on Customs

Facilitation of Goods – Transit

***2001 – 2004***

AIA, ASEAN FTAS (PRC, India, Japan....)

ASEAN Concord II

Sectoral Integration

***2005 -2009***

AFAS (5<sup>th</sup>, 6<sup>th</sup>, 7<sup>th</sup>)

ASW, ASEAN + 3

FTA, ACIA, ATIGA

Source: Author's classification

**Table 3**  
**Illustrative Economic Agreements (and dates)**  
**That Contribute to Key Areas in AEC**

1. Single Market and Production Base
  - Flow of Goods - AFTA/CEPT, ATIGA, ASW, PIS, Agreement on Customs, FTA's (India, ROK, PRC, AUS/NZ)  
 (1992, 2003) (2009) (2005) (2008)
  - Flow of Services - AFAS, MRA, MA (Full Liberalization of Air Freight Services),  
 (1995, 2009) (1996, 2007, 2008) (2009)
  - Protocol Unlimited Freedom Traffic Rights, Financial Services Package in AFAS  
 (2008)
  - Flow of Investments - ACIA, AIA  
 (2009) (1998)
  - Flow of Capital
  - Flow of Skilled Labor - MRAS  
 (1998, 2009)
2. Competitive Economic Region - MOU
3. Equitable Economic Development - IAI
4. Integration into the Global Economy

Source: Author's classification

Clearly, the evolution of ASEAN economic cooperation has been from one of country centrality to a more regional perspective; from one of groping for regional parameters to a vision of an integrated region. As shown in Table 3, ASEAN is viewed as single market and production base in terms of the flow of goods, services, investments, and skilled labor, integrated with the global economy, and having a more equitable development and competitive region. This vision of the ASEAN region as production base recognizes that in the current global environment, the region captures a significant slice of global value chain (GVC). Yet much of the region's ability to encompass GVC depends not only on a regional agreement but on many dynamic factors, including technology and networked firms. Indeed as early as 1995, when AFTA was just beginning, the relevance of networks had been raised in the context of regional economic cooperation (Alburo 1995).

This is the broad backdrop against which Philippine readiness for the AEC is examined. The next section is a slight digression into the notion of an economic community. Here we reference the European (Economic) Community (EEC), its similarities to the ASEAN evolution and major differences in current practice. Recent developments in the EEC show weaknesses that were apparently glossed over in its enthusiasm. The section argues that the meaning of "community" in the AEC needs qualification, especially when carried to its extreme, and that it would make sense to sort out issues that particularly impinge on the AEC.

The third section analyzes the Philippines' readiness for AEC, focusing primarily on the first pillar i.e., single market and production base trade in goods. We argue that while there are pockets of readiness especially in an ex post sense, many of these hold true even without ASEAN. In fact, in drawing its CEPT schedules, the Philippines' tariff reduction path was lower than the ASEAN average, it had a limited exclusion list, and it adopted a program for reducing

non-tariff barriers. Many of the liberalization measures were of course global and not catered to ASEAN. Yet like other ASEAN economic outcomes, the country's trade with ASEAN did not accelerate, Form D utilization rates were low, and in tracing releases of cargoes, those from ASEAN were slower than those from other source countries (SATMP 2003).

Section 4 briefly examines the other elements of the AEC. We argue that although these other elements are important, they (i) hinge on trade in goods (in the single market and production base pillar) which will draw in services, investment and labor movement; (ii) will require the combination of the other 3 pillars for AEC, and (iii) will be instrumental for integration into the global economy including ASEAN.

In the concluding section we bring back the main theses of the paper.

## **2. Referencing Economic Community**

The European Union (EU) is often considered as setting the bar for an economic community. The EU started out as EEC (1957), later on transforming into union, a single Europe (1986, 1992), and a currency union (1999, 2002). Several things were happening in the EEC: southern enlargement, eastern enlargement, liberalized movement of labor, harmonization of product, safety, and food regulations, etc. The parallels with ASEAN are clearly evident.

Like ASEAN, the EEC's primary impetus was peace and security. In fact, it really began as a coal and steel community pooling major war protagonists' production to solidify the region; it was also a project to bring democracy and prosperity to a war-torn continent. Succeeding parts of the project fell into place, particularly customs union and the free movement of goods and eventually factors of production. The culmination was of course the EU single currency, adopted by most of the European nations. The key outcomes of this economic community were the large

amount (more than 75 percent) of intra-European trade, seamless nature of regional infrastructure, and the seeming convergence of financial markets (especially bond spreads).

The EEC became synonymous with a homogeneous economy— a single market. In its early period, many of production bases were within the EEC. The emergence of European Parliament gave the region the appropriate oversight institutional machinery and soon moved to provide development resources to newer members (in reference to one of the pillars of the AEC, Equitable Economic Development).

Yet in the run-up to the EU crisis in 2009 the community's vulnerability surfaced. Whatever the primary causes, the crisis revealed that there really was no economic homogeneity: e.g., bond spreads varied considerably after early convergence. The loss of currency independence for the countries in crisis (e.g. Greece, Spain, Ireland, and Italy) reduced policy adjustment space necessary for recovery (Krugman 2011) and exposed in the form of a monetary union. Indeed, independent views argue that the EU single currency did not conform to the theoretical framework set out by Mundell (1961), particularly the assumptions of labor mobility and fiscal integration.

There are several reasons why the AEC is likely to evolve in a manner different from the EU. First, it is unlikely that a single production base can be built around ASEAN in the same way the EEC had in its early days. Given dynamic changes in technology, firm behavior and transactions, and general unpredictability of production location and trade, the ability of ASEAN to capture global value chains (GVC) around the region may not be easy. The single market part of the pillar seems achievable in the AEC with the ATIGA aiming for dismantling residual tariffs as well as non-tariff barriers. However, the single market has to overcome border barriers which are often non-transparent. More importantly these may not be easily removed without a

uniform regional mechanism or strong inter-country coordination and may create glitches in cross-NSWs electronic communications. Second, there are early limits to labor mobility even for highly-skilled labor, as evident in the EU's inability to see labor adjusting to country recessions. The reason is simply that cultural and linguistic differences constrain such an adjustment to take place (Schirru 2014). Third, a community that would be true to its very name and core would aim for single currency. There is no doubt that the EU will ensure the Euro survives (short of some members withdrawing from the union), but only after long and inequitable pain and suffering (high unemployment-internal devaluation) are inflicted on some members. If AEC is to be true to its very name and core, should it go likewise for a single currency? Finally, the other pillars in the AEC (competitive economic region, equitable economic development, and integration with the global economy) are subsumed in the EEC in its supranational status which conveys regional authority through the Council of Ministers or the European Council to carry out concerted competition policy, consumer protection, affirmative action for small and medium enterprises as part of equitable economic development particularly new EU members and collective approaches to forging free-trade-areas and more recent "mega-areas". Contrast this with how these analogous pillars are to be pursued in the AEC, which would be scattered across members and within them different agencies and instrumentalities.

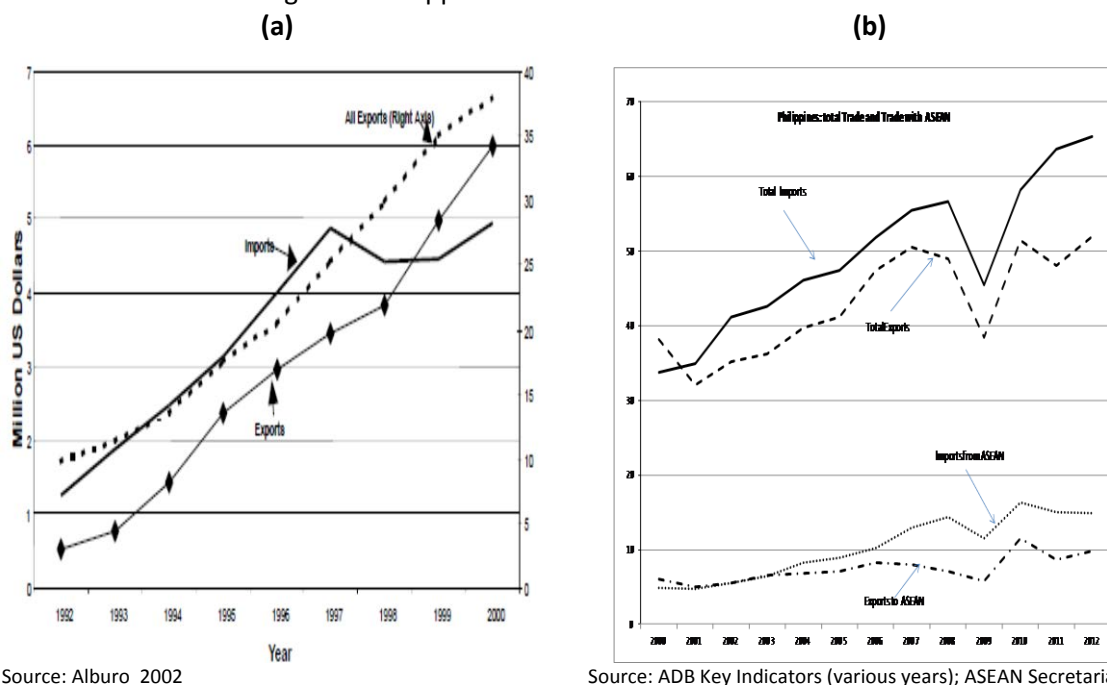
In short, we must avoid drawing parallelisms between the EEC and AEC and its component pillars, more so since the environments of the community in the ASEAN and EEC contexts presumably differ and have dramatically changed since ASEAN was founded, implying a different bar to define and achieve. The meaning and content of the AEC therefore have to be pinned down in which case the notion of economic community is removed of reference to the EEC.

### 3. Philippine Readiness for AEC

Numerous awareness campaigns, studies, and outreach programs and assistance are in full swing in the Philippines to enhance its readiness for the AEC. Recent economic analysis suggests that in the last three years, the economy may have started breaking out of its past patterns of spurts of growth and decline and the inability to create a momentum and sustain economic performance (Habito 2014). It is not clear, however, if this recent economic performance derives from or influences transactions within ASEAN. The recent aggregate economic record does not suggest that it has been caused by ASEAN economic transactions or that it has influenced such transactions.

To examine this further, we trace the behavior of Philippine trade with ASEAN—historical magnitudes and growth—and compare this with extra-ASEAN trade. In terms of the AEC, we hypothesize what behavioral change is expected in the area of Philippine exports to ASEAN and its imports from the region. Figure 1b below shows the magnitudes of total Philippine merchandise exports and imports from 2000 to 2012 and the country's trade (merchandise exports and imports) with 9 other ASEAN Member States (AMS) for the same period. As a reference, Figure 1a shows the country's ASEAN trade and its merchandise exports from 1992 to 2000. Notice that Philippine merchandise trade with ASEAN is a mirror image of its total trade with the world; this is especially evident during the financial crisis of 2009, when world trade collapsed. What is interesting is that there is a perceptible break from 2010, when there appears to be an acceleration of global imports relative to global exports (thus widening the trade deficit). Yet the country's ASEAN trade does not mirror this break in merchandise imports from AMS, which flattened during 2010-2012 thus reducing its regional trade deficit. The same can be said for 2003, when trade deficit started to open up. Philippine

Figure 1: Philippine Trade with ASEAN and Total

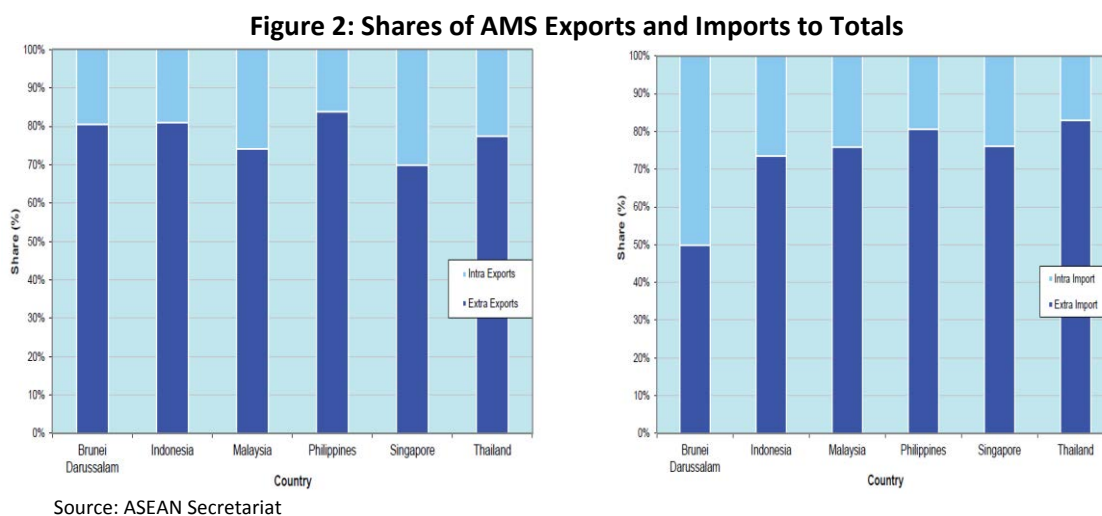


trade with ASEAN has been fairly stable for nearly a decade (2000-2009), except for the noticeable break beginning 2010. Figure 1a traces an accelerating path of Philippine exports to ASEAN, when AFTA started even during the Asian financial crisis of 1997 (showing a fall in imports from ASEAN). Philippine exports to ASEAN followed a trajectory similar to overall exports and was even slightly better towards the end of the decade.

Since the AEC envisions complete liberalization of all goods traded among the AMS, there are fears that a surge of intra-ASEAN imports will take place. These fears seem unfounded in the case of the Philippines. First, the pace and pattern of the country's trade with AMS shown in Figure 1 indicates that intra-ASEAN trade has been subdued relative to global trade and more so in the last 3 years (2010-2012 in Figure 1b).

Second, historically, ASEAN's share of Philippine exports or imports has never breached 20 percent (between 1993-2012) and is the lowest among the ASEAN 6 (Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand). Figure 2 shows the average shares to country

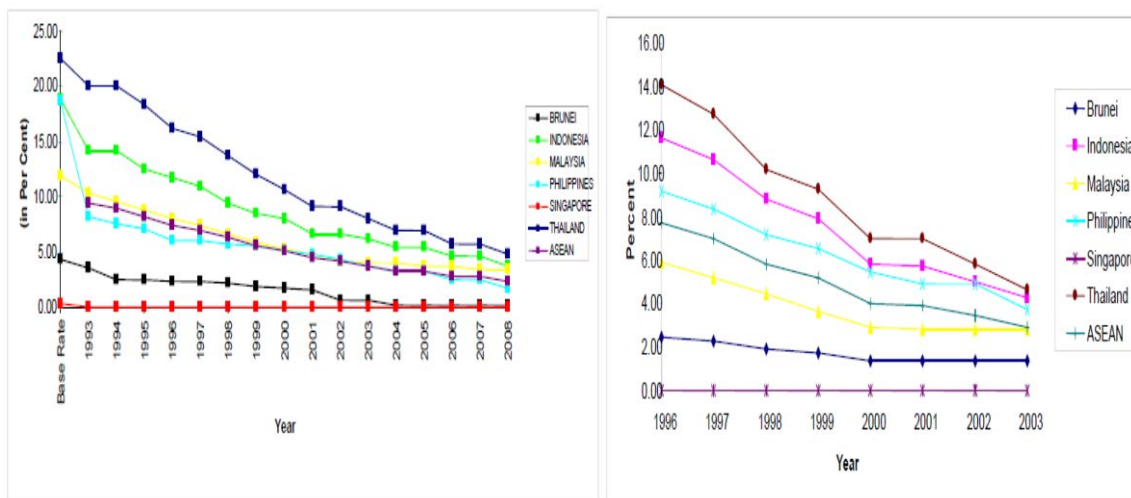
totals of extra- and intra-ASEAN exports and imports. To expect this share to sharply rise for the Philippines because of the AEC is highly unlikely. It is also true that the country's MFN rates have been falling almost in tandem with CEPT rates, reducing possible trade diversion. And as Calvo-Pardo et al (2009) have argued, ASEAN in general and perhaps the Philippines in particular have had their welfare improved from AFTA, which may also partly explain the stable share of the region's trade to total trade.



Third, there seems to be little room for more liberalization vis-à-vis ASEAN in terms of tariff rate reductions. For one, between the original CEPT time line of 15 years (1993-2008) and the accelerated CEPT into 10 years (1993-2003) the Philippines (as well as the rest of the original 6 AMS) changed its tariffs to meet the original target of 0-5 percent rates. For another, the Philippines had a more aggressive reduction in the accelerated program. Consequently, the room for further reduction narrowed between the original and accelerated CEPT. These are averages, however, and there are clearly individual tariff lines for which further reduction is always possible, especially for inter-related lines. Indeed, disparities in some tariff lines in the

accelerated CEPT across ASEAN countries indicate wide differences for some product lines, limiting market access for the Philippines or opening wider access to the country from other ASEAN countries. What is evident is that the commitment to liberalization in terms of average tariff rates still hides wide variation in rates among specific lines. In short, it appears that the CEPT rates were not sufficiently rationalized. Figure 3 shows the CEPT rates for the ASEAN 6 – original (Figure 3a) and the accelerated (Figure 3b).

**Figure 3: CEPT Rates: Original and Accelerated**  
(a) (b)



Source: ASEAN Secretariat

Finally, it seems that the AEC instrument for trade in goods is quite complete with the CEPT rates reaching their targets. The path to zero tariffs in 2015 would be rather incremental and may not really have significantly distorted effects on the AMS. By default, the Philippines' readiness for the AEC was set way back in 1993, throughout the period of the accelerated program.<sup>4</sup> Access to Philippine markets of products that were previously in the exclusion list may lead to spikes in their imports, which may threaten domestic substituting industries. Our

<sup>4</sup> This is of course not totally true since the country still had exclusion lists (temporary, sensitive, and general) which would be completely gone in the AEC. This may be critical for some products, e.g. unprocessed agricultural products.

readiness for this was also set in 1993, when focus was given to items in the exclusion list, systematically assessing their competitiveness and considering alternatives, including adjustment mechanisms when their liberalization (in 2015) shall have taken place.

As shown in Figure 1, imports from ASEAN, on average, seem to have leveled in the last 3 years in the midst of a rise in overall imports. This is similar to the country's experience in the last 3 years of the nineties. Depending on the magnitudes of trade in products in the exclusion list and the weight of ASEAN sources, it may be that imports will not spike. On the other hand, what is relevant to see is the readiness of the country to expand its exports to the region, which happened in the earlier period (see Figure 1a), not in the latter. This needs further investigation. With the extended experience of the country in AFTA, and in the run-up to the AEC, it is possible to hypothesize why Philippine-ASEAN trade has leveled off and where the country may pay attention to improve readiness.

Given the length of time of AFTA implementation, the apparent stable product menu traded with AMS, and the tandem decline in MFN tariff rates, ASEAN markets have probably matured in terms of product preferences and accessibility. Whether in the form of intermediate or final products, their maturity has probably been associated with an increasing and careful eye for quality. To the extent that the Philippines' product menu falls short of quality properties relative to other countries in ASEAN, it will be difficult to maintain and increase market penetration, move up a product's value chain efficiently, and face more formidable obstacles outside the ASEAN markets, where the Philippines supplies products that are similarly produced in the rest of the region.<sup>5</sup> The magnitude of this quality factor, especially in products that have

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<sup>5</sup> Of the many Philippine exports to ASEAN (which have been stable) some have gained dramatically in the last 5 years. These are mostly products that are differentiated and susceptible to quality differences – for

matured, can be seen in the country's active participation in international standards bodies such as ISO and CODEX, the number of testing and calibration laboratories, product certification bodies, and schemes offered by national accreditation bodies, among others.

A quick comparison of quality efforts among some of the ASEAN countries will show that the Philippines is behind Indonesia, Thailand, and Malaysia – even Viet Nam in some benchmarks – reflecting poor quality infrastructure. Table 4 below illustrates some of these indicators relative to Indonesia, Malaysia, Singapore, Thailand, and Viet Nam.

Table 4  
Illustrative Quality Indicators: 2011

	Indonesia	Malaysia	Philippines	Singapore	Thailand	Viet Nam
ISO [participation (no.)]	225	280	121	150	295	79
Testing Labs (no.)	541	344	17	238	368	479
Calibration Labs (no.)	142	69	27	68	194	58
Schemes by NAB (no.)	11	11	9	12	10	8

Source: ASEAN Secretariat and Country websites

A country's active participation in ISO meetings involves the country's products in setting international standards which are fulfilled by its testing and calibration laboratories. Table 4 shows that the Philippines lags behind Indonesia, Malaysia and Thailand. While these comparisons are not clear-cut, that with Indonesia, being archipelagic, may be more appropriate. In this case, the Philippines is even farther behind.

Without attending to measures that would help in sustaining advances in market penetration, those products may lose competitiveness. Indeed, since many Philippine products

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example preparations of cereal, flour, starch or milk, essential oils/perfumery, apparel/clothing accessories, and optical and photographic products, among others.

have attained some maturity, increased readiness for quality-driven product differentiation will not only keep market shares but actually enlarge markets, since intra-industry trade goes with increased economic growth. But what is also true is that failure to attend to such readiness associated with product quality is also a strong basis for erecting non-tariff barriers (e.g. health and sanitary standards, labeling requirements, etc.).

This readiness for maintaining if not enhancing markets in ASEAN does not only pertain to the region but to the rest of the world. After all, product improvements meant for the region can also be accessed by world markets, and vice versa.

The Mid-Term Review (MTR) of the Philippines AEC blueprint notes that the country is progressing well towards ASEAN standards and conformance, especially among the 8 Priority Investment Sectors (Milo 2013; Aldaba and others 2013). With regard to national obligations for standards, conformity assessments, and technical regulations, overall compliance rates are high. The numerical scorecard is based on the MTR Economic Research Institute for ASEAN and East Asia (ERIA) Survey of Core Measures, where (for the Philippines) 33 firms were surveyed to determine their awareness of the AEC and the degree of compliance with the measures. For the assessment of ASEAN standards and conformance along the 8 priority sectors, the respondents were even fewer. For example, for cosmetics only 7 were surveyed (5 multi-national firms, 1 SME, and the FDA); in electronics only 3 were surveyed (1 representing industry associations, 1 from Bureau of Products Standards, and 1 from a laboratory). While the responses may reveal degrees of awareness and product standards, they are clearly quite incomplete. But these results are not inconsistent with the assertion underlying Table 4.

First of all, what is being evaluated in the MTR and in the standards and conformance part of the AEC under trade facilitation is adherence of products to minimum standards i.e.

mandatory product properties intended to provide consumer protection and safety. This is often confused with product quality—indeed this is the minimum that must be met by manufacturers and distributors.<sup>6</sup> And this is what regulators are concerned with at the national level, while at the regional level harmonization of those mandatory requirements ensure that goods move faster and that they do not constitute technical barriers to trade.

Second, what is asserted above is that as product markets mature, consumers tend to look for quality. Quality standards are thus private sector provided and driven but require a quality infrastructure that is reflected by the illustrative indicators in Table 4. Laboratories aim for international compliance, allowing their certifications to be internationally recognized and accepted by private consumers. These are often beyond the mandatory technical standards and are initiated to satisfy quality requirements which may lead to more competitiveness, if not to price premiums that manufacturers can charge.

Third, the focus of the MTR and reported scorecard is compliance by manufacturers and traders with standards, conformity assessments, and technical requirements as imposed by regulators. Thus the tables underlying the scorecard for standards and conformance in the AEC relate to equivalence of national standards with agreed international and ASEAN standards, ratification of Mutual Recognition Agreements and their transposition into domestic laws, ratification of regional agreements containing harmonized technical regulations and regional post-market surveillance, among others (Aldaba and others 2013, Tables 2.1 – 2.3). It is only appropriate to take this focus in fulfilling the country's obligations for the AEC.

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<sup>6</sup> In the review of Philippine adherence to the ASEAN Cosmetic Directive, "... the harmonized technical requirements are readily available to the industry and both manufacturers and distributors appear to register high compliance with the essential requirements for product safety and *quality*..." (Milo 2013 pp. 10-11, emphasis added).

Finally, it appears that the AEC measures for the Philippines (as well as the other AMS) are necessary conditions for integration, but as argued here they are not sufficient especially in terms of sustaining what the country has gained from AFTA implementation. Indeed, where harmonization of standards and conformance is achieved the challenge is for the private sector to move for quality standards to be competitive.

In summary, the Philippines is well within reaching its targets for the AEC's first pillar of a single market and production base, through trade in goods. However if the ultimate test of its readiness is being able to sustain the momentum of its regional goods trade, its readiness is quite inadequate relative to the other AMS. With respect to trade in services, foreign investment, and flows of capital and skilled labor, the country's readiness for AEC is uneven—some requiring basic measures, some requiring regional approaches, and some requiring largely national efforts.

In services liberalization, the path to the AEC remains long and difficult. Although the pace of AFAS has quickened since the 7<sup>th</sup> Round, and the Philippines has been adding more sectors for liberalization, the country's regional commitments hardly differ from its commitments under the WTO General Agreement on Trade in Services (GATS). There are a number of services trade with significant returns which are of interest to the country (e.g. travel and related services, business process outsourcing, other business services), and where liberalization has been unilaterally pursued; in terms of regional interest what is of immediate importance are services which remove barriers to movement of goods across countries. This would cover transport, logistics services, and freight forwarding, among others. Unfortunately while ASEAN agreements on specific transport services liberalization have long been signed in these have not been ratified by all AMS and thus remain unimplemented. For instance, the

ASEAN Framework Agreement on Multimodal Transport, signed by the ASEAN Transport Ministers in 2005, clearly recognized the need for multimodal transport operator to cross borders and to use at least two different modes of transport in the carriage of goods from a place in one country to a place designated for delivery in another country—meaning that the goods are taken in charge of only once by the transport operator (Cf. Chapter II). The same can be said of the ASEAN Framework Agreement on the Facilitation of Inter-State Transport, signed by the ASEAN Transport Ministers in 2009 which has yet to see ratification by AMS. Indeed some 40 agreements, protocols, and Memoranda on Understanding related to transport (framework, land, air, maritime) have been signed not only among AMS but between dialogue partners and with China. Less than 10 have entered into force. The readiness of the country for trade-related ASEAN-centric services can partly be gauged by its ratification of important regional transport agreements even with continuing resistance to cabotage.

In investment and capital flows, the ratified ASEAN Comprehensive Investment Agreement (ACIA) enhances and supersedes the ASEAN Investment Area (AIA) and ASEAN Investment Guarantee (AIG) agreements. And under the AEC the aim of the free flow of investment and capital in the region is a liberal, facilitative, open, and competitive investment environment in ASEAN following international best practices. This means liberalized investment regimes in the AMS, and rules that facilitate, protect, and promote investments. Readiness of the Philippines for this ASEAN investment climate requires more national measures than regional efforts. In particular, there is a need to open up the economy to regional investments, especially in sectors that enhance the country's access to the global and regional markets. This will require removing constitutional limitations on ownership; harmonizing investment promotions policies which differ by investment promoting agency (IPA); paying full attention to

basic and fundamental physical and institutional infrastructure (already ubiquitous in other AMS); and ensuring compatibility of investment incentives with the rest of the region.<sup>7</sup>

With regard to liberalizing movement of skilled labor within ASEAN, individual AMS need to jump several hurdles to integration. Even within one profession there would be at most 10 different educational and training curricula with different courses and varying lengths of time. Although there may be best practice available, the models may differ as well, such as between American or British systems. Then there are varying licensure requirements for practice of professions. These are apart from different languages and cultural practices. ASEAN has resorted to a more systematic process of encouraging freer mobility of skilled labor—facilitation of visa issuances for business travelers; incentives for traders and investors; intra-corporate transferees (of MNCs in the region); professionals including doctors, nurses, lawyers, engineers, accountants, IT personnel and other professions; a schedule of mutual recognition arrangements for the practice of professions, for which 7 have been identified; development of core competencies and qualifications for skills required in the priority services sector; greater cooperation among ASEAN University Network members for staff and student mobility; and strengthened research in the AMS for promoting job skills and labor market information, among others.

However, having signed 7 MRAs does not mean that the Philippines is ready for freer flow of skilled labor in the region. Although the country has been a net sender of certain skilled (and semi-skilled) labor to the rest of ASEAN, the AEC envisions mutual mobility, which means it will also have to be open to the inflow of professionals into the domestic labor market. This

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<sup>7</sup> There have been various reviews by investment agencies of the AMS to ensure there would be no “race to the bottom” through competing incentives to attract investments. Part of the AEC may have to address the tendency to outdo each other in giving incentives.

means the country undertakes procedures similar to the other AMS, entailing the steps enumerated above. This will involve many government and private organizations responsible for the education and training of professionals, examining and licensing them to practice, reviewing curricula equivalences, matching fieldwork and training for some professions, and other qualifications. While some professional organizations are on their way to negotiating with counterparts in other AMS on a bilateral basis (e.g. accountancy, although here some AMS still have to achieve a level of sophistication analogous to the Philippine Institute of Certified Public Accountants), others need a better understanding of what is involved to prepare the country for free mobility of professional skilled labor.

#### **4. The Remaining AEC Pillars**

All four pillars are integral parts of the AEC package (see Table 3 above). The remaining 3 pillars evolved out of the AEC roadmap but are nevertheless equally important for AEC's realization. It is evident from Table 3, however, that the single market and production base pillar has the most number of agreements for its support. This is also where the Philippines is most ready in terms of a key component, trade in goods. We now turn to the country's readiness in terms of the 3 remaining pillars: competitive economic region, equitable economic development, and integration into the global economy.

##### *Competitive Economic Region*

International trade generally imposes market discipline (at least in the tradable sectors) and tends to diminish monopoly power in the domestic economy. But that discipline is limited, and competition policy is essential to overall competitiveness. The AEC Blueprint envisions competition policy in place in the AMS by 2015. The Philippines has promulgated a new law "The Philippine Competition Act" amending an interim Executive Order No. 45 creating the

Office for Competition at the Department of Justice as the designated the competition body. This will consolidate all the fragmented pieces of regulations and legislations that address restrictive business practices, price control, and unfair trade practices. At the same time, the dividing line between competition policy and regulation has to be clearly delineated under the new law to foster a competition environment— in the country some government entities are both regulators and promoters of competition in such major sectors as telecommunications, electricity, ports, and air commerce.

The other tasks in the AEC are in consumer protection, intellectual property rights, infrastructure development, taxation, and e-commerce. There has been some progress in some of these, (services related to infrastructure discussed above) indicating some readiness on the part of the country.

#### *Equitable Economic Development*

The third pillar of the AEC is meant to address the development divide in ASEAN and integrate CLMV states and focuses squarely on broad-based economic development. Regardless of how it is named, e.g., “inclusive and resilient ASEAN” (ERIA 2013), 2 action fronts are specified in the Blueprint: SME development and the Initiative for ASEAN Integration (IAI). The latter is ASEAN-6 systematic assistance for the new members’ integration with the rest of the AMS. The former is an affirmative action to enhance the development of micro, small, and medium-sized enterprises (MSME) in the region. The MTR for the Philippines’ progress in the ASEAN Strategic Plan for SME Development and the ASEAN Policy Blueprint for SME Development shows low effectiveness in terms of access to finance, technology development, human resource development, and other regional SME concerns. However, these are not regional initiatives but national concerns that must be addressed at the national level. On the other hand, the

Philippines continues to support and contribute assistance to the regional IAI and participates in seeking technical assistance from dialogue partners.

### *Integration into the Global Economy*

With the AEC, ASEAN is envisioned to increasingly become integrated into the global economy while maintaining an “ASEAN centrality” in its external economic relations, especially in terms of concluding FTAs or regional economic cooperation arrangements. To achieve some coherence in ASEAN’s external relations, the Blueprint suggests actions towards common positions in regional and multilateral forums. A second direction is to support less developed AMS enhance their capability and productivity in participating in regional and global supply chain networks. This “ASEAN centrality” can be seen in the regional FTAs that have been negotiated, concluded, and ratified. Indeed this pillar obtained the highest achievement rate in the AEC scorecard for its first 2 phases (2008-2011) with 85.7 percent, measured by the entry into force of 5 FTAs (Australia and New Zealand, China, India, Japan, and South Korea).

At the same time, the AMS negotiated bilateral FTAs with these same partners covering items which are not in the ASEAN-centered FTAs such as movement of natural persons (Chia 2011). To the extent that the bilateral FTAs are with partners that also have FTAs with ASEAN, regional integration may be further strengthened. Given the limited number of collective FTAs, it is not surprising that the AEC scorecard for this pillar is high. On the other hand, since the ASEAN-centered FTAs also contain a schedule of products for tariff reduction, among other provisions, giving Pillar 4 a scorecard based simply on the entry into force of the FTA is not comparable to a scorecard for Pillar 1 which goes into products and services trade. In the case of the ASEAN-Japan Comprehensive Economic Partnership Agreement (AJCEPA), each of the AMS (and Japan) has a schedule of elimination on reduction of customs duties (Annex 1 of AJCEPA).

For example the Philippines has 223 pages of 8-digit HS products listed in the Annex 1 (to Article 16) which has 10 classification schedules using base tariff rates and their elimination to 0 -20 percent running into Year 11 of the FTA. It is not clear how the country's readiness should be viewed for this ASEAN-centered FTA without referring to its MFN schedules, even if its intra-ASEAN rates would have been zero. Note also that from examining the ASEAN-centered FTA it is also not clear how differing schedules laid out by each AMS lead to an enriched regional economy. Yet the individual FTAs have the potential to raise trade (and investment) bilaterally and when combined with ASEAN-level FTAs, regional trade (and investment). As noted above, these will depend on how the regional FTAs have been formulated.

## 5. **Concluding Remarks**

Of the 4 pillars underlying the AEC, our focus in this paper has been on Pillar 1—Single Market and Production Base—and within this, trade in goods. This is not to deny the importance of the other pillars, or the other components of Pillar 1 i.e. the flow of services, investment, capital, and skilled labor. Trade in goods, however, has had the longest tracking of regional trade since it began with AFTA (theoretically even earlier preferential trade). It also has the largest number of core agreements. The paper has shown that during the period of AFTA implementation the Philippines did not only aggressively pursue a program of preferential tariff reduction but a concomitant reduction of MFN tariff rates. Between 1993 and 1999 the margins between Philippine AFTA rates and its MFN rates sharply declined, so that the initial preferential bias in terms of both exports to and imports from ASEAN diminished (see Figure 1 above) and trade shares with the region remained stable. As Calvo-Pardo, et. al (2009) have argued, the simultaneous decline in both CEPT and MFN rates was welfare-improving, minimizing trade-diversion and increasing trade-creation. While it is difficult to disentangle the contribution of

either, this paper posits that the country's readiness for AEC was already laid down at the start of AFTA and fortified when it unilaterally liberalized on an MFN basis. But this is only one, albeit critical, part, of the AEC package. The other pillars and the other parts of Pillar 1 are still beset by barriers to effective regional trade. These are mostly homegrown and putting the domestic house in order is necessary not only for the AEC but for firmer integration with the world economy. Even with the current progress in trade-in-goods, sustaining this requires a readiness that needs to be attended—with or without the AEC. On the other hand, the AEC itself can be argued to be a strong incentive for the country to carry out the necessary reforms—the country's ASEAN commitments pressure it to continue on its reform path.

The literature on the AEC and related ASEAN initiatives is staggeringly voluminous. Many of them tout ASEAN as icon of regional integration and cooperation, which would be true. They make it appear as if the world is all ASEAN and that the community is there.<sup>8</sup> The more sober of the literature is more cautious, declaring that AEC is not an end but a milestone, and warning that the AEC targets are not likely to be met as scheduled (Menon 2014; Hill and Menon 2010).<sup>9</sup> Most of the papers detail regional readiness for AEC as reflected in the monitoring system in place i.e. the number of measures implemented relative to the total measures committed (showing for example an 84.1 percent implementation rate for the Philippines).

A way in which this readiness is argued is by first identifying the weaknesses in a particular area of regional competition through comparative analysis. Then a specific measure is

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<sup>8</sup> Other than government bureaucrats, some businesses, and limited regional organizations, the general public in ASEAN is not aware of AEC or even ASEAN. Surprisingly, in one survey of manufacturers and traders the number of respondents who are not aware of the AEC is highest in Singapore (Hu 2013).

<sup>9</sup> Included in this is probably the lengthy document *ASEAN Rising: ASEAN and the AEC Beyond 2015* which admits of AEC-targets failing but appropriately maintains ASEAN as the primordial star in regional integration (Intal and others 2014).

proposed as policy direction meant to strengthen the country in the coming AEC. For example, if the Philippines is weak in science and technology such as in R and D and public funding of education, which results in uncompetitive products and migration of skills, among others, the solution is to increase support to R and D, provide performance-based resources for selected higher educational institutions, and link tertiary education to industry (Pernia and Clarete 2014). But these measures are neutral and their resultant incidence may be on ASEAN but may also be on the rest of the world.<sup>10</sup> This is analogous to the simultaneous decline in both CEPT and MFN rates during AFTA in part explaining the low submission of forms to avail of lower CEPT rates. Did this mean poor progress of ASEAN, AFTA, or the AEC? Not necessarily; these may have instead been welfare-improving for the country. Indeed, narrowing measures only for ASEAN/AEC necessarily “locks-in” the country to the region. And in the increasing globalization of production and consumption, where it may be impossible to capture let alone identify segments of the value chain (that ASEAN can indefinitely hold on), the forgone opportunities may be more significant at this time than during the early period of AFTA.

A remaining argument for preparing for the AEC rather than more neutrally for the world is that it forces us to undertake reforms, gear policies for the coming wider markets, and work for attracting (regional) investment and capital. This is an appealing point suggesting that concentrating on the single market pillar particularly on trade in goods (and eventually services) will also influence the environment for investments, capital, and movement of labor. After all dynamic trade in regional and global markets ultimately dictates product location, the ensuing

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<sup>10</sup> In terms of the AEC this can always be catered through such means as the ASEAN University Network or faculty and staff/student exchanges, in which case first movers would come from ASEAN (assuming the outputs respond to these AEC measures).

associated capital and investments, and the flow of particular labor. Neighbors may be the first to benefit from such dynamism but so would the world at large.

Of the original 5 ASEAN members, most have successfully overcome barriers to integration into the regional and global trade and investment systems. Thus, for some of these countries, aggressive pursuit of the AEC is marginal and a by-product of global readiness. Their institutional machineries have been built around the global trading arena, their economic actors exploit their borders' opportunities, their governments bold in forging agreements that open markets. The Philippines has yet to fully be ready for the global markets, its economic actors still have to appreciate borders and their potential for expanding markets, and its government carries out audacious reforms that realize its nearby neighbors can be exploited as part of the larger world economy.

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