



R.G. Manabat & Co.

Moving Across Borders: The Philippines and the ASEAN Economic Community

2016 Investment Guide
by KPMG in the Philippines

In this issue:

Is the Philippines ready for the AEC?

The challenges of the AEC

Strengthening the ASEAN integration

What role will the Philippines
play in the AEC?



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Foreword

Since 2010, the Philippines has been taking big leaps in terms of economic performance, posting an average GDP growth rate 6.3% until the end of 2014. In the second quarter of 2015, GDP grew by 5.6%, higher than the growth rate of 5.0% in the first quarter. It is one of the most rapidly emerging markets in the ASEAN region with its sound economic fundamentals and highly skilled and productive workforce. This has also helped the country attain investment grade status from ratings agencies such as Moody's, Standard & Poor's and Fitch.

As one of the strongest and fastest-growing economies in the region, what role will the Philippines play in the upcoming ASEAN integration? This is the question that KPMG R.G. Manabat & Co. (KPMG RGM&Co.) strives to answer through this latest thought leadership publication. KPMG RGM&Co. partnered with the University of Asia and the Pacific (UA&P), one of the country's premier research universities and leading economics schools, to explore the Philippines' readiness and role in the upcoming implementation of the ASEAN Economic Community (AEC).

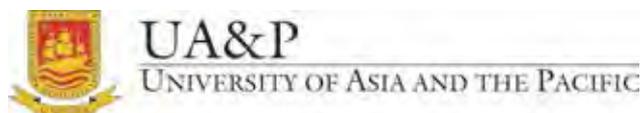
In this guide we identify the challenges of the ASEAN integration such as labor mobility, trade facilitation and connectivity, and transforming into one ASEAN market. We also look at the opportunities that the AEC will bring about and how the Philippines can position itself as a game changer in the region. Finally, we hope to shed light on how businessmen and investors can take full advantage of the integration as the country continues to become one of the strongest economies in Southeast Asia.



Roberto G. Manabat
Chairman and CEO
KPMG R.G. Manabat & Co.

About the University of Asia and the Pacific

The University of Asia and the Pacific (UA&P) is a private, not-for-profit institution of higher learning that offers some of the most outstanding academic programs in Asia. UA&P began in 1967 as the Center for Research and Communication (CRC), a think tank conducting research and offering graduate courses in economics and management. The UA&P School of Economics has been recognized as a catalyst of economic progress in the Philippines and in Asia and has earned a reputation for its highly relevant economic research. The major areas of its research activities include the fields of economic forecasting, financial markets, wage determination, and macroeconomics.



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The Philippines gearing towards a Borderless ASEAN Economic Community

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We are grateful for the valuable insights of:

Mr. Cezar Consing
President
Bank of the Philippine Islands

We are grateful for the assistance and research support of the following:

Ms. Marcella Maria Karaan
Graduate staff
University of Asia and the Pacific

Atty. Mark Darryl A. Caniban
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The Philippines: Gearing Towards a Borderless ASEAN Economic Community

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As emerging markets like Brazil and Russia have lost some of their luster, those of the Association of Southeast Asian Nations (ASEAN) continue to shine. Vietnam, Indonesia, and the Philippines have been attaining GDP growth rates of 5 to 7 percent annually while Myanmar has achieved GDP growth rates of 8 percent. Over a longer period of 30 years, growth has averaged 5.4 percent, surpassing the global average of 3.4 percent over the same period. As Edward Lee of the Standard Chartered Bank wrote in *Asian Management Insights*, growth in the ASEAN has been faster than other emerging regions such as Latin America, Sub-Saharan Africa, the Middle East and North Africa. This superior performance has narrowed the gap between global GDP capita and ASEAN GDP per capita by more than half, from 6.0 times in 1980 to only 2.7 times in 2013¹.

Thanks to the lessons learned during the East Asian Financial Crisis in 1997 to 1999, ASEAN countries' growth remained higher than that of the rest of the world during the recent Great Recession. The most resilient were Indonesia and the Philippines, countries that are not as export-dependent as the rest of ASEAN. But even the more export-driven members of the ASEAN grew on the average faster than developed countries, thanks to exports to a pump-priming China, which has slowed down only recently. There is much room for future growth because ASEAN is still predominantly rural. As Mr. Lee argued in the article cited above, ASEAN's urban population in 2013 was only about 47 percent, while the world had crossed the 50 percent mark in 2007. Within ASEAN, only Singapore, Brunei and Malaysia are highly urbanized. Assuming that the urbanization trend in the ASEAN continues along its recent path, GDP per capita in the region will be more than double

at US\$8,500 in 2030 from US\$3,900 in 2013. By then, 60 percent of the region will be urbanized. The Philippines already surpassed this 60 percent mark in 2014.

Foreign direct investors are the first to capitalize on the attractiveness of the emerging markets of the ASEAN. In 2013, ASEAN overtook China for the first time in terms of foreign direct investments (FDIs). This trend can only intensify as China has already lost a great deal of its labor cost competitiveness, having experienced increases of 15 percent annually in its wages over the last five years. To make matters worse, attrition rates in Chinese factories can range from 30 to 50 percent monthly, making manufacturing operations less predictable. The first to benefit from these developments will be the Mekong area (Cambodia, Laos, Myanmar and Vietnam). The young and growing population of the Mekong region provides low operating costs.

¹ Edward Lee (2015) ASEAN Growth in the Fastlane. *Asian Management Insights*. 2 (1). P. 20-26.



A Chinese manufacturing worker in the Pearl River Delta earns around US\$700 per month while in Myanmar, a comparable worker earns only US\$110. The Philippines, however, enjoys the added advantage of having attained labor peace in contrast with the ongoing radicalization of workers in the other ASEAN emerging markets.

The young and growing population of the large ASEAN economies is not only a rich source of manpower for the factories of the world, it also provides a huge market that totals as much as 600 million for the ten ASEAN countries. This demographic dividend is accompanied by the rapid rise of the middle classes that will constitute one of the most attractive markets for all types of consumer goods and services that will attract industries from all over the world to relocate in the region.

A Growing Middle Class

The ASEAN region is growing fast and now has greater opportunities to capture the needs of a rapidly expanding ASEAN middle class. Combined with a GDP of US\$2.4 trillion, it is now the seventh largest in the world – 25 percent higher than that of India.

Per capita incomes have been growing more than 5 percent annually since 2000. It rose from US\$2,267 to US\$3,759 in 2012. The region has over 600 million consumers from about 125 million households that by 2025, will earn over US\$7,500. ASEAN also now has the third largest in labor force.

Table 1. ASEAN Region GDP Performance

| Country/region | GDP 2013, current prices (\$ trillion) | Country/region | Real GDP growth, 2000-13 (%) |
|----------------|--|----------------|------------------------------|
| United States | 16.8 | China | 10.0 |
| China | 9.3 | India | 7.0 |
| Japan | 4.9 | ASEAN | 5.1 |
| Germany | 3.6 | Russia | 4.4 |
| France | 2.7 | Brazil | 3.2 |
| United Kingdom | 2.5 | Canada | 1.9 |
| ASEAN | 2.4 | United States | 1.8 |
| Brazil | 2.2 | United Kingdom | 1.5 |
| Russia | 2.1 | Germany | 1.1 |
| Italy | 2.1 | France | 1.0 |
| India | 1.9 | Japan | 0.8 |
| Canada | 1.8 | Italy | 0.0 |

Source: IHS; World Economic Outlook, IMF, April 2014; McKinsey Global Institute Analysis in Alfredo Perdiguero (n.d) The ASEAN Economic Community: Progress, Challenges and Opportunities. ADB Presentation

The ASEAN region is also experiencing a demographic gift, a state where low mortality and fertility rates, alongside rapidly growing populations of working-age adults, will provide several countries in ASEAN with the opportunity for remarkable GDP growth in the next 20 to 30 years. ASEAN's working-age population is on the rise while dependency ratios have been falling, translating to greater resource for professional and skilled labor in the region.

Table 2. ASEAN Domestic Markets

| | Mid-Year Population 2013 (in millions) | Age Distribution 2013 (as % of total population) | | | Age Dependency Ratio |
|-------------------|--|---|-------|------|----------------------------|
| | | 0-14 | 15-64 | 65 + | |
| ASEAN | 621.8 | | | | |
| Brunei Darussalam | 0.4 | 25.3 | 70.4 | 4.3 | 42.0 |
| Cambodia | 15.0 | 31.1 | 63.6 | 5.4 | 57.3 |
| Indonesia | 248.8 | 28.9 | 65.9 | 5.2 | 51.8 |
| Lao PDR | 6.7 | 35.2 | 61.0 | 3.8 | 63.8 |
| Malaysia | 29.9 | 26.1 | 68.5 | 5.4 | 45.9 |
| Myanmar | 61.6 | 24.9 | 69.9 | 5.2 | 43.1 |
| Philippines | 97.4 | 34.1 | 62.0 | 3.9 | 61.4 |
| Singapore | 5.4 | 16.1 | 73.8 | 10.2 | 35.6 |
| Thailand | 66.8 | 18.2 | 72.1 | 9.7 | 38.6 |
| Vietnam | 89.7 | 22.7 | 70.7 | 6.6 | 41.4 |

Source: ADB Key Indicators 2014



The ASEAN also boasts of being the 4th biggest exporter in the world. Trade of ASEAN grew by 16.8 percent, from US\$2.05 trillion in 2010 to US\$2.4 trillion in 2011. Intra-ASEAN trade reached US\$598 billion from US\$520 billion, an increase of 15.1 percent, over the same period.

Foreign direct investments continue to pour in. ASEAN foreign investments generated a record US\$114 billion FDI inflow in 2011, a 17 percent increase from US\$97.5 billion in 2010, and continued to increase in 2013 with US\$122.4 billion. The European Union, Japan and the United States are the top three major partner countries and region in foreign direct investments of ASEAN. Intra-ASEAN activities also continue to increase, posting a total of US\$ 57.2 billion of direct investment from 2011 to 2013.

Table 3. Foreign direct investment net inflow to ASEAN from selected partner countries/regions

| Partner country/region | Value in US\$ million | | | | Share to total net inflows (%) | | | |
|---|-----------------------|------------------|------------------|------------------|--------------------------------|--------------|--------------|--------------|
| | 2011 | 2012 | 2013 | 2011-2013 | 2011 | 2012 | 2013 | 2011-2013 |
| ASEAN | 15,228.4 | 20,657.6 | 21,321.5 | 57,207.6 | 15.6 | 18.1 | 17.4 | 17.1 |
| Australia | 1,530.2 | 1,831.0 | 2,002.3 | 5,363.5 | 1.6 | 1.6 | 1.6 | 1.6 |
| Canada | 767.9 | 923.9 | 851.0 | 2,542.8 | 0.8 | 0.8 | 0.7 | 0.8 |
| China | 7,857.7 | 5,376.8 | 8,643.5 | 21,878.0 | 8.1 | 4.7 | 7.1 | 6.5 |
| European Union (EU) | 29,693.3 | 18,084.9 | 26,979.6 | 74,757.8 | 30.4 | 15.8 | 22 | 22.4 |
| India | -2,230.5 | 2,233.4 | 1,317.5 | 1,320.4 | -2.3 | 2.0 | 1.1 | 0.4 |
| Japan | 9,709.0 | 23,777.1 | 22,904.4 | 56,390.5 | 10 | 20.8 | 18.7 | 16.9 |
| New Zealand | 7.5 | -107.6 | 246.5 | 146.3 | 0.0 | -0.1 | 0.2 | 0.0 |
| Pakistan | 12.5 | -21.4 | -0.6 | -9.5 | 0.0 | 0.0 | 0.0 | 0.0 |
| Republic of Korea | 1,742.1 | 1,708.4 | 3,516.2 | 6,966.7 | 1.8 | 1.5 | 2.9 | 2.1 |
| Russian Federation | 67.6 | 184.4 | 542.1 | 794.2 | 0.1 | 0.2 | 0.4 | 0.2 |
| USA | 9,129.8 | 11,079.5 | 3,757.5 | 23,966.9 | 9.4 | 9.7 | 3.1 | 7.2 |
| <i>Total selected partner countries/regions</i> | 73,515.5 | 85,728.1 | 92,081.6 | 251,325.1 | 75.4 | 75 | 75.2 | 75.2 |
| <i>Others</i> | 24,022.7 | 28,556.0 | 30,294.9 | 82,873.6 | 24.6 | 25 | 24.8 | 24.8 |
| Total FDI inflow to ASEAN | 97,538.1 | 114,284.0 | 122,376.5 | 334,198.7 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: aseansec.org

These remarkable achievements have encouraged the formation, and now 2015 implementation, of the ASEAN Economic Community (AEC). The AEC is a milestone, promoting economic integration and development in the region. It aims to foster equitable economic development and the creation of a highly competitive economic region that will be fully integrated into the global economy.

Salient features of the envisioned AEC are:

- Regional integration of priority sectors that allow free movement of business persons, skilled labor and talents.
- Tariffs will be eliminated and non-tariff barriers will be gradually phased out.
- ASEAN investors will be free to invest in all sectors throughout the region.
- Simple, harmonized and standardized trade and customs requirements are expected to reduce transaction costs.

The following priority integration sectors are targeted to benefit from the single market and production base: agro-based products, air travel (air transport), automotive, e-ASEAN, electronics, fisheries, healthcare, rubber-based products, textiles and apparel, tourism, wood-based products, and logistic services.

Lessons from the European Economic Community (EEC) Experience

The diversity of cultures, religions, political systems and levels of development among the ten ASEAN nations do not deter the viability of the ASEAN Economic Community (AEC), much in the same way that there were “Euroskeptics” when the process of the European Union (EU) began in the middle of the last century.

Despite the almost insurmountable obstacles to the EU, evidence exists that by the end of the last century, the European Economic Community (EEC) as an economic union reached such a high level of economic development that it was able to challenge the two other world powers then – the U.S. and Japan – for economic supremacy. There is no question that the last century saw a “tripolar” world in the global economy. The amazing thing about this phenomenon was that the countries that waged the fiercest wars against one another in World War I and World War II overcame their animosity towards one another for the sake of the economic gains they foresaw in fostering closer economic relations.

In contrast, the ten member nations of the ASEAN have never been at war with one another in modern times. Most of them have common experiences of resisting imperial forces. With the exception of Singapore and Brunei, they generally face similar stages of economic development and, therefore, perceive the advantages of the economies of scale provided by a larger market reach. In the last ten years, their trade with one another has increased at a faster rate than their trade with the rest of the world. Despite the continuing dangers of a protectionist mindset among some of their leaders, there is a high probability that the AEC will become the third economic force in Asia that will challenge the economic supremacy of the two economic giants, China and India, in the so-called Asian Century.

ADB reports the AEC’s achievements to date², which are:

- Tariff reduction. More than 70 percent of intra-ASEAN trade is now tariff-free
- Trade facilitation. Live implementation of National Single Windows in Indonesia, Malaysia, the Philippines, Singapore and Thailand
- Investment liberalization. ASEAN-6 member states are near achieving international best practices, but newer member states need to catch-up

Needless to say, the AEC is a work in progress that may take at least twenty years to complete. It took more than twenty years for the EEC to be a real union and even now, there are some member states that are threatening to secede. On the optimistic side, the AEC as an economic union may be realized faster than the EEC because the ten member nations are realistic enough not to get sidetracked by any utopian vision of a political union (which has caused a lot of distractions in Europe). Because a political union is considered farfetched from the beginning, there will be no attempt to have a common fiscal policy and therefore, there is very little chance that AEC will try to evolve a common currency. To make a monetary union work, there must be first congruence in fiscal policies. This became very obvious during the recent Great Recession when the Euro experienced some turbulence.

The private business sector in ASEAN must undertake a formidable task: develop in the next ten to twenty years a new breed of leaders who will know how to capitalize on the opportunities of a larger regional market. To meet this challenge, they can learn from the experiences of the EEC.

Sowing the Seeds of Cooperation

On 12 January 2014, before an audience that included top Philippine business executives, Dr. Carlos Cavalle of IESE Business School in Barcelona, Spain, talked about “Developing Leaders for the Asian Century” in a CEO forum. Among the entrepreneurs and executives addressed by Dr. Cavalle were the pioneers in operating in the AEC.

It was pointed out in the open forum that the year 2015 (or more precisely the beginning of 2016) is only symbolic for the ASEAN Economic Community. Tariffs for most manufacturing goods have already fallen to near-zero levels within the ASEAN. Services, except for some professions like law and architecture, have been freely flowing from one country to another. There is largely unhampered movement of capital. For example, the Bangko Sentral ng Pilipinas (BSP) did not have to wait for 2015 to allow foreign equity to be invested in local banks.

On the other hand, the free flow of labor among AEC members will take time. It may be only for agricultural commodities such as sugar that 2015 has significant implications: sugar from Thailand and Malaysia may make many sugar-producing regions in the Philippines like Central Luzon and CALABARZON uncompetitive.

² Alfredo Perdiguero (n.d) The ASEAN Economic Community: Progress, Challenges and Opportunities. ADB Presentation.

The Services Sector as the Philippines' Competitive Advantage

It cannot be denied that the Philippines suffers a serious competitive disadvantage vis-à-vis countries such as Thailand, Malaysia and Indonesia in the agricultural and manufacturing sectors because of the Philippine government's negligence and failures in the past.

In services, however, the Philippines can capitalize on its young, growing and English-speaking population. Services can be as powerful an instrument to attain inclusive economic growth as manufacturing. Take, for example, the booming export-oriented business process and knowledge process outsourcing industry in the Philippines. It generates over one million well-paying jobs today and can employ as many as 1.5 million in 2016. In addition, its multiplier effects on real estate, retailing, food businesses and other consumer-oriented good and services are so visible, not only in Metro Manila, but also in other cities like Cebu, Davao, Bacolod, Cagayan de Oro, Dumaguete, Iloilo, Baguio, etc.

All over the ASEAN, the services sector is a major contributor to an expanding Gross Domestic Product (GDP). It accounts for anywhere from 40 to 60 percent of GDP. The exports of commercial services by the ASEAN have been expanding steadily, from US\$79 billion in 2003 to US\$219 billion in 2010. ASEAN's import of services has always been on a strong growth path: from US\$104 in 2003 to US\$229 in 2010. In recognition of the growing importance of intra-ASEAN integration in the services sector, the ASEAN Economic Ministers signed the ASEAN Framework Agreement on Services (AFAS) way back in 1995 in Bangkok, Thailand. The objectives of the AFAS are:

- Enhance cooperation in services among ASEAN Member States to improve the efficiency and competitiveness of ASEAN services industries, diversify production capacity and supply, and distribution of services;
- Eliminate substantial barriers to trade in services; and
- Liberalize trade in services by expanding the depth and scope of liberalization beyond those undertaken under the General Agreement on Trade in Services of the World Trade Organization (WTO).

Since the signing of the AFAS, ASEAN has concluded five rounds of negotiations resulting in eight packages of commitments under the AFAS. These include a wide range of services sectors under the purview of the ASEAN Economic Ministers (AEM), such as business and professional services, Since the signing of the AFAS,

ASEAN has concluded five rounds of negotiations resulting in eight packages of commitments under the AFAS. These include a wide range of services sectors under the purview of the ASEAN Economic Ministers (AEM), such as business and professional services, construction, distribution, education, environmental services, health care, maritime transport, telecommunications and tourism. These packages are implemented via Protocols signed by the AEM and provide details of liberalization of the services sub-sectors where commitments are made. In addition to these AFAS packages, there have also been four additional packages of financial services commitments signed by the ASEAN Finance Ministers and five additional packages for air transport services signed by the ASEAN Transport Ministers.

The 8th Package was the most ambitious set of commitments completed. Subject to a limited pre-agreed flexibility, the commitments were in line with the targets set under the AEC Blueprint, which include:

- Scheduling no restrictions for cross border supply and consumption abroad;
- Allowing for foreign equity participation of 51 percent or more; and
- Progressively removing other restrictions.

Mutual Recognition Arrangements (MRAs) have been concluded for engineering services, nursing services and agricultural services. In addition, there is an MRA on Tourism Professional that was adopted at the 12th Meeting of ASEAN Tourism Ministers in 2009. There have also been MRA agreements on medical practitioners, dental practitioners, accountants and architects.

The Philippine services sector has a distinct competitive advantage within the ASEAN because of the above-average quality of Filipino manpower. Ward Howell, a leading executive search firm in Southeast Asia, says that the advantages of Filipino talents are based on a high level of tertiary education (more than 500,000 university graduates every year and a stock of 3.2 licensed professionals); adaptable and multicultural workers; fluent in English and familiar with the culture of the biggest market in the world, the U.S.; low cost of labor (average monthly compensation of about US\$279); and labor peace (only 2 strikes in 2011 vs. 222 in China and 978 in Vietnam). Compared to Singapore, Malaysia and Thailand, the Philippines still has a young and growing population. Its median age is 23.1 while

Vietnam's is 28.1, Indonesia 28.5, Singapore 31.5, China 35.9 and Japan 45.4. There is no question that the Philippines can supply high quality professional manpower in such fields as accounting, health services, education, architecture and business process outsourcing to such labor-short ASEAN countries as Singapore, Malaysia and even Thailand that are already showing signs of rapid aging³.

It is highly unlikely that the ASEAN countries, especially Indonesia, Vietnam, Myanmar, Cambodia and Laos, will allow free movement of unskilled labor, even under the ASEAN Economic Community, considering the high rates of underemployment prevailing in these countries. Filipino service workers, however, have better prospects in the skilled labor market. Given the experiences of Indonesia and Vietnam, that have been open for some time now to Filipino professionals (especially in the management sector), it can be expected that as the AEC leans on more Mutual Recognition Agreements in the coming years, Filipino knowledge workers will be at the forefront of the free movement of professionals in management, accounting, health services, architecture, lawyers, engineers and agricultural experts, especially into Singapore, Malaysia and Thailand that are already suffering from manpower shortages. The area in which the Philippines is peerless is that of maritime workers. Filipino seafarers account for as much as 30 percent of the international manpower supply. These bright prospects for Philippine service workers should put pressure on the institutions of higher learning of the Philippines to increase the supply of highly qualified professionals in the coming years.

Conclusions

There is no such thing as decoupling of the AEC from the rest of the global economy. Although trade and investment relations among the AEC will definitely grow faster than with the rest of the world (e.g. Japan, U.S. and Europe), the individual economies in the AEC will continue to be important trade and investment partners with countries outside of their region.

The AEC may also discover major opportunities of linking with other emerging markets such as Brazil, Russia, South Africa, Nigeria, Turkey, India, Pakistan and Bangladesh. Needless to say, China will be a dominant market and source of foreign direct investments for the AEC, especially in the construction of vital infrastructure. The establishment of the China Infrastructure Bank augurs well for a big leap in infrastructure investments especially in such emerging markets as Vietnam, Indonesia, the Philippines and Myanmar.

As mentioned above, it will be the private sector that will take the lead in making the AEC happen. In fact, some

ASEAN member states are expected to retrogress by introducing ultranationalistic non-tariff barriers such as Indonesia and Malaysia are wont to do. This backtracking should not intimidate the private sector who should be creative enough to roll with the punches, so to speak, as the earlier ASEAN companies have already done.

It is important that the Philippines will have enough flexibility to compete with the other ASEAN countries in attracting FDIs which are completely indispensable in the aggressive infrastructure investment program that it will have to implement in the next ten to twenty years. The country needs to make these large investments to be able to catch up with its neighbors in the efficiency of physical infrastructures, such as airports, seaports, trains and highways.

It took more than twenty years for the European Economic Community to reach such high level economic development. The ASEAN Economic Community is no different. It will take time to implement and become deeply embedded in the fabric of its Community. Only with a pro-growth stance of all members of the ASEAN can accelerate the realization of the ASEAN Community Vision of 2025.



³ Mr. Jesus M. Zulueta, Jr. in his presentation *The Talent Advantage of the Philippines*, presented in the Philippine Investment Roadshow in the US, April 2013.



Reaping the fruits of labor mobility in the AEC

The ASEAN is well-positioned to become a production powerhouse with sophisticated production networks, growing regional trade, and a strategic location in important trading routes in the Asia Pacific. Set to form the ASEAN Economic Community (AEC), the ten countries aspire to be an integrated production hub by the end of 2015, promising greater efficiency for the supply chains that operate in the region and enhancing its attractiveness for investments. Indeed, there are many reasons for being optimistic of the region's potential production prowess. Most products are already being traded tariff-free, foreign direct investments are being welcomed with incentives, and transportation corridors are already being created for seamless connectivity and borderless transactions, ensuring that critical production inputs will be available at the right place, at the right time, and at the right price. But the vision will not be complete without taking into account a most critical resource:

people.

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In the Master Plan on ASEAN Connectivity, people-to-people connectivity was recognized as the glue that supports and anchors the efforts for physical connectivity and the regulatory and institutional reforms in the region. These constitute the region's efforts to realize a people-oriented ASEAN community, keeping in mind that the ASEAN people will be both agents and recipients of the economic benefits that the integration is expected to bring about. They are agents because their cultural diversity, shaped by different customs and beliefs, and enriched by investments in education, life-long learning and other initiatives for human resource development can provide the much needed impetus for new, creative and innovative business ideas that will only sprout if there will be greater interaction among them. They are also recipients because the collective effort to accelerate economic growth, enhance social progress and intensify cultural development can only lead to an improvement of their living standards. The vision is to ultimately make a connected ASEAN that will be a single community abounding with opportunities meant to enhance the well-being and livelihood of the ASEAN people. With this in mind, efforts for people-to-people connectivity focus on two main strategies: to promote deeper intra-ASEAN social and cultural interaction and understanding, and greater intra-ASEAN people mobility through progressive relaxation of visa requirements and

development of mutual recognition arrangements (MRAs). Creating an integrated ASEAN labor market out of an integrated ASEAN market is easier said than done. Labor issues have always been sensitive for many countries for several reasons. Prompted by nationalism or sometimes even by guild mentality, local labor authorities consider it their job to ensure that local employment opportunities are reserved for its own citizens. Some employers who have already encountered economic needs tests required by labor authorities may attest to this – they may have had to prove that local workers are not available in order to justify their need to hire a foreigner. The other side of the coin is the fear of local employers of losing precious talent who are looking for greener pastures abroad. The issue of a possible brain drain still looms in the mind of some. Mobility issues also transcend economic issues – security problems in light of transnational crime, cross-border terrorism and illegal migration, as well as socio-cultural issues such as health and assimilation. But despite the threats, it is not a question of whether labor mobility should be permitted or not – the pros outweigh the cons but ASEAN will have to take a more gradual approach in tackling the mobility of human resources in the region by first earning the support of the national governments and business sectors, and then preparing the educational systems in the member-countries.

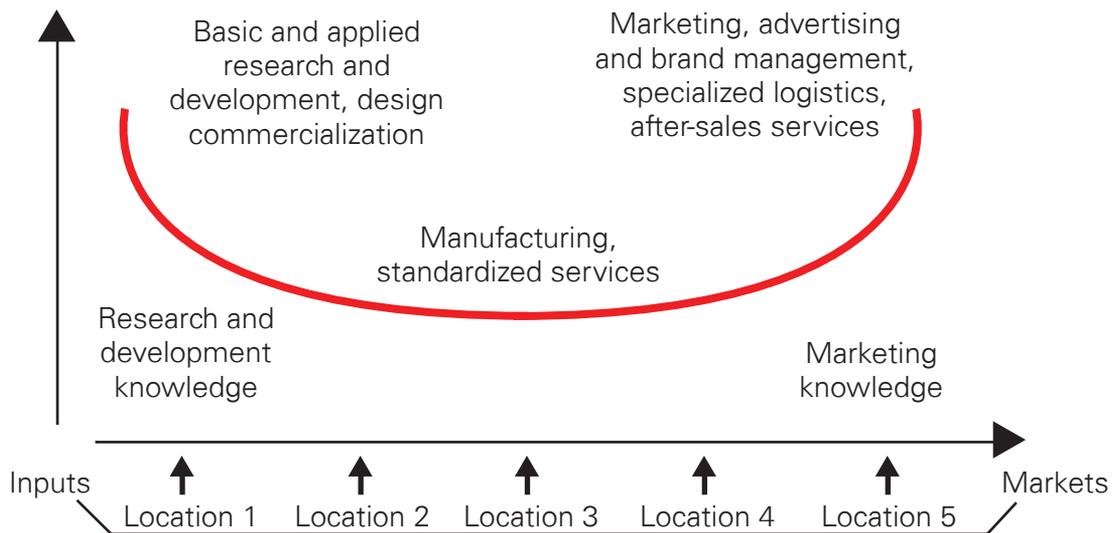
The ASEAN as a production hub: labor is part of the equation

Transforming ASEAN into a single market and production hub will be difficult unless it is oiled by the mobility of the people who will manage the free flow of goods, services and investments. To carry this out, the AEC blueprint includes, among its many elements, the free movement of skilled labor. Bringing down the barriers to labor market integration in ASEAN will not only benefit businesses in terms of a better and larger talent pool, but participating countries and the workers themselves stand to benefit as well. For host economies, labor migration helps boost growth and address labor shortages. The growth of countries sending workers abroad will also be spurred by financial remittances and possible knowledge transfers. The workers, on the other hand, will also gain higher wages and opportunities to acquire skills and experience.

The case for labor mobility in the AEC is strengthened by the participation of the ASEAN countries in complex international supply chains. The World Bank (WB), World Trade Organization (WTO) and Organisation for Economic Co-operation and Development (OECD) have pointed out that the formation of cross-border supply chains has been tantamount to a “trade-investment-services-know-how nexus”. Goods, services, investments and knowledge are now fully intertwined and inseparable in production. This means that for the efficiency of supply chains, not only should the barriers to goods trade be addressed, but also the barriers to the other components of the nexus, especially services. As cited in the IMF publication *Finance and Development*, for manufacturing firms in developing economies, simply providing services that connect their industries to global value chains is not enough. They also have to develop competitiveness in more skill-intensive activities along the value chain¹. The concept of the “smile curve” of value creation comes to mind, which categorizes manufacturing and standardized services such as transportation and communication as low value-added activities, while more sophisticated services such as research, development, design, marketing, advertising, brand management and other after-sales services are in the higher ends of the value chain. Initially, developing economies join the chain by starting with the low value-added tasks, and then eventually upgrading to the higher value-adding activities. Note that the services element in the higher value components (marketing, advertising, after sales services, etc.) have very strong ‘professional services’ flavor. The upshot on international trade in services is that ‘movement in natural persons’ will become an important policy issue.

Figure 1. Say cheese

The “smile” of value creation shows how companies break up the location of high-value-added and low-value-added activities.



Source: Mudambi, 2007 in Loungani and Mishra, 2014 (*Finance and Development*, IMF)

¹ Prakash Loungani and Saurabh Mishra, “Not your Father’s Service Sector,” *F&D Finance and Development*, IMF, June 2014

Statistically speaking, part of the domestic value-added in an exported product are the services used to produce it. Such services are considered “embodied” or “carried” by goods which are exported across borders. Proof of this could be found using the OECD-World Trade Organization (WTO) Trade in Value-Added (TiVA) database. Taking ASEAN as a whole, more than a third of the value-added in gross exports are services, with the highest exhibited by Singapore, the Philippines and Cambodia. Focusing on the manufacturing sector, the share of services in the value-added of ASEAN manufacturing exports increased between 1995 and 2009, except in Indonesia, Thailand and Vietnam.

Table 1. Services Industry Value-added Embodied in Gross Exports (as % of gross exports)

| | 1995 | 2000 | 2005 | 2008 | 2009 |
|----------------------|------------|------------|------------|------------|------------|
| Cambodia | 33% | 43% | 47% | 43% | 41% |
| Indonesia | 25% | 25% | 23% | 21% | 21% |
| Malaysia | 34% | 34% | 33% | 33% | 37% |
| Philippines | 45% | 35% | 37% | 42% | 44% |
| Singapore | 49% | 48% | 51% | 53% | 57% |
| Thailand | 36% | 36% | 33% | 32% | 30% |
| Vietnam | 39% | 34% | 31% | 29% | 27% |
| ASEAN average | 37% | 36% | 36% | 36% | 37% |

Source of Basic Data: OECD-WTO Trade in Value-Added (TiVA) database

Table 2. Services Value-Added in Manufacturing (as % of gross manufacturing exports)

| | 1995 | 2009 |
|----------------------|------------|------------|
| Brunei | 20% | 28% |
| Cambodia | 14% | 17% |
| Indonesia | 22% | 18% |
| Malaysia | 24% | 25% |
| Philippines | 26% | 32% |
| Singapore | 31% | 34% |
| Thailand | 26% | 23% |
| Vietnam | 35% | 28% |
| ASEAN Average | 25% | 26% |

Source of Basic Data: OECD-WTO Trade in Value-Added (TiVA) database

Bringing down the barriers to labor market integration in the ASEAN will not only benefit businesses in terms of a better and larger talent pool, but participating countries and the workers themselves stand to benefit as well.



The services value-added in manufacturing exports could be further segmented into foreign and domestic services. Interestingly, the share of domestic services in the services value-added in manufacturing exports decreased from 1995 to 2009 for most countries in the region, except the Philippines. This implies that as the participation of ASEAN countries in international supply chains deepens through time, the more they will use imported services as inputs in manufacturing their exports. However, in the case of the Philippines, it could also signal a potential upgrading in the value chain of its manufactured exports. Both cases say a lot about the need to keep the services trade in the region as open as possible, especially services that are delivered through the presence of people providing them. For instance, it might help to allow the mobility of skilled personnel, especially within companies that operate in more than one country in the region. This is where the issue of people-to-people connectivity in the AEC context becomes interesting as a policy question.

Table 3. Shares of Domestic and Foreign Services in the Services Value-added in Manufacturing Exports

| | 1995 | | 2009 | |
|----------------------|------------|------------|------------|------------|
| | Domestic | Foreign | Domestic | Foreign |
| Brunei | 78% | 22% | 72% | 28% |
| Cambodia | 65% | 35% | 44% | 56% |
| Indonesia | 71% | 29% | 64% | 36% |
| Malaysia | 40% | 60% | 35% | 65% |
| Philippines | 28% | 72% | 31% | 69% |
| Singapore | 40% | 60% | 30% | 70% |
| Thailand | 34% | 66% | 31% | 69% |
| Vietnam | 37% | 64% | 27% | 73% |
| ASEAN Average | 49% | 51% | 42% | 58% |

Source of Basic Data: OECD-WTO Trade in Value-Added (TiVA) database

What services are usually being used as inputs to manufacturing exports? A study by the Asia-Pacific Economic Cooperation (APEC) Policy Support Unit shows that business services, such as legal, accounting and engineering services as well as research and development services had the highest share in total services value-added in manufacturing exports in 2009 and had the fastest-growing indirect exports through manufacturing among APEC member-countries². For the Philippines, a 2013 study by the United Nations Conference on Trade and Development (UNCTAD) using 2010 data showed that in manufacturing semiconductors, which

comprise the largest share in Philippine goods exports, most of the domestic value-added from other industries come from services, particularly business services, real estate, and education and research³. Normally, business services require physical presence – the provider of the service has to be in the actual place where the service is to be rendered.

Ultimately, the AEC targets to become a production powerhouse not just to lower the costs of production but also to tap opportunities of upgrading to higher value-adding activities in the value chain. As the services needed in production become more sophisticated, knowledge-driven and skills-based, and therefore requires physical presence of the people providing them, channels through which they can apply their skills across borders must be kept open. The countries that will receive foreign workers may tend to reserve job opportunities for locals, but welcoming knowledge and innovation in a globalized world may mean opening up labor markets.



² Gloria Pasadilla and Andre Wirjo, "Services, Manufacturing and Productivity", Issues Paper No. 9, APEC Policy Support Unit, January 2015.

³ United Nations Conference on Trade and Development, "Global Value Chains: Trade and Investment for Development", World Investment Report, 2013.



How open is services trade in the ASEAN?

Labor and migration policies vary widely across ASEAN countries, but they have one thing in common: their restrictiveness. A policy brief by the Asia-Pacific Research and Training Network on Trade enumerated some of the restrictions imposed by ASEAN countries on the employment of foreigners. In Indonesia, foreigners must: hold only the positions that cannot be filled by locals; have at least five years' relevant work experience; be willing to eventually turn over the position to a local; and be able to communicate in Indonesian. In Cambodia, Thailand, Myanmar and Lao PDR, before an employer can hire a foreigner, there must be assurance that knowledge will be transferred to locals and that the position will eventually be taken over by a local. In the Philippines, the constitution does not allow foreigners to practice some professions like accountancy, medicine and engineering⁴.

While the targets in the AEC blueprint for goods trade in the region have largely been achieved, ASEAN's progress in freeing the service sector, including professional and business services, lags behind that of other trade blocs, as proven by the Service Trade Restrictiveness Index (STRI) of the World Bank. In general, the regional groupings that include more developed countries such as the European Union (EU), OECD, and Trans-Pacific Partnership (TPP) tend to have the most liberal services regulation regimes. The STRI quantifies the barriers to trade in services sectors in 103 countries. The higher the index, the more restrictive the regulatory regime. An important caveat is that the STRI does not include Singapore data in the ASEAN. Note that Singapore is relatively more liberal in terms of services liberalization, and its exclusion in the ASEAN index reveals the restrictiveness of other ASEAN members. In an ASEAN STRI that excludes Singapore, it is in the professional services, such as auditing and law practice, where ASEAN appears to be more restrictive compared to other services sectors and compared to the other trading blocs. Note that the STRI is an aggregate index for which restrictions in movements of natural persons is only one element.

Table 4. Services trade restrictiveness index per services sector, by regional grouping

| Regional Grouping | Banking Services | Insurance Services | Fixed-line Telecom Services | Mobile Telecom Services | Air Transport Service | Retail Distribution Services | Maritime Transport Service | Accounting and Auditing | Legal Service |
|-------------------|------------------|--------------------|-----------------------------|-------------------------|-----------------------|------------------------------|----------------------------|-------------------------|---------------|
| GCC | 47.78 | 60.00 | 75.00 | 50.00 | 48.50 | 45.00 | 17.00 | 43.00 | 62.32 |
| SAPTA | 39.24 | 36.32 | 50.00 | 40.00 | 57.76 | 30.00 | 33.75 | 52.50 | 66.16 |
| ASEAN | 36.90 | 31.67 | 37.50 | 37.50 | 30.63 | 33.33 | 37.08 | 61.67 | 68.48 |
| EAC | 30.16 | 20.68 | 25.00 | 35.00 | 54.76 | 15.00 | 0.00 | 38.00 | 52.84 |
| MERCOSUR | 28.90 | 24.66 | 30.00 | 20.00 | 38.76 | 5.00 | 8.13 | 36.67 | 46.00 |
| TPP | 27.81 | 26.39 | 30.56 | 27.78 | 25.84 | 11.11 | 27.22 | 37.00 | 48.52 |
| NAFTA | 17.97 | 21.13 | 33.33 | 25.00 | 21.27 | 0.00 | 35.83 | 38.33 | 50.83 |
| OECD | 6.84 | 12.30 | 12.07 | 11.21 | 26.21 | 7.76 | 16.15 | 42.24 | 48.37 |
| EU | 2.69 | 13.46 | 3.57 | 3.57 | 31.46 | 7.14 | 6.00 | 40.00 | 46.09 |

Source: Suave, 2013 Source of basic data: World Bank, <http://iresearch.worldbank.org/servicetrade/> Note: The regional groupings are as follows: GCC-Gulf Cooperation Council; SAPTA - South Asian Association for Regional Cooperation (SAARC) Preferential Trading Agreement; ASEAN - Association of Southeast Asian Nations; EAC - East African Countries; MERCOSUR - Mercado Comun del Sur or the customs union for Argentina, Brazil, Paraguay, and Uruguay; TPP - TransPacific Partnership; NAFTA - North American Free Trade Agreement; OECD - Organisation for Economic Co-operation and Development; EU - European Union

⁴ Sarah Huelser and Adam Heal, "Moving Freely? Labour Mobility in ASEAN"; Policy Brief no. 40, Asia-Pacific Research and Training Network on Trade, June 2014.



Within ASEAN, the relatively new members, Cambodia and Vietnam, have the lowest STRI because of the more relaxed policy measures of the two countries on FDI and maximum ownership. At a time when other Asian countries had restrictive and almost closed services sectors, Cambodia opened its retailing markets for FDI and imposed minimal restrictions on banking, telecommunications, maritime shipping, and accounting. Meanwhile, Vietnam does not have a nationality requirement for board directors in the services sector, while green field subsidiary and maximum ownership is allowed in the banking and insurance sectors⁵. The Philippines, on the other hand, has the highest STRI among all ASEAN members because of the key restrictions in the financial, telecommunications, retail, transportation, and in the professional services sector where the country scored a very high STRI of 80.

Table 5. Overall STRI, ASEAN, ASEAN+1, ASEAN+3, ASEAN+6, and TPP

| Country | Overall STRI |
|-------------|--------------|
| Cambodia | 23.70 |
| Indonesia | 50.00 |
| Malaysia | 46.10 |
| Philippines | 53.50 |
| Thailand | 48.00 |
| Vietnam | 41.50 |
| ASEAN | 43.80 |
| China | 36.60 |
| Australia | 20.20 |
| New Zealand | 11.00 |
| Japan | 23.40 |
| Korea | 23.10 |
| India | 65.70 |
| TPP | 25.05 |

Source: *Suave, 2013 Source of basic data: World Bank, <http://iresearch.worldbank.org/servicetrade/>*

Notes: ASEAN: Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Vietnam

ASEAN+1 refers to any of the following: ASEAN+China, ASEAN+Korea, ASEAN+India

ASEAN+3 refers to ASEAN countries, People's Republic of China, Japan, and Korea

ASEAN+6 refers to ASEAN+3 countries and Australia, New Zealand, and India

TPP includes Australia, Brunei, Canada, Chile, Japan, Singapore, Malaysia, Mexico, New Zealand, Peru, United States, Vietnam

⁵ Borchert, Gootiiz and Mattoo, "Policy Barriers to International Trade in Services: New Empirical Evidence", World Bank Policy Research Working Paper, 2012.

⁶ Guntur Sugiyarto and Dovelyn Rannevig Agunias, "A 'Freer' Flow of Skilled Labour within ASEAN: Aspirations, Opportunities and Challenges in 2015 and Beyond", Issue in Brief, International Organization of Migration and Migration Policy Institute, December 2014.

Table 6. Philippine STRI per sector

| Service Sector | STRI |
|--------------------|------|
| Financial | 45 |
| Telecommunications | 50 |
| Retail | 50 |
| Transportation | 44 |
| Professional | 80 |

Source: *Development Economics Research Group, World Bank, 2012, Trade Restrictions Database*

Aside from the political and regulatory setbacks of services liberalization, opening up professional services sectors poses a great challenge because of the complex system of dealing with stakeholders. According to the International Organization for Migration (IOM) for Asia and the Pacific and the Migration Policy Institute, occupational regulation is usually delegated by governments to subnational actors such as professional associations. To complicate further, some broad occupations such as engineering are further divided into several subfields where different training systems and standards exist and must be considered separately. These wide variations could sometimes hinder professional organizations from altering existing standards in order to welcome professionals from abroad. As a result, the extremely time-consuming and difficult process of applying for foreign workers' rights to practice in different countries has hampered the movement of skilled labor in the region. It was also cited that these tedious and cumbersome processes cause skilled migrants to be underemployed because their qualifications, experience and knowledge are not readily recognized in the destination countries⁶.

Movement of labor in the ASEAN: surpluses, shortfalls and imbalances

Despite the barriers keeping ASEAN nationals from practicing their professions in a different country in the region, there is still substantial labor migration. From a global standpoint, labor migration is already a reality for ASEAN countries, some of which are net senders of labor and the others net receivers of labor. The biggest net exporter of labor among the ASEAN members is the Philippines. This is hardly surprising given the worldwide presence of Overseas Filipino Workers (OFWs). It is followed by Vietnam, Indonesia, Myanmar, Lao PDR and Cambodia. The net importers of labor in the region, on the other hand, are Brunei, Thailand, Malaysia, and the largest net importer, Singapore.

Table 7. ASEAN Labor Migration in 2010

| Indicator (in millions) | Population | Labor Force | Outward Migration | Inward Migration | Net Migration Flow |
|-------------------------|----------------|----------------|-------------------|------------------|--------------------|
| Singapore | 5,184 | 2,632 | 297 | 1,967 | 1,670 |
| Malaysia | 28,251 | 12,250 | 1,481 | 2,358 | 876 |
| Thailand | 63,878 | 38,977 | 811 | 1,157 | 346 |
| Brunei | 414 | 202 | 24 | 148 | 124 |
| Cambodia | 14,953 | 8,050 | 350 | 336 | -15 |
| Lao PDR | 6,437 | 3,179 | 367 | 19 | -348 |
| Myanmar | 61,187 | 27,337 | 515 | 98 | -417 |
| Indonesia | 237,641 | 117,578 | 2,504 | 397 | -2,107 |
| Vietnam | 88,257 | 47,936 | 2,226 | 69 | -2,157 |
| Philippines | 94,010 | 39,639 | 4,276 | 435 | -3,840 |
| ASEAN | 600,212 | 297,780 | 10,626 | 6,915 | -3,710 |

Source: G. Capannelli, "Key Issues of Labor Mobility in ASEAN", Presentation during the 3rd Roundtable on Labor Migration in Asia, ADB Institute, January 2013

Note that the net exporters of labor in the ASEAN are also the countries with the largest workforce and the youngest median age. Measured in number of workers, the Philippines has the third largest workforce in the ASEAN as of 2010, next only to Indonesia, which also has the biggest population, and Vietnam. However, in terms of the share in total population, only 61.7 percent of all Filipinos are of working age. This ratio is still expected to grow as indicated by the median age of Filipinos in 2010 at 22.2 years old, one of the youngest in the region. Interestingly, Lao PDR and Cambodia, which are among the nations with the least income in the ASEAN, have young populations with median ages of 21.5 and 22.9 respectively. Conversely, Singapore and Thailand, two of the better performing ASEAN countries in terms of income, have higher median ages at 37.6 and 34.2, respectively.

Table 8. Working age Population in 2010

| Country | In Millions | % of Total Population | Median Age | Total land area (sq. km.) | GDP at current prices (million US\$) | GDP per capita at current prices (US\$) |
|-------------|-------------|-----------------------|------------|---------------------------|--------------------------------------|---|
| Brunei | 0.28 | 70.3 | 28.9 | 5,769 | 16,117.5 | 39,678.7 |
| Cambodia | 9.70 | 63.6 | 22.9 | 181,035 | 15,659.0 | 1,046.5 |
| Indonesia | 160.37 | 65.6 | 27.8 | 1,860,360 | 862,567.9 | 3,466.7 |
| Lao PDR | 3.85 | 60.4 | 21.5 | 236,800 | 10,002.0 | 1,505.4 |
| Malaysia | 20.12 | 68.3 | 26.0 | 330,290 | 311,676.0 | 10,407.2 |
| Myanmar | 44.25 | 69.5 | 28.2 | 676,577 | 56,408.0 | 916.1 |
| Philippines | 59.11 | 61.7 | 22.2 | 300,000 | 269,024.3 | 2,706.9 |
| Singapore | 3.99 | 73.8 | 37.6 | 715 | 297,945.8 | 55,183.3 |
| Thailand | 46.42 | 72.1 | 34.2 | 513,120 | 387,534.1 | 5,678.1 |
| Vietnam | 63.82 | 70.6 | 28.2 | 330,951 | 171,219.3 | 1,908.6 |

Source: International Monetary Fund Database, 2014. <http://data.imf.org/?sk=7CB6619C-CF87-48DC-9443-2973E161ABEB>

Labor migration within the ASEAN is already happening, albeit not as freely as planned and more so, in irregular conditions. In fact, 70 percent of migration in ASEAN is intra-regional, and 87 percent of intra-regional migration are unskilled labor⁷. Records show that in 2013, more than six million ASEAN citizens resided in other ASEAN member states. It is believed, however, that the actual number is larger. This regional movement of labor in the ASEAN

⁷ Aniceto Orbeta Jr., "Enhancing Labor Mobility in ASEAN: Focus on Lower-Skilled Workers", Discussion Paper, Philippine Institute for Development Studies, 2013.

may be due to income and demographics differences among the ASEAN countries. Workers migrate from poorer countries to richer countries, and from more populated countries to countries where the population is aging and dwindling. This is the case for Indonesians who move to Malaysia and Singapore and for Burmese and Cambodians who move to Thailand. In fact, data on intra-ASEAN migration in 2013 show that Thailand, Malaysia and Singapore received the most inward migration from their neighbors in the region. It could also be observed that currently, most intra-ASEAN migration is concentrated in just a few migration corridors. The flow of migrants from Myanmar to Thailand, Indonesia to Malaysia, Malaysia to Singapore, Lao PDR to Thailand, and Cambodia to Thailand already comprise 88 percent of total intra-ASEAN migrant stock.

Table 9. Intra-ASEAN Migrant Stock by Origin and Destination

| Origin | Brunei Darussalam | Cambodia | Indonesia | Lao People's Democratic Republic | Malaysia | Myanmar | Philippines | Singapore | Thailand | Vietnam | TOTAL ASEAN |
|--------------------|-------------------|----------------|------------------|----------------------------------|------------------|------------------|---------------|----------------|----------------|----------------|------------------|
| Destination | | | | | | | | | | | |
| Brunei Darussalam | | | 352 | | 643 | | 3,468 | 2,285 | 25,451 | | 32,199 |
| Cambodia | | | 108 | 265 | 175 | 53 | 156 | 125 | 31,472 | 37,225 | 69,579 |
| Indonesia | | | | | 1,979 | | 3,517 | 19,681 | 19,681 | | 44,858 |
| Lao PDR | | 1,201 | | | | 282 | | | 1,652 | 11,447 | 14,582 |
| Malaysia | 5,975 | 13,876 | 1,051,227 | | | 247,768 | 21,345 | 78,092 | 8,137 | 85,709 | 1,512,129 |
| Myanmar | | | | | | | | | | | 0 |
| Philippines | 82 | 40 | 3,325 | | 798 | 424 | | 825 | 342 | 416 | 6,252 |
| Singapore | | | 152,681 | | 1,044,994 | | 14,176 | | 17,644 | | 1,229,495 |
| Thailand | | 750,109 | 645 | 926,427 | 1,191 | 1,892,480 | 1,196 | 632 | | 5,966 | 3,578,646 |
| Vietnam | 121 | 2,485 | 7,671 | 4,284 | | 9,783 | 292 | 466 | 512 | | 25,614 |
| TOTAL ASEAN | 6,178 | 767,711 | 1,216,009 | 930,976 | 1,049,780 | 2,150,790 | 44,150 | 102,106 | 104,891 | 140,763 | 6,513,354 |

Source: United Nations, Department of Economic and Social Affairs, "Trends in International Migrant Stock: Migrants by Origin and Destination", 2013 Revision, (<http://www.un.org/en/development/desa/population/migration/data/estimates2/estimatesorigin.shtml>)

The concentration of intra-ASEAN labor migration in a few corridors means that there is much room to improve the balance of migrant flows, especially for skilled labor. Some studies have also shown the surpluses and shortfalls of some professional workers in ASEAN countries. Take for instance the case of medical workers. Most ASEAN countries lack physicians, nurses, midwives and pharmacists. The only ASEAN country with a surplus of all these types of medical workers is the Philippines. Singapore and Brunei have surpluses of physicians, nurses and midwives. Malaysia, which is an upper middle-income country, did not even meet the average number of physicians and pharmacists for lower middle-income countries⁸.

There are countries that may be rich in capital but are scarce in labor and vice-versa, so that the natural progression for them is to exchange capital and labor. The imbalances may only be compensated if the barriers that hinder the free flow of skilled labor are brought down.

Table 10. Medical Workforce in each ASEAN Country per 10,000 population in 2010

| Country | Physician | Nursing and Midwifery Personnel | Pharmaceutical Personnel |
|--|-----------|---------------------------------|--------------------------|
| Singapore | 15 | 44 | 3 |
| Philippines | 12 | 61 | 6 |
| Brunei Darussalam | 11 | 61 | 1 |
| Malaysia | 7 | 18 | 1 |
| Vietnam | 6 | 8 | 3 |
| Myanmar | 4 | 10 | less than 0.5 |
| Thailand | 3 | 14 | 1 |
| Lao PDR | 3 | 10 | n/a |
| Cambodia | 2 | 8 | less than 0.5 |
| Indonesia | 1 | 8 | less than 0.5 |
| Global average for lower middle-income countries | 9 | 15 | 4 |

Source: World Health Statistics, World Health Organization in Deunden Nikomborirak and Supunnadee Jitdumrong, "ASEAN Trade in Services", The ASEAN Economic Community A Work in Progress, Asian Development Bank and Institute for Southeast Asian Studies, 2014.

⁸ Deunden Nikomborirak and Supunnadee Jitdumrong, "ASEAN Trade in Services", The ASEAN Economic Community A Work in Progress, Asian Development Bank and Institute for Southeast Asian Studies, 2014.

In the case of unskilled labor, however, there are less chances of allowing free movement, considering the high rates of underemployment prevailing in some ASEAN countries like Indonesia, Vietnam, Myanmar, Cambodia and Lao PDR. Although the economic rationale for promoting the mobility of professionals is solid, there are, of course, policy challenges owing largely to political and economic factors.

Towards a 'Freer' Flow of Skilled Labor within ASEAN

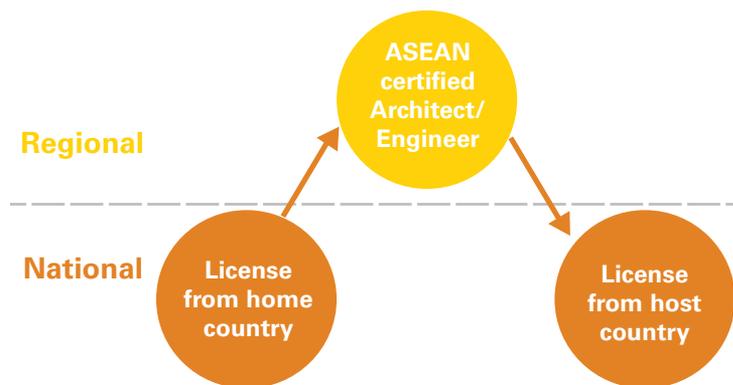
It has been commented that unlike the EU, Caribbean Community (CARICOM) and other regions where labor flows are unrestricted, ASEAN only aims to facilitate a "freer" flow through the issuance of temporary visas and the implementation of Mutual Recognition Agreements (MRAs) based on national and ASEAN Qualification Frameworks. Although both initiatives are still limited and can only do so much to allow professionals to work in another ASEAN country, these already serve as significant first steps in bringing down some of the barriers.

Through the ASEAN Agreement on the Movement of Natural Persons signed in 2012, ASEAN professionals and skilled workers may be issued with visas or employment passes to work in another ASEAN country temporarily. However, according to the commitments of the ASEAN member states in the AEC Blueprint, this privilege is only limited to those engaged in cross-border trade and investment-related activities. In other words, only business visitors, contractual service suppliers and intra-company transferees will benefit from streamlined and transparent procedures in applying for immigration formalities. The ASEAN Comprehensive Investment Agreement, with the goal of facilitating the flow of investments, also grants entry, temporary stay and work authorization to investors, executives, managers and board members of corporations with a substantial investment in another ASEAN country.

In the ASEAN Framework Agreement on Services (AFAS), ASEAN member states promised to come up with MRAs through which they could recognize the education or experience obtained, requirements met, or licenses or certifications granted in any ASEAN member state. ASEAN already started with signed MRAs in engineering, nursing, architecture, medicine, dentistry, tourism, surveying and accounting. However, for an ASEAN professional to be recognized as eligible for foreign practice, he or she still has to possess a qualification recognized by the local authority as well as a valid professional registration and current practicing certificate in both the home and host country. Minimum years of active practice was also set for some occupations: seven years for engineers and architects, five years for physicians and dentists, and three years for nurses.

The contents and implementation of each MRA vary. For example, in engineering and architecture, the MRA will harmonize standards and qualifications. This means that a licensed engineer or architect in an ASEAN country has to apply for eligibility as an ASEAN Chartered Professional Engineer (ACPE) or ASEAN Architect. The eligible person can then work as a Registered Foreign Professional Engineer (RFPE) in another ASEAN country. However, domestic rules and regulations still apply, and as already mentioned earlier, the laws in some ASEAN countries still have nationality or residency requirements. In this case, the certification from the ASEAN body only serves as a ticket to fast-track their application for a license abroad.

Figure 2. Registration of ASEAN Engineers and Architect according to MRAs



In the case of unskilled labor, however, there are less chances of allowing free movement, considering the high rates of underemployment prevailing in some ASEAN countries

In the Philippines, engineers may submit their applications as candidates for registration as ACPE to the ASEAN Monitoring Committee on Engineering Services of the Philippines (AMCESP), which is under the Professional Regulation Commission (PRC) and also includes representatives from the Commission on Higher Education (CHED) and Philippine Technological Council. There are also hopes for standardizing the salaries and fees as well as developing a Code for Technical Standards of engineering professionals across ASEAN. Currently, there are ACPE in five ASEAN countries, most of whom are Singaporeans. But for now, ASEAN countries still impose restrictions on non-residents working as professional engineers. In Thailand, ACPEs will only be recognized as “irregular” members of their local council of engineers. In Malaysia, the ACPE should have been staying in Malaysia for at least 180 days and his/her license has to be sponsored by the Malaysian company carrying out the project, with additional requirements such as an economic needs test to prove the unavailability of a domestic engineer fit for the job⁹.

In the case of ASEAN architects, the ASEAN Monitoring Committee on Architectural Services for the Philippines (AMCASP) is still undergoing consultations for their implementing rules and regulations, with the help of the United Architects of the Philippines (UAP). Eventually, the 14,000 registered Filipino architects could apply for registration as ASEAN Architects. So far, there are only 115 ASEAN Architects from Indonesia, Singapore and Malaysia¹⁰.

The MRAs for engineers and architects have progressed faster than the MRAs for the other professions. ASEAN governments have already accepted the fact that some local laws have to be amended in order to accommodate the provisions of MRAs. The Philippine PRC has also identified some issues that need to be re-examined in the light of the mobility of skilled labor. Naturally, with efforts to harmonize standards and qualifications, problems regarding the implementation of academic programs, competency testing, and certification system would arise. To address these, the Philippine government has been working on the Philippine Qualifications Framework which attempts to match industry needs with the students produced by the academe with the appropriate skill sets and qualifications that will be recognized here and abroad. In such a scenario, there will be additional pressure for academic institutions to provide quality education and training to young Filipinos so that their skills would meet ASEAN standards. This also means that professional

associations and accrediting organizations have a larger role to play because of their active involvement in facilitating the recognition of Filipino workers abroad.

Filipino workforce of the future: with brilliant minds and a strong sense of ASEAN culture

The end of 2015 marks a significant milestone for professionals and potential employers in the ASEAN community in its quest to form an integrated production hub. Because of the importance of some key services in international supply chains, especially business services, such as legal, accounting and engineering services as well as research and development services, various efforts have been taken to address the mobility of people in these professions and other occupations. Beyond the issuance of visas and employment passes, other opportunities for ASEAN professionals to practice in other countries are being worked out through harmonization of standards, qualifications and certification systems in the region. Although currently, the ASEAN is among the most restrictive trading blocs when it comes to services trade, especially in the case of professional services, a number of national government agencies and professional associations are already working double-time to fast-track the opening up of the labor market. However, barriers set by domestic laws still prevail. For instance, the Philippines is even considered more restrictive than our neighbors because of the limitations set by the constitution in some professions.

Despite the presence of some barriers, some Filipino professionals, especially high-skilled ones, still found opportunities to work in other ASEAN countries because of their valuable skills, insights and contributions to the business community. In terms of labor supply and demand, the numbers are already in our favor with a young population and a growing workforce; but what are the concrete steps to prepare young Filipinos to be ready for the future job market?

The industries in ASEAN countries are in the position to work their way up the value chains for both goods and services. As they upgrade in various value chains, the jobs that will be in demand are those requiring sophisticated knowledge and skills. It is in these fields that young Filipinos should be encouraged to enter and excel in. As predicted by Dr. Bernardo Villegas, a professor from the University of Asia and the Pacific, the sunrise industries will be agribusiness, telecommunications, transportation,

⁹ Ibid.

¹⁰ Professional Regulation Commission, “Prospects for Deeper Services Integration in the AEC”; Presentation, November 2013.



tourism, health care, infrastructures of all types, education, logistics, and the creative industries. Highly skilled engineers and scientists and other youngsters who are comfortable with mathematics and data analysis will also be needed in the so-called knowledge industries – IT and software, biotechnology and material sciences (the three areas that will define the technological breakthroughs in the twenty first century).

Aside from acquiring the knowledge and skills needed in the fields mentioned above, the young Filipino workforce also has to remember that opportunities are not limited to national companies anymore, their decisions on career prospects will already be influenced by regional demand. They also have to prepare in terms of soft skills because the decision to work in another ASEAN country means having to deal with people with a different set of beliefs and customs. Although learning other ASEAN languages may not really be necessary, learning more about the history and culture of other ASEAN countries could help.

Not only do future Filipino workers have to prepare, local employers and managers have their own share of challenges. Faced with a bigger talent pool, prospect employers may face information asymmetries in getting to know their applicants. In checking the skill set and capabilities of applicants, employers may rely a lot on the qualifications and certifications that will be granted by ASEAN-recognized professional associations and accrediting bodies. Also, to counter the possibility of losing talented Filipino professionals who plan to go abroad for higher wages in other ASEAN countries, employers may also have to offer better training

programs that could convince local talent to stay. Given the thrust to foster mobility of skilled labor, human resource strategy has to be oriented positively towards continuous training rather than advocacy in policy measures to restrict such movements. The rosy economic prospects of the Philippines and the increasing sophistication of the private sector would herald a buoyant labor market.

Managers may also have to adapt to a more diverse cultural mix among their subordinates which may require different leadership styles and ample knowledge of the culture in other ASEAN countries. Cultural growth has also been seen as an instrument for economic sustainability which makes it a great opportunity and responsibility for executives to take advantage of cultural diversity in the workplace.

There may be other ways for governments, academic institutions, business executives, managers and workers to prepare for a potential ASEAN labor market integration. The best advice would be to see it not as stumbling block but as a stimulus for economic growth as it provides a mechanism to balance the labor surpluses and shortages in the region and a channel for the innovations brought about by interactions among people from different cultures and traditions. Ultimately, the winners from this effort are the workers themselves who could earn higher wages and acquire more learnings through the experiences of working abroad. In which case, the ASEAN would have achieved its main target of becoming a people-oriented community where there is enhanced well-being among the citizens.



Addressing the implementation challenge of facilitation and connectivity

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The formation of the ASEAN Economic Community (AEC) envisions the ASEAN to no longer be a group of ten individual and fragmented markets but a single market and production hub with a market of more than 600 million people. For businesses, this means opportunities to scale up. For consumers, this means facing a wider variety of products at better prices. For the region as a whole, this means a more dynamic, competitive market place with a larger pool of resources such as raw materials and other inputs, services, capital, and human resources to draw from. To reap all these benefits, the ten member countries have to be as seamlessly connected as possible. But how will goods, services and investments flow freely across ten countries that are geographically separated, culturally and institutionally diverse, and economically different in terms of their levels of development? The answer lies in the Master Plan of ASEAN Connectivity (MPAC). With the goal of narrowing the development gaps between the member-countries and ensuring the ASEAN's place at the center of growth and development in Asia-Pacific, the MPAC is envisioned to reduce the costs of investment and international trade in goods and services to deepen and widen the production and distribution networks in the region.

Competition and cooperation in an era of production networks

The nature of international competition has evolved over time. More and more firms compete and cooperate simultaneously in international trade. They cooperate in the way they organize themselves in a production network or supply chain where each firm specializes in a particular part or component and compete to vie for more production activities in such networks.

Either way, the ability to produce goods at the lowest cost still remains the name of the game. What has changed is the way governments 'intervene' to steer business towards their national firms. Using tariff protection in order to shield local industries from international competition is no longer the preferred choice of trade instrument in this era of global production networks. In fact, the participation in production networks dictate that tariffs on the parts and components be kept relatively low or even zero to maintain low costs. If protection is 'out,' what sort of intervention is 'in'? The answer is trade facilitation.

Trade facilitation encompasses any measure that cuts down the costs of international transactions. Natural trade facilitation targets are in the simplification and harmonization of trade procedures. For instance, cooperation by

governments in minimizing the time to process traded goods can generate savings leading to lower costs of moving goods across borders. Another area where trade facilitation works is in enhancing the access of firms to trade-related infrastructure. One can be very efficient at the farm or factory level but if the trade-related infrastructure, such as ports are very poor, then the trade costs could nullify the production cost advantage. Thus, any policy that speeds up the connectivity across the entire supply chain could enhance a country's competitiveness leading to more trade volume as well as deeper participation in the international production networks. The role of trade facilitation is getting more pronounced in the region. It is increasingly evident that trade in the Asia Pacific region is anchored on the ability of nations to tap global production networks (GPNs) which calls for lower trade protection. Even closer to home, more than 60 percent of ASEAN's exports in 2011 is already in intermediate products, mostly products that are part of GPNs. It is also noted that a country's trade facilitation performance also stimulates inclusive growth within a country. Evidence on the contribution of effective trade facilitation to the enhancement of trade, GDP per capita, FDI flows and revenue also suggests that trade facilitation measures aid poverty reduction¹.

Trade facilitation in the ASEAN context

Fostering greater intra-regional trade already started with the formation of the ASEAN Free Trade Area (AFTA) in 1992 which implemented a Common Effective Preferential Tariff (CEPT) scheme for member-countries. The CEPT scheme allowed exports from ASEAN members to be more competitive than those from non-member countries, thereby increasing intra-regional trade and reducing dependence on extra-regional markets – a prospect that deserves some merit given the negative effects of the recent global financial crisis on ASEAN trade. To date, 99.65 percent of commodities, or about 50,000 products from ASEAN members are already duty free in Brunei, Indonesia, Malaysia, Philippines, Singapore and Thailand. The tariff reduction entails cost-competitiveness in GPNs, especially since trade within the ASEAN is more complementary than competitive.

Unfortunately, cutting tariffs may not be enough to spur intra-regional trade. Studies on trade costs

show that tariffs only account for less than 10 percent of overall trade costs in Asia². The non-tariff costs are even higher for agricultural commodities because of their perishable nature. There are also studies pointing out that for Indonesia, Malaysia, Philippines, and Thailand, the non-tariff costs of trading with their ASEAN partners are higher their partners outside the ASEAN, such as China, Japan and the United States³. These realities undermine the goal of the AEC to be an integrated production hub at the center of the Asia-Pacific region. Clearly, a pragmatic approach where policy is supported by measures to improve implementation is needed.

The weak links

Some of the factors driving up the costs of trade among ASEAN countries are the poor quality of transport infrastructure, inefficiencies in the customs clearance process, arranging shipment, tracking and tracing consignments and delivery schedules. These factors are compiled in the Logistics Performance Index (LPI) of the World Bank, which gives the scores and rankings of 160 countries in each of the said factors. According to the World Bank, a trade supply chain is only as strong as its weakest link. The wide differences in the LPI scores and rankings of the AEC members say a lot about why costs of trading, especially within the region, remain high. Two ASEAN countries, Singapore and Malaysia, made it to the top 30 out of 160 countries in 2014. Two other members, Lao PDR and Myanmar, are at the bottom 30. The Philippines ranked only 57th in the LPI, the lowest among the ASEAN-5 (Singapore, Malaysia, Thailand, Indonesia, Philippines), and even lower than Vietnam. This reflects the poor quality of the country's local infrastructure which could sometimes cause delays in the delivery of shipment.

A trade supply chain is only as strong as its weakest link. The wide differences in the LPI scores and rankings of the AEC members say a lot about why costs of trading, especially within the region, remain high

¹ United Nations, Economic and Social Commission on Asia and Pacific. "Asia Pacific Trade and Investment Report 2013: Trends on Trade Facilitation Performance." Bangkok: United Nations, 2013. (<http://www.unescap.org/tid/publication/aptir2668.asp>)

² Duval Yann and Chorthip Utoktham. "Trade Costs in Asia and the Pacific: Improved and Sectoral Estimates." Trade and Investment Division Staff Working Paper Series 05/11. Bangkok: ESCAP, 2011.

³ Ibid.

Table 1. LPI Scores and Rankings (aggregate and per criterion) for ASEAN and East Asian countries, 2014

| | LPI | | Customs | | Infrastructure | | Int'l Shipment | | Logistics quality and competence | | Tracking and tracing | | Timeliness | |
|-------------|------|-------|---------|-------|----------------|-------|----------------|-------|----------------------------------|-------|----------------------|-------|------------|-------|
| | Rank | Score | Rank | Score | Rank | Score | Rank | Score | Rank | Score | Rank | Score | Rank | Score |
| Singapore | 5 | 4.00 | 3 | 4.01 | 2 | 4.28 | 6 | 3.70 | 8 | 3.97 | 11 | 3.90 | 9 | 4.25 |
| Japan | 10 | 3.91 | 14 | 3.78 | 7 | 4.16 | 19 | 3.52 | 11 | 3.93 | 9 | 3.95 | 10 | 4.24 |
| Hong Kong | 11 | 3.77 | 17 | 3.72 | 14 | 3.97 | 14 | 3.58 | 13 | 3.81 | 13 | 3.87 | 18 | 4.06 |
| Taiwan | 19 | 3.72 | 21 | 3.55 | 24 | 3.64 | 5 | 3.71 | 25 | 3.60 | 17 | 3.79 | 25 | 4.02 |
| Korea | 21 | 3.67 | 24 | 3.47 | 18 | 3.79 | 28 | 3.44 | 21 | 3.66 | 21 | 3.69 | 28 | 4.00 |
| Malaysia | 25 | 3.59 | 27 | 3.37 | 26 | 3.56 | 10 | 3.64 | 32 | 3.47 | 23 | 3.58 | 31 | 3.92 |
| China | 28 | 3.53 | 38 | 3.21 | 23 | 3.67 | 22 | 3.50 | 35 | 3.46 | 29 | 3.50 | 36 | 3.87 |
| Thailand | 35 | 3.43 | 36 | 3.21 | 30 | 3.40 | 39 | 3.30 | 38 | 3.29 | 33 | 3.45 | 29 | 3.96 |
| Vietnam | 48 | 3.15 | 61 | 2.81 | 44 | 3.11 | 42 | 3.22 | 49 | 3.09 | 48 | 3.19 | 56 | 3.49 |
| Indonesia | 53 | 3.08 | 55 | 2.87 | 56 | 2.92 | 74 | 2.87 | 41 | 3.21 | 58 | 3.11 | 50 | 3.53 |
| Philippines | 57 | 3.00 | 47 | 3.00 | 75 | 2.60 | 35 | 3.33 | 61 | 2.93 | 64 | 3.00 | 90 | 3.07 |
| Cambodia | 83 | 2.74 | 71 | 2.67 | 79 | 2.58 | 78 | 2.83 | 89 | 2.67 | 71 | 2.92 | 129 | 2.75 |
| Lao | 131 | 2.39 | 100 | 2.45 | 128 | 2.21 | 120 | 2.50 | 129 | 2.31 | 146 | 2.20 | 137 | 2.65 |
| Myanmar | 145 | 2.25 | 150 | 1.97 | 137 | 2.14 | 151 | 2.14 | 156 | 2.07 | 130 | 2.36 | 117 | 2.83 |

Source: World Bank. Logistics Performance Index Global Rankings 2014. (<http://lpi.worldbank.org/international/global>)

Note: For each indicator, the highest possible score is 5. The overall LPI is a composite of all six factors determining logistics performance.

The World Bank also ranks countries according to the ease of trading across borders, considering the time and documents needed to export or import, as well as the equivalent cost. These data further reflect the gaps in trading within the AEC because of the differences between the member-countries in terms of documents required, time needed and costs incurred in trading. Within Indonesia alone, the cost to export and to import already differs between Jakarta and Surabaya. The Distance to Frontier (DTF) indicator is an index of how well a country performed relative to the top performer since 2005, which has a score of 100. The higher the score of a country, the better its performance. The rank and DTF of the Philippines was just at par with the ASEAN average. Singapore, being the top performer in 2014, had a DTF of almost 100. On the contrary, the CLMV economies (Cambodia, Lao PDR, Myanmar, Vietnam) scored lower than the ASEAN average. It takes longer and requires more documents to import than to export in all ASEAN countries. However, in Lao PDR, Myanmar, Singapore, and Vietnam, it costs higher to export than to import.

Table 2. Trading Across Borders Indicators for ASEAN Countries, 2014

| | Rank | Distance to Frontier | Documents to export (number) | Time to export (days) | Cost to export (US\$ per container) | Documents to import (number) | Time to import (days) | Cost to import (US\$ per container) |
|----------------------|-----------|----------------------|------------------------------|-----------------------|-------------------------------------|------------------------------|-----------------------|-------------------------------------|
| Brunei Darussalam | 46 | 80.87 | 5 | 19 | 705 | 5 | 15 | 770 |
| Cambodia | 124 | 65.92 | 8 | 22 | 795 | 9 | 24 | 930 |
| Indonesia | 62 | 77.46 | 4 | 17 | 572 | 8 | 26 | 647 |
| Indonesia - Jakarta | .. | 77.37 | 4 | 17 | 585 | 8 | 26 | 660 |
| Indonesia - Surabaya | .. | 77.77 | 4 | 17 | 525 | 8 | 26 | 600 |
| Lao PDR | 156 | 52.96 | 10 | 23 | 1,950 | 10 | 26 | 1,910 |
| Malaysia | 11 | 89.94 | 4 | 11 | 525 | 4 | 8 | 560 |
| Myanmar | 103 | 70.02 | 8 | 20 | 620 | 8 | 22 | 610 |
| Philippines | 65 | 77.23 | 6 | 15 | 755 | 7 | 15 | 915 |
| Singapore | 1 | 96.47 | 3 | 6 | 460 | 3 | 4 | 440 |
| Thailand | 36 | 83.57 | 5 | 14 | 595 | 5 | 13 | 760 |
| Vietnam | 75 | 75.56 | 5 | 21 | 610 | 8 | 21 | 600 |
| ASEAN average | 70 | 77.00 | 6 | 17 | 759 | 7 | 17 | 814 |

Source: World Bank. Doing Business Trading Across Borders Rankings 2014. (<http://www.doingbusiness.org/data/exploretopics/trading-across-borders>)

Note: The Distance to Frontier indicator is an index of how well a country performed relative to the top performer from 2005 until the present.

The top performer as a Distance to Frontier score of 100; the higher the score of a country, the better is its performance.

The logistics performance of ASEAN countries in 2014 could already be considered a large improvement from past years. It has been recognized that ASEAN countries have reduced trade costs by more than the global average from the 1990s-2003, the same time the AFTA started⁴. Between 2005 and 2010, the average time for completing trade procedures in the ASEAN decreased from 29 days to 21 days, with the most improvement exhibited by Cambodia, Lao PDR and Thailand. In the same way, the cost of completing trade procedures in the region was reduced by 9.7 percent, with the highest reductions in the Philippines, Thailand and Vietnam. Likewise, the DTF scores of all ASEAN countries improved between 2010 and 2015.

Table 3. Trade Facilitation Indicators in the ASEAN, 2005 and 2010

| Country | Time for Completing Trade Procedures (days) | | Change in the cost of completing trade procedures between 2005 and 2010 (%) |
|----------------------|---|-----------|---|
| | 2005 | 2010 | |
| Cambodia | 49 | 24 | -6.3 |
| Indonesia | 28 | 24 | 1.3 |
| Lao PDR | 72 | 49 | 13.7 |
| Malaysia | 16 | 16 | -0.1 |
| Philippines | 18 | 15 | -20.4 |
| Singapore | 4 | 5 | 3.7 |
| Thailand | 23 | 14 | -31.9 |
| Vietnam | 24 | 22 | -29.8 |
| ASEAN Average | 29 | 21 | -9.7 |

Source: UN-ESCAP, 2011 in Austria, M. "Non-Tariff Barriers: A Challenge to Achieving the ASEAN" in Basu Das, et. al., *The ASEAN Economic Community a Work in Progress*. Singapore: Institute of Southeast Asian Studies, 2013

Table 4. Distance to Frontier in Trading Across Borders from 2010 to 2015

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|----------------------|--------------|--------------|--------------|--------------|--------------|--------------|
| Brunei Darussalam | 77.66 | 76.90 | 80.26 | 81.14 | 81.02 | 80.87 |
| Cambodia | 61.23 | 65.31 | 65.49 | 65.50 | 65.87 | 65.92 |
| Indonesia | 74.91 | 75.71 | 76.13 | 77.58 | 78.01 | 77.46 |
| Indonesia - Jakarta | 74.91 | 75.71 | 76.13 | 77.58 | 77.90 | 77.37 |
| Indonesia - Surabaya | | | | | 78.42 | 77.77 |
| Lao PDR | 41.65 | 41.86 | 45.75 | 49.25 | 52.04 | 52.96 |
| Malaysia | 89.18 | 88.99 | 89.17 | 90.66 | 90.43 | 89.94 |
| Myanmar | | | | 63.09 | 63.22 | 70.02 |
| Philippines | 74.73 | 77.94 | 78.14 | 78.71 | 78.79 | 77.23 |
| Singapore | 96.62 | 96.69 | 96.70 | 96.72 | 96.76 | 96.47 |
| Thailand | 82.73 | 82.83 | 83.16 | 83.50 | 83.50 | 83.57 |
| Vietnam | 72.62 | 73.01 | 73.44 | 74.92 | 75.37 | 75.56 |
| ASEAN Average | 74.59 | 75.47 | 76.47 | 76.11 | 76.50 | 77.00 |

Source: *Doing Business Distance to Frontier 2014*, World Bank

(<http://www.doingbusiness.org/data/exploretopics/trading-across-borders/frontier>)

Note: The Distance to Frontier indicator is an index of how well a country performed relative to the top performer from 2005 until the present. The top performer as a Distance to Frontier score of 100; the higher the score of a country, the better is its performance.



⁴ Pomfret and Sourdin, 2009 in Marie Isabelle Pelland and Marn-Heong Wong. "Trade Facilitation in ASEAN and ASEAN+1 FTAs: An Analysis of Provisions and Progress" in Findlay, C. (ed.), *ASEAN+1 FTAs and Global Value Chains in East Asia*. ERIA Research Project Report 2010-29, Jakarta: ERIA.



Trade Costs Index

A complementary system for ranking countries in terms of ease of trading is trade cost. It has often been lamented, albeit anecdotally, that it is cheaper to ship a container van from the southern Philippine island of Mindanao to California than it is to ship one to Manila. This can be observed through the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) and the World Bank international trade costs database⁵. It provides a comparison of the intra- and inter- regional comprehensive trade costs in the Asia-Pacific region in 2006-2011. Intra-regional trade costs are costs incurred upon the trading of the members belonging to the same region. Inter-regional trade costs, on the other hand, are the costs of trading between one region and another. The table provides the regions in columns and their trading region partners in rows. It excludes tariff costs and thereby focuses only on the other trade related costs. It also puts the average percent change of the cost between 2000 to 2005 and 2006 to 2011 in parenthesis.

Using ASEAN-4 (Philippines, Thailand, Malaysia and Indonesia) as an example, the intra-regional cost of trade in the ASEAN region is 77 percent tariff equivalent while ASEAN-4's inter-regional trade costs with East Asia, North and Central Asia, Pacific Island Developing economies, SAARC-4, EU-3 and U.S. are 77 percent, 387 percent, 263 percent, 124 percent, 111 percent and 84 percent tariff equivalent, respectively.

To compare the magnitude of trade costs between regions, the database uses EU-3 (Germany, France and the United Kingdom) as a benchmark. The non-tariff related comprehensive trade cost of trading goods among the three largest European countries is estimated to be equivalent to 46 percent average tariff on tradable goods. East Asian economies Japan, China and Republic of Korea have the second lowest intra-regional trade cost averaging to 52 percent tariff-equivalent. This is followed by the ASEAN-4 with an average intra-regional trade cost of 77 percent tariff-equivalent in 2006 to 2011 due to reasonable trade facilitation among themselves. The Pacific Islands Developing Economies and the South Asian countries intra-regional trade costs are slightly more than double that of the European Union's (EU) while trade within the North and Central Asia has the highest cost of 141 percent tariff-equivalent.

Table 5. Intra and extra regional comprehensive trade costs in the Asia-Pacific region (excluding tariff costs), 2006-2011

| Region | ASEAN-4 | East Asia | North and Central Asia | Pacific Islands Developing Economies | SAARC-4 | EU-3 |
|--------------------------------------|-------------|--------------|------------------------|--------------------------------------|------------|-----------|
| ASEAN-4 | 77 (10) | | | | | |
| East Asia | 77 (8) | 52 (-8) | | | | |
| North and Central Asia | 387 (6) | 220 (-11) | 141 (0) | | | |
| Pacific Islands Developing Economies | 263 (31) | 268 (36) | 308 (17) | 107 (-31) | | |
| SAARC-4 | 124 (2) | 124 (2) | 270 (-10) | 342 (13) | 107 (4) | |
| EU-3 | 111 (8) | 86 (-4) | 166 (-3) | 327 (38) | 114 (7) | 46 (0) |
| United States (US) | 84 (13) | 63 (-1) | 189 (2) | 228 (19) | 107 (8) | 67 (1) |

Source: United Nations, Economic and Social Commission on Asia and Pacific. *Asia Pacific Trade and Investment Report 2013: Trends on Trade Facilitation Performance*. Bangkok: United Nations. (<http://www.unescap.org/tid/publication/aptir2668.asp>)

⁵ UN-ESCAP, 2013



Note that the gap between the effectiveness of the trade facilitation implementation among the countries in the Asia Pacific region makes the trade between two Asian regional groupings more costly than the trade between an Asian grouping and a non-Asian grouping. For instance, the cost of trade between the ASEAN-4 and North and Central Asia is about four times bigger than the trade costs between the ASEAN-4 and the U.S.

It has been expressed that a delay of one day in shipping a product translates to one percent reduction in trade volume⁶. This is only true if we consider non-tariff trade costs as marginal costs. Unfortunately, most non-tariff trade costs are actually fixed costs that exporters have to pay before they can even actually ship the goods. For example, establishing contact with shippers and freight handlers, accomplishing necessary documents, setting up a foreign distribution network, and complying with foreign technical regulations are all pre-trade processes that incur costs regardless of the value of good to be exported⁷. In which case, small and medium enterprises (SMEs) that can only ship small

quantities at a time due to the lower productivity of their operations will have less chances of gaining profit should they enter trade. Despite substantial tariff cuts, SMEs are still daunted by the non-tariff trade costs which act as a disincentive to exporting. Under these circumstances, trade facilitation initiatives can be most useful in encouraging SMEs to internationalize. For instance, if the number of days needed to export were at least reduced by half, SMEs may increase the share of exports in their total sales from 1.6 percent to 4.5 percent, based on the results from a study on the Asia-Pacific Economic Cooperation (APEC) economies. As described by the World Bank, removing unnecessary obstacles would encourage entrepreneurs to look beyond their own borders for business opportunities⁸.

The cost of trade between the ASEAN-4 and North and Central Asia is about four times bigger than the trade costs between the ASEAN-4 and the U.S.

⁶ Peng, 2008 in Pellán and Wong, 2011

⁷ Ben Shepherd and John Wilson. "Trade Facilitation in ASEAN Member Countries: Measuring Progress and Assessing Priorities". Policy Research Working Paper. The World Bank Group Trade Team, 2008.

⁸ World Bank. "Good Practices". Doing Business Trading Across Borders. 2014 (<http://www.doingbusiness.org/data/exploretopics/trading-across-borders/frontier>)

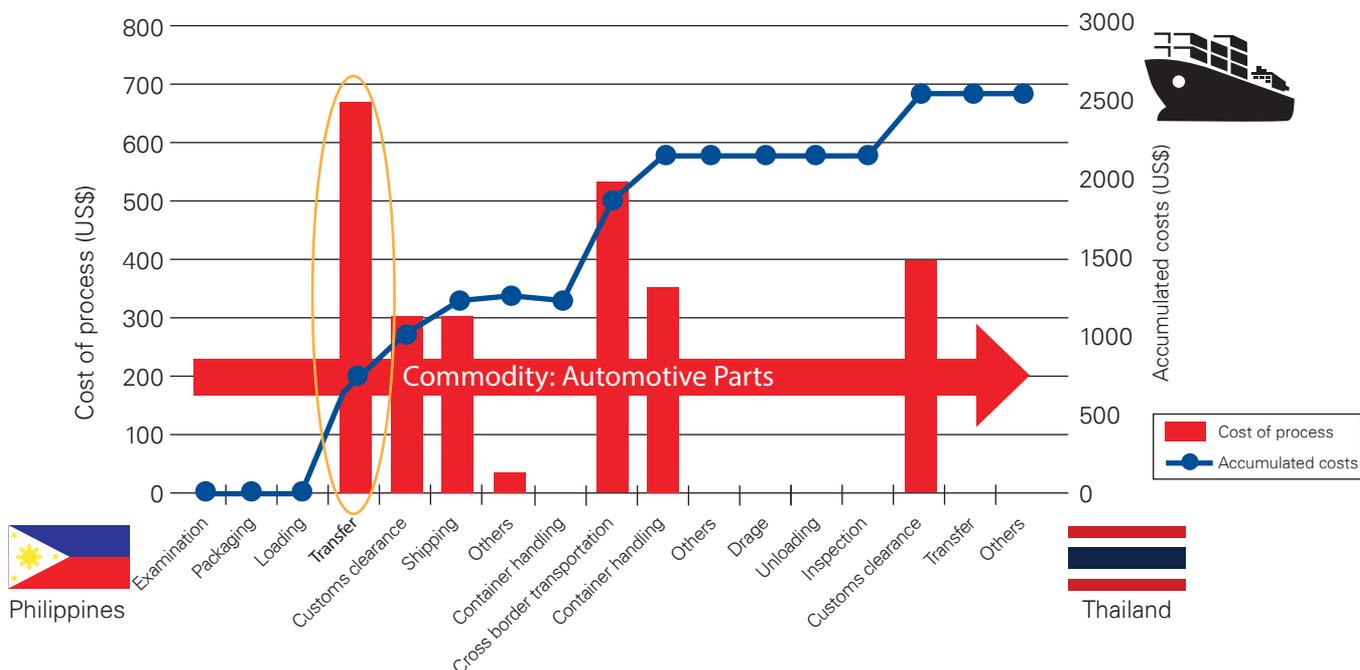
What it takes to be connected

Regional efforts to enhance connectivity are strong contributing factors in freeing up and increasing intra-regional trade flows, as proven by the experience of the EU and smaller trade blocs like the Baltic States, Scandinavian countries and the United Kingdom. The World Bank cited some of the effective connectivity programs that worked for these groups: the formation of Roll-On/Roll-Off (RORO) Networks and the standardization of Customs, Immigration, Quarantine and Security (CIQS). The former addresses lapses in physical infrastructure, while the latter addresses institutional barriers. This goes to show that the issue of connectivity is multi-faceted, which is why the member-states of the AEC focus on three areas: physical, institutional and people-to-people connectivity. To what extent could the AEC bring about greater physical and institutional connectivity? The following sections highlight some initiatives in these areas.

Enhanced Physical Infrastructure Development

Improving the ability to travel and trade across the region requires better quality infrastructure such as roads and seaports. As described above, despite the proximity of the ASEAN countries to each other, it could even cost higher to transport goods from one ASEAN country to another than to a country outside the region such as China, Japan or the U.S. In some cases, transporting goods within the country, like in the case of the Philippines, already accounts for significant costs. This was illustrated by the Japan External Trade Organization (JETRO) in their 2008 study⁹ on the Logistics Network on the ASEAN. It was described that in transporting automotive parts from the Philippines to Thailand by sea, the largest share comes from domestic transportation cost within the Philippines, although customs clearance also costs a lot in both countries. Conversely, a study¹⁰ done by the World Bank on Sub-Saharan Africa shows that a one-day reduction in inland travel time leads to a seven percent increase in exports. This critical importance of good connectivity in bringing down trade costs is not lost among ASEAN policymakers. The flagship infrastructure projects of the ASEAN are those that form part of the ASEAN Highway Network (AHN) and the ASEAN RORO Shipping Network because most goods are still traded via land and sea.

Figure 1. Transportation Cost of Automotive Parts from Philippines to Thailand by Sea



Source: Japan External Trade Organization (JETRO), "Current Status and Issues of Logistics Network in ASEAN". Presentation during the Workshop on Statistics of Asian Traffic and Transportation, March 2008.

⁹ JETRO, 2008 in ERIA Study Team, 'Current Status of ASEAN Transport Sector' in ASEAN Strategic Transport Plan 2011-2015, Jakarta: ASEAN Secretariat and ERIA, 2010.

¹⁰ World Bank in Pellán and Wong, 2011

ASEAN Highway Network

The ASEAN Highway Network forms part of the broader Trans-Asian Highway Network. The Trans-Asian Highway Network, a network of 141,000 kilometers of standardized roadways crisscrossing 32 Asian countries with linkages to Europe, is composed of 87 routes, 16 of which are in ASEAN (labelled AH11 to AH26), as designated by the Asian Land Transportation Infrastructure Development (ALTID) project of the UNESCAP. The highway linkages among ASEAN member-states depend on the number of neighboring borders and geographical location of each nation. To illustrate, Thailand is surrounded by four neighboring states (Cambodia, Lao PDR, Malaysia and Myanmar), so it has 13 routes that are directly connected to other ASEAN countries, the highest number in the ASEAN. In fact, although Lao PDR and Myanmar share a border, the only highway linking them still passes through Thailand. On the other hand, the Philippines has its own route (AH26) that does not directly connect to routes in other ASEAN countries because of its archipelagic nature.

Figure 2. Asian/ASEAN Highway Route Map



Source: ASEAN Logistics Network Map Study, JETRO, 2009 in ERIA, 2010

In the Philippines, signs that read "AH26" were already installed by the Department of Public Works and Highways (DPWH) in the roads that are part of the Trans-Asian Highway Network. The entire AH26 route is 3,517 kilometers long, stretching from Laoag City, Ilocos Norte in the north to Zamboanga City in the south and includes two main highways, EDSA and the Pan-Philippine Highway or Maharlika Highway, as well as two expressways, the North Luzon and South Luzon Expressways (NLEx and SLEx). Since the Philippines is archipelagic, AH26 also includes RORO ferry routes to close the gaps between smaller islands.

Table 6. Itinerary of AH26

| Route | From | To |
|----------------|--|--|
| Nothern Luzon | Maharlika Highway | Sta. Rita Exit of NLEX |
| Central Luzon | Sta. Rita Exit of NLEX | Balintawak Exit of NLEX |
| Metro Manila | Via Eastward route: C4 Road then Radial Road 10 then Roxas Boulevard | SLEX |
| | Via Westward route: EDSA | |
| Southern Luzon | Calamba Exit of SLEX | Maharlika Highway to Legazpi |
| Bicol to Samar | Via Ferry: Matnog, Sorsogon | Allen, Northern Samar |
| Leyte | Tacloban City segment of Daang Maharlika | Ormoc City segment of Daang Maharlika |
| | Via Ferry: Ormoc City | Cebu City |
| | Via Ferry: Liloan, Southern Leyte | Surigao City, Surigao del Norte |
| Mindanao | Surigao City segment of Daang Maharlika | Davao City segment of Daang Maharlika (via Cagayan-de-Oro) |
| | Davao City segment of Daang Maharlika | General Santos City segment of Daang Maharlika |
| | General Santos City segment of Daang Maharlika | Zamboanga City segment of Daang Maharlika |

Source: ERIA Study Team, 'Current Status of ASEAN Transport Sector' in ASEAN Strategic Transport Plan 2011-2015, 2010 and Michael Bueza, 2014 in <http://www.rappler.com/newsbreak/iq/74846-ah26-road-sign>

As these roads form part of a wider logistics network map in the region, it is of utmost importance that these roads be of high quality. In a presentation by DPWH Assistant Secretary for Planning and Private-Public Partnerships (PPP) Catalina Cabral last year, the surface conditions of roads that are part of the AH26 were given ratings of good, fair, poor, bad, and no rating. Majority of AH26 roads are already in good and fair conditions, but 17 percent are still in poor conditions, eight percent in bad conditions, and 10 percent without rating. In terms of surface type, more than 99 percent of the AH26 roads are already covered in concrete or asphalt; most of the remaining roads that are still made of gravel are in Mindanao, particularly the segment from General Santos City to Zamboanga City.

The business community is well advised to keep track of the different projects to improve connectivity in the region, for a number of reasons. First, to the extent that these projects integrate parts of the economy into the mainstream Philippine market, development is expected to flourish along these corridors. By linking different parts of the economy, these improved transportation networks will not only enable an enlargement of markets or make feasible the development of new sources of raw materials, but also lead to urbanization. Second, these plans also provide business opportunities especially in construction, construction materials, energy, housing, etc. Knowledge about the highway networks and road conditions in the ASEAN region and even within the Philippines help businessmen to come up with logistics plans for their businesses. It also helps to hear from the national governments their specific infrastructure projects because such information could also affect business decisions and solicit investments from the private sector, since most infrastructure projects are under the PPP scheme.

ASEAN RORO Shipping Network

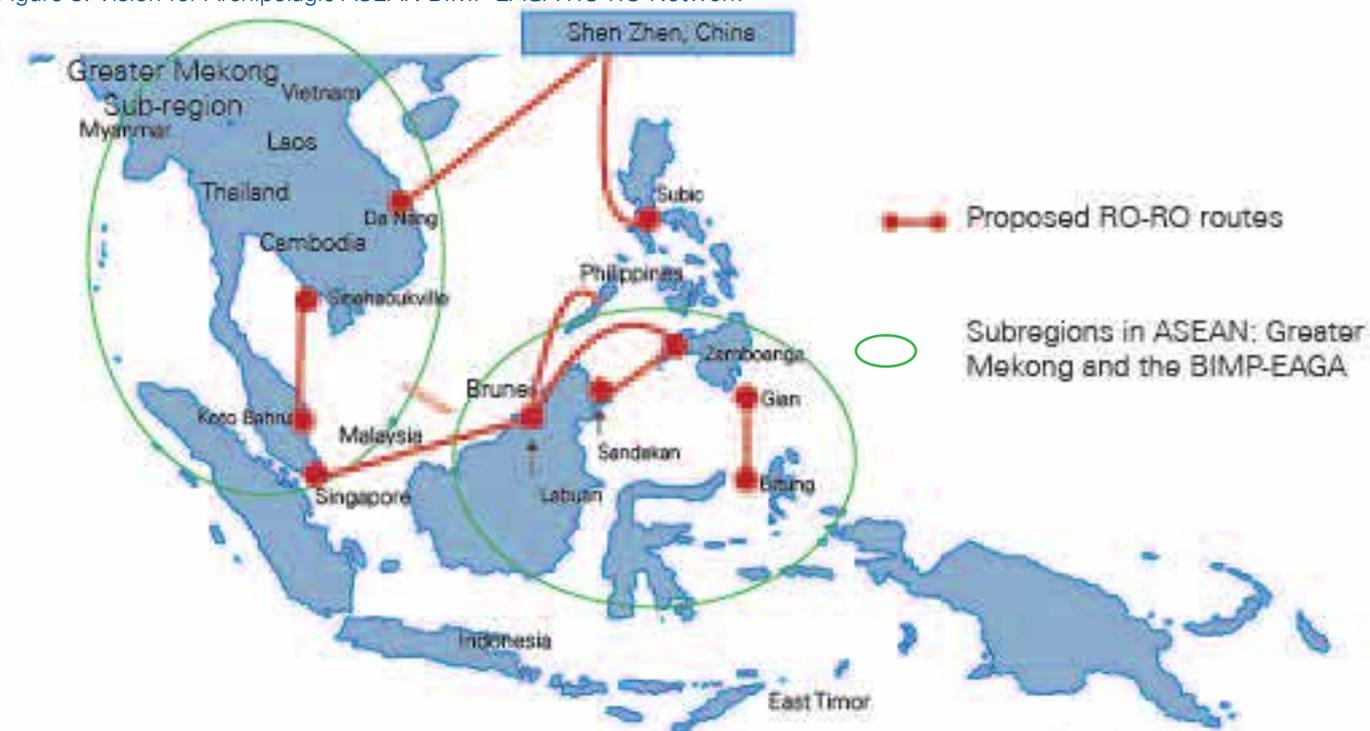
The highway networks increase connectivity within and across countries especially for ASEAN members that are part of mainland Asia. For the archipelagic countries, however, it is water transportation and seaport infrastructures that prove to be most crucial in increasing international trade activities. Since the ASEAN is home to two of the largest archipelagos in the world, namely, the Philippines and Indonesia, the RORO technology appears to be the best option, as it has already proven its impact on decentralizing trade flows in other parts of the world such as in Europe and in East Asia, where there are 21 RORO links connecting Japan, China and Korea. RORO is a mode of shipping wherein cargoes (cars, buses, trucks, chassis-mounted containers) do not require cranes for loading or off-loading because they can simply roll on or roll off the ship. The Philippine experience in implementing the RORO system was also proven effective as shipping costs were reduced by up to 40 percent through increased direct connections throughout the 7,000 scattered islands of the archipelago¹¹.

¹¹ Asia Foundation. "Philippines spearheads ASEAN effort to establish regional RO-RO transport network." In-Asia. 2010. (<http://asiafoundation.org/in-asia/2010/09/22/philippines-spearheads-asean-effort-to-establish-regional-ro-ro-sea-transport-network/>)



The Philippines and Indonesia took it as their responsibility to co-head the RORO Initiative in the region. It was also included in the 15 ASEAN Flagship (Priority) projects for 2011 to 2015. It is interesting to note that the transportation initiative in shipping, which involves the Philippines, is related to the subregional cooperation such as the Brunei-Indonesia-Malaysia-Philippines East Asia Growth Area (BIMP-EAGA). To the extent that deepening the transportation links can help bring about commercial progress, they can play a role in narrowing the developmental gaps between Mindanao and the rest of the Philippines. The first designated ASEAN RORO route connects Davao City and General Santos City to Bitung in Northern Indonesia. This route was supposed to be launched last December of 2014, but it was postponed due to the elections in Indonesia¹². The second ASEAN RORO route, on the other hand, which is expected to be launched this year, will connect the Batangas City port to Humen town in China and Danang City in Vietnam¹³.

Figure 3. Vision for Archipelagic ASEAN BIMP-EAGA RO-RO Network



Source: The Asia Foundation, "Roll-on Roll-off Transport: Connecting Maritime Southeast Asia" November 2010

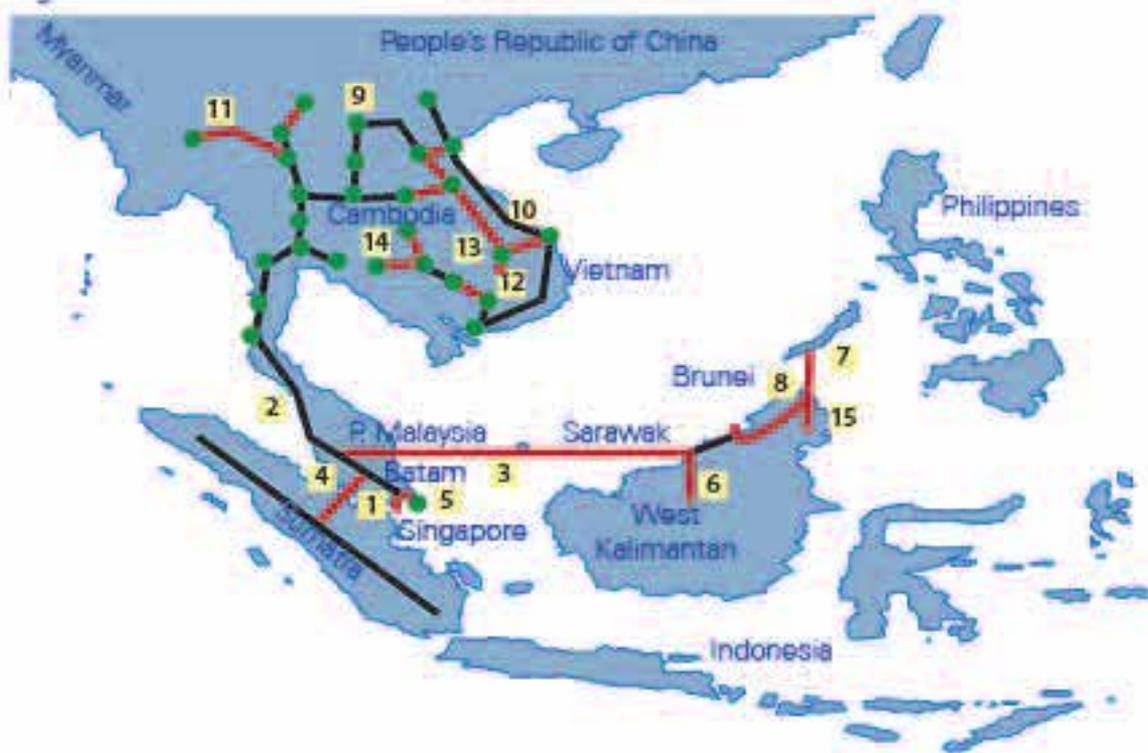
¹² Manila Bulletin. "ASEAN RO-RO project to benefit SEA countries with low shipping cost. February 2015. (<http://www.mb.com.ph/asean-ro-ro-project-to-benefit-sea-countries-with-low-shipping-cost/#rgv1PRGprVfiEOOL.99>)

¹³ Philippine Daily Inquirer. "Ph to lead ASEAN-wide RO-RO connectivity. September 2013. (<http://business.inquirer.net/144605/ph-to-lead-asean-wide-ro-ro-connectivity#ixzz3bPdubu0>)

ASEAN Power Grid

Another channel of connectivity is in energy, more particularly electricity. Findings from the World Bank Enterprise Survey¹⁴ for 135 economies show that electricity connection serves as the second biggest obstacle to doing business and that power outages could lead to losses amounting to an average of 5.1 percent of annual sales. Securing power supply has also been a challenge for many economies in recent years, including the Philippines. Aiming for faster economic growth does translate to higher electricity consumption, which is why the ASEAN also took the initiative of integrating the power grids of its member-countries to ensure reliable supply of electricity in the region. The ASEAN Power Grid (APG) consists of 15 interconnection projects through which up to 3,000 MW of energy will be traded across borders. However, most of the projects are in Indochina, Indonesia and Malaysia. Only one project involves the Philippines, and is still slated at the tail end, scheduled to begin in 2020. The APG interconnection projects would have helped solve issues regarding power shortages in some ASEAN countries like the Philippines. However, the implementation is taking longer than planned. While the Heads of ASEAN Power Utilities Authorities (HAPUA) found the projects technically feasible, financing the undersea cable interconnections and inland interconnections especially those connected to the grids of the CLMV economies remains a challenge.

Figure 4. Status of the APG Network



| | Earliest COD | | | |
|----------------------------|----------------|------------------------------|------------|----------------------------------|
| 1) P. Malaysia - Singapore | Existing | 6) Sarawak - West Kalimantan | 2013 | 10) Lao PDR - Vietnam |
| 2) Thailand - P. Malaysia | | 7) Philippines - Sabah | 2020 | 11) Thailand - Myanmar |
| • Sadao - Bukit Keteri | Existing | 8) Sarawak - Sabah - Brunei | | 12) Vietnam - Cambodia |
| • Khlong Ngae - Gurun | Existing | Sarawak - Sabah | 2020 | 13) Lao PDR - Cambodia |
| • Kolok - Ranatau Panjang | Newly Proposed | Sabah Brunei | MOU Signed | 14) Thailand - Cambodia |
| 3) Sarawak - P. Malaysia | 2015/16 | Sarawak - Brunei | 2012 | 15) East Sabah - East Kalimantan |
| 4) P. Malaysia - Sumatra | 2015 | 9) Thailand - Lao PDR | | |
| 5) Batam - Singapore | 2015 | • Roi Et - Nam Theun 2 | 2009 | |
| | | • Udon - Nabong | 2011 | |
| | | • Mae Moh - Nan - Hong Sa | 2015 | |

Source: HAPUA Report to 28th Senior Officials Meeting on Energy, 2010 in the Master Plan of ASEAN Connectivity, ASEAN Secretariat

¹⁴ World Bank. "Why it Matters": Doing Business Getting Electricity. 2014. (<http://www.doingbusiness.org/data/exploretopics/getting-electricity/why-matters>)

Effective institutional arrangements

Institutional connectivity highlights the soft infrastructure, or the policies and other reforms that have to be in place to complement the hard infrastructure. Unnecessary and burdensome regulations could lead to higher transaction costs that could compromise the competitiveness of a country. As proven by the experience of the EU, creating a single market would not have been successful if not for the regional harmonization of regulations in order to lessen the difficulties firms face in structuring their business across multiple countries as well as to reduce uncertainty and operating costs¹⁵. A survey of 171 companies by The Economist Intelligence Unit also found that ASEAN firms consider the differences in business laws and regulations, such as industry standards across the ASEAN, serve as their number one issue in applying a regional sales strategy¹⁶.

Aside from the importance of the harmonization of regulations in the creation of a single market, the greatest beneficiary of institutional reforms are the small and medium enterprises (SMEs), the so-called backbone of developing economies. SMEs are found to be less responsive to improvement in transportation infrastructure than large enterprises but are rather more affected by increasing regulatory predictability, based on the results from a survey of 14,862 firms in ten East and Southeast Asian countries and four South Asian countries from 2002 to 2006¹⁷. This means that SMEs benefit more from the “soft” part of trade facilitation, which includes increased predictability of rules, regulations, and procedures. To address this, the ASEAN Trade Facilitation Programme highlights the need to reform customs, create an ASEAN Single Window and ASEAN Trade Repository, as well as harmonize standards, technical regulations and conformity assessment procedures.

Customs modernization

Customs regulates trade at the border and is the prime implementing agency of governments when it comes to trade in goods. It hardly needs saying that an inefficient customs agency could affect the commercial viability of trade transactions. According to the World Bank, the most efficient economies in terms of trading environment are those that allow their traders to exchange information with customs and other control agencies electronically, as this mechanism improves timeliness. Indeed, electronic systems for filing, transferring, and processing and exchanging customs information do not just help reduce customs clearance times, but also serve as a tool for managing flows of information in complex trading systems. Free access to such systems could even mean addressing information asymmetry by promoting greater transparency,

thereby reducing commercial risks and enhancing trading activity. Some advanced systems even allow traders to submit documents and to pay duties online from anywhere in the world. If implemented effectively, electronic systems for customs can also limit direct interactions with officials which reduces opportunities for corruption¹⁸.

The experiences of other regional communities have also shown how the harmonization of customs procedures and electronic data interchange systems fosters regional integration initiatives. In Central America, nine economies were able to harmonize their procedures in a single document that would manage the movement of goods across the region. This translated to a 90 percent reduction in clearance times for goods in transit at some border locations. In the AEC, accelerating the modernization of customs techniques and procedures is envisioned by implementing a harmonized tariff nomenclature, developing a common ASEAN Customs Valuation Guide, ASEAN Customs Post Clearance Audit Manual and ASEAN Cargo Processing Model, and activating the ASEAN Customs Transit System all with the goal of releasing any containerized shipment within no more than 30 minutes.

The ASEAN's efforts for modernizing customs lie on the ability of the member countries to adapt their regulatory frameworks to advances in information technology applications. In the Philippines, customs modernization is consistent with the government's policy to eradicate corruption by eliminating face-to-face transactions through institutionalized electronic systems¹⁹. This started in 2005 with the Electronic-to-Mobile (e2m) Customs Project which facilitates end-to-end cargo clearance process through mobile broadcasting and internet. The Bureau of Customs (BoC) and the Philippine Economic Zone Authority (PEZA) also developed the Automated Import Cargo Transfer System, Electronic Import Permit System, and the One-Stop Export Documentation Center (OSED) which helped reduce clearing time and lowered the costs by 50 percent to 70 percent, as traders no longer have to pay overtime charges and filing fees. The World Bank also recognized the Philippines' efforts in upgrading the risk-based inspection system and in adding the electronic payments function and online submission of declarations. As of 2012, e-customs has already been implemented in major seaports and airports. Among basic customs operations, 80 percent are already electronic, catering to 95 percent of imports, 25 percent of exports and 75 percent of all firms²⁰. It is expected that at the end of this year, all seaports and airports will already have e-customs facilities.

¹⁵ The Economist. “Trade Bloc or Trade Block?” ASEAN Insight, 2015. (<http://aseaninsight.economist.com/2015/04/06/trade-bloc-or-trade-block/>)

¹⁶ The Economist. “Barriers to a Regional Sales Strategy.” ASEAN Insight, 2015. (<http://aseaninsight.economist.com/2015/03/09/barriers-to-a-regional-sales-strategy/>)

¹⁷ Li and Wilson, 2009 in Krista Joosep. “Trade Facilitation as a Means to Improve SME Competitiveness and Consumer Welfare in Developing and Least-Developed Countries.” Briefing Paper, Geneva: CUTS International, 2014.

¹⁸ World Bank, “Good Practices”; Doing Business Trading Across Borders.

¹⁹ Ray Butch Gamboa. “Modernization of the Bureau of Customs – a must.” Business Leisure. PhilStar, 2014.

(<http://www.philstar.com/business/2014/11/22/1394347/modernization-bureau-customs-must>)

²⁰ Erlinda Medalla. “Managing the ASEAN Economic Integration Process in the Philippines: An Assessment of Progress in Trade Liberalization and Facilitation.” Discussion Paper Series. Makati City: Philippine Institute of Development Studies, 2012.

Other initiatives that are in their early stages are the development of the Customs Transit System and facilities in BIMP-EAGA border crossings. A one-stop shop for CIQS was also in the pipeline although this was met with much resistance because unlike its counterpart for exports, import customs have been associated with more revenues. Nonetheless, former Customs Commissioner John Phillip Sevilla promised to reduce the time to complete customs procedures to four hours, a lofty promise to be fulfilled by current Commissioner Alberto Lina by continuing the reforms started by his predecessor. Although this is longer than the more ambitious AEC target of shortening the time to only 30 minutes, this is already a huge leap from the current 10-15 days needed to complete customs procedures. All these programs that are aimed at reforming customs are consolidated in the proposed Customs Modernization and Tariff Act, some provisions of which are listed in the box below. The proposed bill is already being reviewed in the Congress and Senate, and is much supported by the Department of Finance (DOF)²¹.

The proposed Customs Modernization and Tariff Act will:

- Mandate the use of Information Communications Technology (ICT) to enhance customs operations and enforcement
- Provide a de minimis value of PhP 5,000, below which no duties and taxes shall be collected.
- Exempt relief consignments from duties and taxes and enable a simplified customs procedure for efficient release of goods when there is a declaration of a state of calamity
- Adopt the principle of an Authorized Economic Operator (AEO) as drafted by the World Customs Organization. An AEO refers to importers, exporters, customs brokers, forwarders, and other entities duly accredited by the bureau based on international standards and various national best practices, and which are entitled to minimal requirements for processing of goods.
- Recognize the use of self-certification system in determining the applicable rules of origin.
- Strengthen the Customs' risk management system. For example, incentives such as the deferred payment of duties and taxes may be granted to highly compliant and low risk importers and exporters.
- Redefine the concept of abandonment where only expressly abandoned goods are deemed property of the government.
- Give the Customs the option to donate the abandoned goods to another government agency, declare the same for official use of the bureau or to dispose of the goods through a public sale. This gives the bureau an option to donate the goods or declare the same for official use even before public auction, which is a limitation in the present law.
- Increase the amount of fines and penalties for violation of the provisions of the bill since the current fines and penalties in the Tariff and Customs Code of the Philippines are outdated.
- Consider unlawful importation and exportation as a heinous crime if the appraised value of the good unlawfully imported, including duties and taxes, exceeds PhP 50,000,000.

Source: Chino Leyco. "DOF urges Congress to pass Customs modernization act". *Manila Bulletin*, 2015. (<http://www.mb.com.ph/dof-urges-congress-to-pass-customs-modernization-act/>)

Self-certification in Rules of Origin (ROO)

Preferential tariff arrangements in the AEC go hand in hand with agreements on the rules of origin (ROO). The rationale of the ROO is to provide a way of verifying that traded goods truly originate from beneficiary countries. Despite the granting of tariff preferences, the Philippine Department of Trade and Industry (DTI) found that in 2010, only 40 percent of Philippine companies take advantage of tariff cuts. One reason for the non-availment of the tariff cuts can be traced to the cumbersome process of applying for the Certificate of Origin (CO)²².

To increase the utilization of trade preferences, the ASEAN took the initiative of developing mechanisms that will streamline certification procedures. One such mechanism is a self-certification arrangement. By allowing "Certified Exporters" to self-declare that their products have satisfied the ASEAN origin criteria by simply affixing a declaration on the commercial invoice, this system simplifies the certification procedure. Before the self-certification

system could be implemented ASEAN-wide, two pilot projects were launched to acquire knowledge and practical experience of the mechanism. The first pilot project was done in Brunei Darussalam, Malaysia and Singapore; the second pilot project includes the Philippines, Indonesia and Lao PDR. In the Philippines, the self-certification project was officially started when the President signed the Executive Order No. 142 on 14 October 2013 and when the Bureau of Customs issued the CAO No. 06-2013 and CMO 02-2014, which provides the operational procedure in the processing of documents under this system and the guidelines for the accreditation of exporters/manufacturers (see box).

Despite the granting of tariff preferences, the Department of Trade and Industry (DTI) found that in 2010, only 40 percent of Philippine companies take advantage of tariff cuts.

²¹ Gamboa, 2014

²² Emmanuel Alcantara. "AEC 2015 Prospects: Qualifying for FTA Tariffs." *Business World*, 2014.

Figure 5. Becoming a Certified Exporter of the Bureau of Customs

Benefits

- Reduced compliance of exporters and administrative cost associated with Certificate of Origin (CO) application
- Facilitated release of shipments availing of preferential tariff under the ASEAN Trade in Goods Agreement (ATIGA)

How to apply

- Apply in writing with the Office of the Deputy Commissioner, Assessment and Operations Coordination Group (AOCG), attn.: Self Certification Implementation and Monitoring Secretariat (SCIMS). The application shall then be reviewed and deliberated upon by SCIMS.

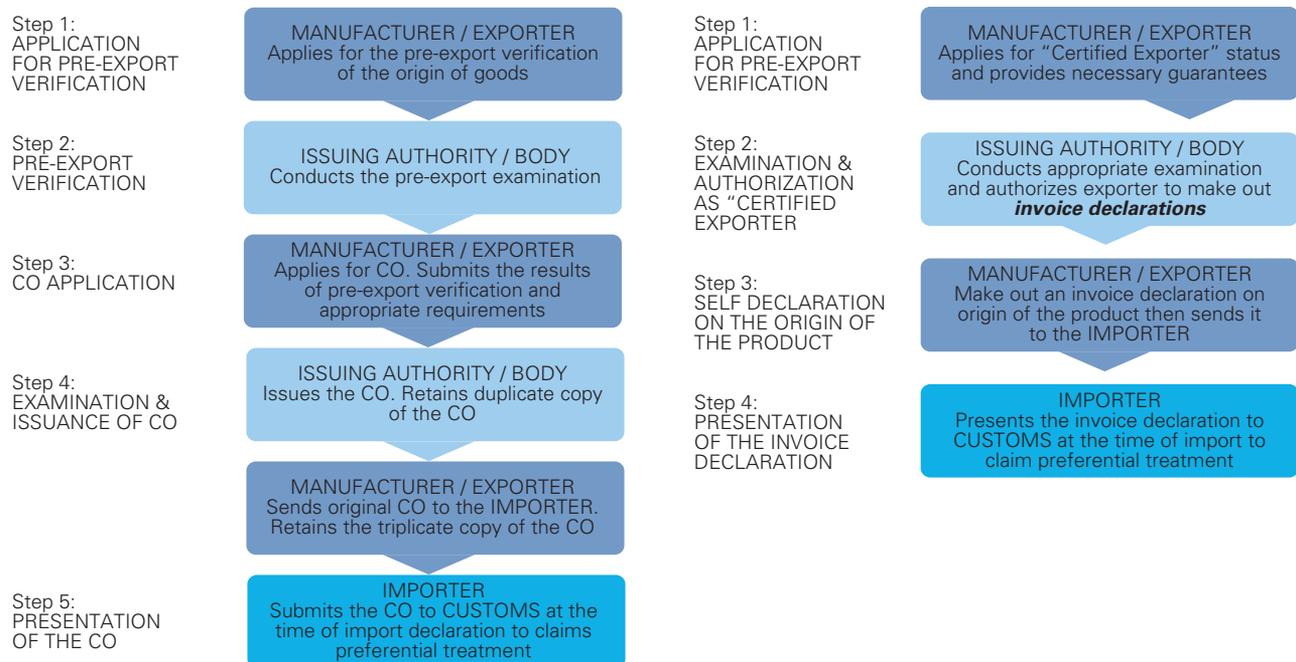
Requirements (to be submitted with the letter of application):

- Latest income tax returns
- Unique Reference Number (URN) for PEZA locators and BOC-CPRS for non-PEZA locators
- Business permit/s
- SEC/DTI registration where applicable
- List of Authorized Signatories which shall not exceed three persons. Any officer or employee of the applicant exporter can be an authorized signatory, provided that such officer, or employee understand or has sufficient knowledge on the Rules of Origin (RO)
- An illustration of the manufacturing process
- List of products applied for authorization

There are no fees required in the accreditation of an exporter except for the documentary stamp attached in the Certificate of Accreditation to be issued to the Certified Exporter.

Source: Bureau of Customs, BOC Self-Certification Project.

Figure 6. Process of applying to qualify for preferential treatment in contrast with and without the Self-Certification System



Source: Philexport, "ASEAN Self-Certification System", presentation during the General Membership Meeting, March 2011

Single window system

The cost of complying with burdensome and complex regulations is another cause of uncompetitiveness. With the intention of streamlining the system, the current trend in facilitation is in linking not only traders and customs but all agencies involved in trade and transport through an electronic single-window system. The best single-window systems feature a single entry point for traders to fulfil all import, export and transit-related regulatory requirements which are all accessible to all parties involved in trade, including private participants such as banks and insurance companies, as well as public agencies such as immigration and vehicle registration authorities.

An ASEAN Single Window (ASW) is envisioned for the AEC. However, it requires all the member-states to have their own national single windows before these systems could then be combined to form the ASW. In the Philippines, although a NSW has already been in place since 2009 and has already connected 40 government agencies related to trade processes, there is still a need to streamline the system further.

Another source of commercial risk in trading is the lack of accurate information, particularly on the trade-related regulations in the partner countries. Thus, providing timely and accurate information can help the private sector weigh the commercial viability of trade and be able to make a more informed decision. To this extent, better information can lead to bigger trade volumes. The ASEAN Trade Repository (ATR) is a facilitation measure that aims to improve information dissemination. While the ASW comes in handy for traders who wish to meet all government agencies related to trade, the ATR allows businessmen who are potential traders to access trade-related information on tariff nomenclature, preferential tariff rates, rules of origin, non-tariff measures, national trade and customs laws and rules, procedures and documentation requirements, administrative rulings, best trading practices and a list of authorized traders. This helps a potential trader to decide whether it would be profitable for him to trade or not based on the possible costs he might face. The box below shows the Indonesia National Trade Repository (INTR). As for the Philippine NTR, technical workshops for parties involved are ongoing.

(Note: a more comprehensive discussion on the Philippine National Single Window can be found on page 65.)

Figure 7. Sample National Trade Repository



Source: <http://eservice.insw.go.id/>

²³ World Bank, "Good Practices"; Doing Business Trading Across Borders, 2014.

²⁴ Gamboa, 2014.

Harmonization of Standards and Technical Requirements

If AEC should bring about an integrated market and production hub, it is important that goods and services be able to flow seamlessly from one member to another. Complaints from the private sector about doing business in the AEC highlighted the technical barriers to trade, or the varying standards and regulations within the region which usually requires duplication of testing if the certification in one country is not accepted by the prospective buyer or by the regulatory authorities in the target market. As early as 1992, the ASEAN recognized how crucial technical regulations and standards are due to issues like environmental protection, consumer information, product safety, and compliance to health requirements, as these issues affect the marketability of a product and the reputation of a manufacturer. To address these, the ASEAN Consultative Committee on Standards and Quality (ACCSQ) was formed with the goal of harmonizing national standards with international standards. Since then, the ACCSQ has focused on eliminating the technical barriers to trade in the following priority integration sectors: agro-based products (prepared foodstuff), automotive, healthcare products (cosmetics, medical devices, pharmaceuticals, traditional medicines and health supplements), rubber-based products, electrical and electronic equipment, wood-based products, and building and construction materials. Likewise, guided by the mantra “one standard, one test, accepted everywhere”, the ACCSQ has the task of adopting mutual recognition of test results and certificates among ASEAN countries, in order to simplify trade procedures and reduce transaction costs.

Table 7. Progress in Harmonizing Standards and Conformity Assessments in the AEC

| PRIORITY INTEGRATION SECTOR | | HARMONIZATION OF STANDARDS | MUTUAL RECOGNITION AGREEMENT (MRA) |
|---|---|--|--|
| Agro-based products (Prepared Foodstuff) | | Harmonization is focused on safety requirements on food additives, food contaminants and food contact materials. The ASEAN Common Food Control Systems also develops and implements technical requirements for food safety and for labelling of pre-packaged food and food hygiene. | ASEAN MRA for Prepared Foodstuff Product by 2015 |
| Automotive | | Harmonize standards/technical requirements based on United Nations Economic Commission for Europe (UNECE) Regulations by 2015 | ASEAN MRA on Type Approval of Automotive Products by 2015 |
| Healthcare products | Cosmetic | The ASEAN Cosmetic Directive has been implemented in 2008. | ASEAN MRA for Good Manufacturing Practice Inspection of Manufacturers of Medicinal Products Inspection was signed in 2009. ASEAN MRA on Bio-Equivalence Study by 2015. |
| | Medical Devices | The ASEAN Medical Device Directive signed in 2014. Harmonization of technical requirements based on the ASEAN Common Submission Dossier Template. | |
| | Pharmaceuticals | Harmonization of technical requirements based on ASEAN Common Technical Dossier implemented in 2009 | |
| | Traditional Medicine and Health Supplements | Harmonization of technical requirements for safety, quality and efficacy and product placement requirements including Good Manufacturing Practices Guidelines. The ASEAN Agreement on Traditional Medicines and Health Supplements | |
| Rubber-based products | | Harmonized safety and specification requirements with ISO and IEC standards. | |
| Electrical and electronic equipment | | The ASEAN Harmonized Electrical and Electronic Equipment Regulatory Regime signed in 2005 harmonized safety and specification requirements with ISO and IEC standards. Mechanisms to implement are in place. However, full implementation requires the ASEAN Member States to translate the agreement into national regulations by 2015. | The ASEAN Sectoral MRA was signed in 2002 and is currently being implemented by all ASEAN members. |
| Building and Construction materials | | | ASEAN MRA on Building and Construction Materials by 2015 |

Source: ASEAN Secretariat, http://portaluat.miti.gov.my/cms/content-aec.jsp?id=com.tms.cms.article.Article_eafdd6ee-c0a8157d-b52a9300-8c202567

Beyond Connections

The AEC is a blueprint that ties up the different elements in transforming the region into an integrated market and production hub. One of the central points of the blueprint is the free and open movement of goods, services, investments and people. To achieve the outcome, AEC seeks to complement the policies that reduce tariff barriers with measures that facilitate such trade. Trade facilitation and connectivity thus becomes an equally important component in moving the AEC to its desired outcome.

Connectivity can be analyzed at three levels: physical, institutional and people to people. The AEC is ambitious in promoting infrastructure development to enhance physical connectivity. As regional investments are primed to flow in the AEC, it is important that physical connectivity should be put in place in order to encourage firms and investors to consider the region as truly one market and production hub as opposed to fragmented markets. The business sector in the region, and particularly the Philippines, are well advised to study the different initiatives in the connectivity – road networks, sea lanes, energy, etc. for these will open many market opportunities.

Rather than physical infrastructure, it is perhaps the institutional connectivity and facilitation efforts that can generate higher returns to the economy, particularly on trade volumes. Unlike infrastructure which demands huge capital outlay, improving institutional connectivity by means of improving the implementation of the AEC policies require less capital resources, and could even be more effective in reducing transaction costs.

Facilitation measures in AEC are varied – from establishing a single window, improving customs procedures, to disseminating information more effectively. The Philippines has yet to catch up with its more progressive neighbors in terms of improving logistical and trade costs, getting engaged in these initiatives is imperative. Thus, the business sector is encouraged to do their homework in order to effectively avail themselves of these measures.

It seems that for the AEC, the success of the integration effort lies in how effectively the member-countries could deepen and widen their participation in the economic activities in the region, particularly trade and investments. The members' extent of engagement provide the means to narrow the development gap in the region and to ensure its position as the growth center in the Asia Pacific region; this also serves as the end towards which the efforts for connectivity, both physically and institutionally speaking, are geared. In this scenario, trade facilitation has become the name of the game, as it benefits both importers and exporters, and allow SMEs greater participation in trade through improved transparency and governance.

Rather than physical infrastructure, it is perhaps the institutional connectivity and facilitation efforts that can generate higher returns to the economy, particularly on trade volumes.



Strengthening ASEAN financial integration

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Banking always looms large among the service sectors in an economy. Because of its peculiarities – its capital structure, the fact that it lends out the money of its depositors, etc.–the banking industry is heavily regulated. In addition, banking is considered by many as a strategic industry very much subject to the political economy. Hence, proposals to liberalize the Philippine banking sector such as that envisioned in the ASEAN Economic Community (AEC), are usually met with a fair amount of enthusiasm.

One of the fears – imagined or otherwise – arising from the move to liberalize the banking sector under the AEC is that Philippine banks may be hard put to compete. For starters, Philippine banks are ‘undersized’ relative to banks in the ASEAN 5. As Mario Lamberte¹, former president of the Philippine Institute for Development Studies (PIDS) recounts, the total assets of Philippine banks are a mere 11 percent, 33 percent and 42 percent of Singapore’s, Malaysia’s and Thailand’s respectively. Even Vietnam’s banking sector has exceeded the Philippines in size already.

Apart from the industry perspective, individually, Philippine banks are also among the smallest banks in the region. The largest bank in the Philippines is merely a third of the size of the third largest bank in Malaysia or a little more than half of the third largest bank in Thailand. The specter that the Philippine banking sector would be dominated by the entry of ASEAN competitors thus pervades.

Another perceived weakness of Philippine banking, relative to its ASEAN counterparts, lies with its relatively shallow banking penetration. Several indicators bear this out. The ratio of broad money to GDP is an indicator of the degree of monetization of the economy. With barely 50 percent, the Philippines ranked only seventh in ASEAN in 2012 on this score. In contrast, Malaysia, Singapore and Thailand exhibit ratios well over 100 percent. Another indicator of bank intermediation is the ratio of private credit to GDP, which reflects the extent to which the banking system extends financing to the domestic market. On this criterion, the Philippine banking performance is rather weak at eighth place out of nine.

What could probably account for the size and limited banking penetration of the Philippines? In the past, the Philippines’ economic performance has lagged behind those of its ASEAN neighbors. In terms of per capita incomes, the Philippines is ranked last among the ASEAN five. In general, the size of the banking system and its relative development is limited by the extent of the market. A relatively low level of development puts constraints on the demand for credit and other banking services, thus limiting expansion. At the same time, a situation where the distribution of income is skewed towards the poor, leads to fairly low supply of savings. Moreover, a general public characterized by low per capita incomes translates into low credit worthiness. A combination of these factors could account for the relatively shallow level of financial intermediation in the Philippines.

The relative size of Philippine banks, on the other hand, could be an offshoot of the ownership patterns. A good number of banks in the Philippines is controlled by family corporations and their

conglomerates. This necessarily puts limits to expansion. Conversely, banks in other ASEAN countries, such as Malaysia and Thailand, have sizeable public ownership. One could note that after the Asian crisis of 1997, there was a deliberate policy to nudge Philippine banks to consolidate in an effort to shore up capital. The motivation was that bigger banks would be less vulnerable to swings in the international capital flows than the smaller ones. Of late however, there is not much incentive for Philippine banks to merge and consolidate as the level of liquidity is desirable and the economy is steadily growing.

Openness of the Philippine banking sector

The AEC blueprint envisions the ASEAN to be a production hub where investments find a viable and competitive environment. Such an outcome, it is said, could be realized if support service industries such as financial services are efficient. Thus, AEC prods the member states to open up their banking sectors to bank entry from the ASEAN in an effort to inject more competition. The legal instrument to implement the liberalization is the ASEAN Framework Agreement for Services (AFAS).

Observers are quick to point out that the commitments of the Philippines in the AFAS for the banking sector is not much different from its existing commitment in the General Agreement for Trade in Services (GATS). Other ASEAN countries also do the same, indicating that they too have similar sensitivities as far as the banking sector is concerned. In fact, the Philippines banking commitment is more generous than Indonesia, Malaysia, and Thailand as it allows higher foreign equity participation.

Philippine domestic laws on foreign bank entry are actually more liberal than those stipulated in the AFAS. For instance, whereas the Philippines puts a cap of 60 percent to foreign equity participation in banks in the AFAS, under current domestic regulations, foreign banks may own 100 percent of the voting stock of an existing bank or a subsidiary. Interestingly, the liberal conditions for foreign bank entry apply to all and not only to ASEAN banks.

Now that the banking sector is open, will ASEAN banks come in droves?

Will the AEC result in a flood of bank entries from the ASEAN? Not necessarily. As mentioned earlier, under current laws, foreign banks are allowed to enter and even hold 100 percent ownership. Yet, despite the liberal terms, foreign banks account for only a little over 10 percent of total Philippine banking assets. In fact, there are currently only three ASEAN banks operating in the Philippines. Incidentally, these are the same banks (Maybank, Bangkok Bank, and United Overseas Bank) that tend to establish presence in most ASEAN banking sectors. Major international players such as Citibank, HSBC, etc., which are even more highly capitalized than the leading ASEAN banks, have operated in competition with the local banks for decades. The fact that the Philippine banking sector is not inundated by ASEAN banks despite the relatively open regime, implies that there are other factors apart from regulations that affect the propensity of foreign bank entry. Local market knowledge and the current legacy of network of branches are some of the entrenched advantages of local banks which foreign banks do not possess.

¹ The banking figures were sourced from the presentation of Mario Lamberte in “Pulong Saliksikan: Enhancing Access to Financial Services through a More Competitive Financial Service,” organized by PIDS on June 17, 2015 in NEDA sa Makati building.

To the extent that the banking system is a critical support service, its demand is naturally a derived one. Thus, the prospects of the banking sector mirrors closely the prospects of the macroeconomy. On this score, the outlook for the banking sector is rosy. Given steady and robust growth over the past years, per capita incomes have increased, thus improving the credit worthiness of the average Filipino saver. Overall economic activity, fueled in no small measure by heady remittances, continues to expand. Moreover, there is a lot of interest from the foreign community in investing in the Philippines, particularly from the Japanese. Besides, the quality of regulation over Philippine banks is quite advanced. These factors, coupled with credit ratings upgrades due to progress in governance, contribute to making the Philippine market an attractive one for foreign banks, in the coming years.

AEC as a game changer in banking in the region?

Liberalization of banking sectors in the ASEAN, as the theory goes, will lead to a more competitive and integrated market. The competitive environment will serve the interests of the consumers of banking credit, spurring them to expand commercial activities. The integrated market, on the other hand, will allow banks to reap the benefits of operating at larger scales. All told, an integrated financial system will expand and increase the range of the sources of finance in the region. By allowing regional banks to operate in different jurisdictions, banks can diversify their portfolios and minimize risks. Naturally, to operate in this environment, regional banks should have the necessary size to seize opportunities. In addition, regulations across jurisdictions should also be harmonized.

When the impetus for integration goes full swing in the AEC, there will be bound to be pressure for many of the smaller banks in the Philippines to consolidate. Of course, there will always be room for small boutique banks well ensconced in particular market niches. To cite, a small but highly specialized bank, the One Network Bank (now owned by Banco de Oro) has been very successful in operating in the rural sector. Nevertheless, in an increasingly integrated market, size will become important.

One clear sector that will benefit from further banking integration in the region would be banking professionals. Facilitated by agreements on mobility of professionals, the demand for banking professionals, which the Philippines has a good supply, will definitely experience a surge.

However, in the greater scheme of things, the AEC may not be the most significant catalyst of change in the banking industry in the region. Rather, according to Bank of the Philippine Islands President Cezar Consing, it could well be the advent of financial technology or *fintech* that would be the game changer. Although it is still in its budding phase, *fintech* has the capability to revolutionize fund intermediation. Thus, how individual banks can deal with *fintech* will determine their destiny.

Setting sail for the ASEAN Single Shipping Market

Aurora M. Hipol, Associate Legal Counsel, KPMG in the Philippines

With the enactment of a concise piece of legislation set in only a few pages, an era spanning more than fifty years of circuitous shipping routes in the Philippines has come to an end. Republic Act No. 10668, which President Aquino signed into law on 21 July 2015, now expressly allows foreign vessels carrying foreign cargo to navigate through shipping routes within the Philippines that used to be reserved for domestic vessels. Under the application of the former cabotage law provisions in the Tariff and Customs Code, foreign vessels were only allowed to transport foreign cargo to one port of destination in the Philippines. Further marine transport of foreign cargo had to be turned over or transshipped to domestic shipping lines, which resulted to unnecessary co-loading expenses. As smaller vessels ply internal routes, massive foreign barges had been constrained to contract several Philippine vessels among which to allocate its load. The economically impractical regulation created absurd scenarios. There were instances when shipping foreign cargo from one Philippine port to another was more expensive than the entire process of shipping the cargo from one Philippine port to a nearby country, like Hong Kong or Taiwan; transshipping the cargo to another vessel at the foreign port; and then, finally transporting the cargo back to the Philippine for its final port of destination.

Through R.A. No. 10668, which now serves as the new cabotage law for foreign shipping within the Philippines, the barriers that closed off Philippine territorial waters to foreign vessels have been lifted. The new law allows a foreign vessel to sail from one Philippine port to another, carrying foreign cargo that it originally has onboard or foreign cargo that has been transshipped to it from

another foreign vessel. Foreign cargo vessels will now be able to pass freely through Philippine territorial waters, as well as co-load with other foreign vessels within Philippine territory. Foreign shipping will no longer be compelled to hire domestic vessels for the local transport of cargo. Consequently, the reduction in transporting expenses and resulting competitiveness in maritime shipping are expected to bring down the final price of goods. Opening up the Philippines to foreign shipping is also anticipated to bring in more global businesses to the local market, which would lead to the introduction of goods, stores and brands that have yet to be available in the country.

The new cabotage law arrived just in time to hoist the Philippines aboard the ASEAN as it embarks on the journey of developing Southeast Asia as an indomitable maritime region. A cornerstone of the ASEAN's goal to market the Southeast Asian region as one trade hub is the creation of the ASEAN Single Shipping Market, a key strategy in the 2010 Ha Noi Declaration on the Adoption of the Master Plan on ASEAN Connectivity. Part of the 10 Key Strategies to Enhance Institutional Connectivity in the ASEAN Region is Strategy 4, which is the development of an ASEAN Single Shipping Market. All ASEAN member-countries have committed to "a progressive integration towards the formation of an ASEAN Single Shipping Market and (the) intensified development of the maritime network infrastructure (that) will lead towards a stronger ASEAN maritime sector, operating efficiently and delivering quality goods and services at competitive prices." The implementing framework for the ASEAN Single Shipping Market will be formulated and adopted this 2015.



Establishing the Philippines as a production base

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As ASEAN production capacities expand, market opportunities increase with the attendant economic growth, which in turn, attracts more investments. The AEC is the blueprint by which ASEAN hopes to bring the region to its desired outcome – an integrated market and a seamless production hub that will flow investments towards the region. While ASEAN as a whole will benefit from the increased economic activity of the region, there will be keener competition among ASEAN member states as each country vies for more investments. This article takes a closer look at the competitive advantage of the Philippines vis-à-vis other ASEAN countries and at the capacity of the country to become a significant production base in the context of integrated markets.

Investments in ASEAN

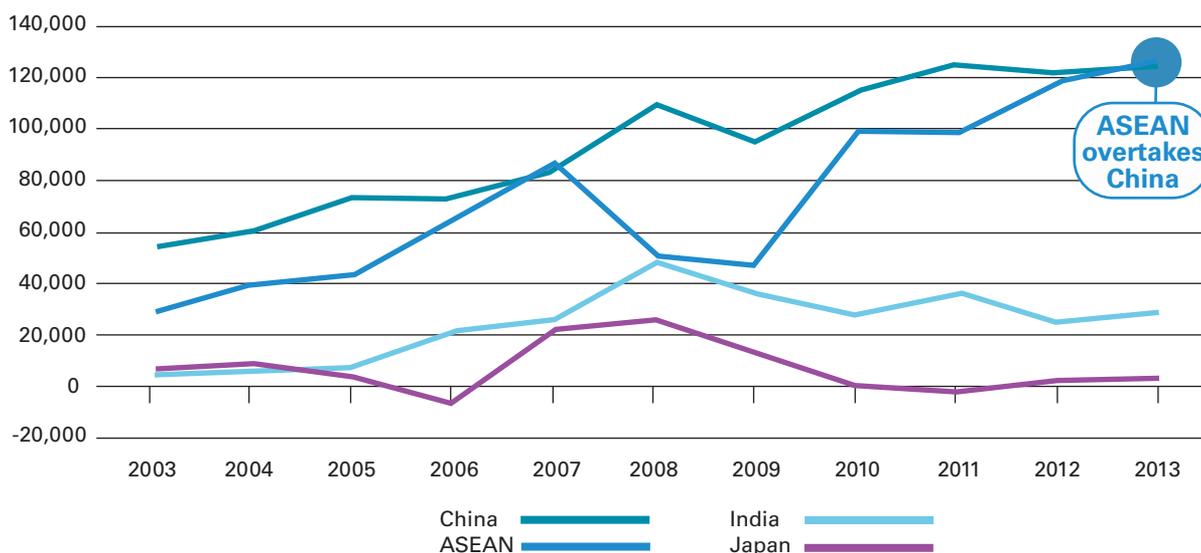
ASEAN has been attracting the surge of investments lately as investment in China appears to be cooling down as a result of higher wages and shift of Chinese policy towards stimulating domestic demand. Interest in ASEAN is further heightened due to the integration of the region, not only because of its large market size, but more importantly, the policy thrust to make the region a production hub. This includes efforts to eliminate tariffs, improve trade connectivity and facilitation, harmonize standards and regulation, liberalize services and develop Mutual Recognition Agreements (MRAs) for mobility of professionals, among others. The ASEAN Comprehensive Investment Agreement (ACIA) is designed to attract more foreign direct investment (FDI) flows. It provides investment liberalization, most-favored-nation and national treatment, investment protection, promotion and facilitation. Policymakers hope that this will increase productive capacity, allow technology transfer, create employment, and beget other investments in terms of supplier industries.

In 2013, FDI inflows to ASEAN rose by seven percent to US\$125 billion owing to a number of factors. In general, there is growth in intra-ASEAN investments and cross-border mergers and acquisitions (M&As) in the region. The improved policy environment, strong macroeconomic fundamentals, regional market prospects, and growing positive investor sentiment also contributed to the FDI surge¹. In particular, FDI inflows in Malaysia increased by 22 percent because of the rising FDI in services. In Thailand, meanwhile, despite the loss of FDI projects due to

¹ ASEAN Secretariat. ASEAN Investment Report 2013-2014: FDI Development and Regional Value Chains. Jakarta: ASEAN Secretariat, 2014

political instability, Japanese investment in manufacturing continued to rise significantly. As a result, inflows to the country grew to US\$13 billion in the same year. Furthermore, the FDI inflows to the Philippines increased by 20 percent to US\$4 billion despite experiencing natural disasters like typhoon Haiyan. Finally, even though Indonesia was greatly affected by the financial crisis in emerging economies in mid-2013, FDI inflows remained stable at US\$18 billion². With this, the total FDI inflows to the ASEAN region overtook that of China in 2013 with US\$125 billion (Figure 1).

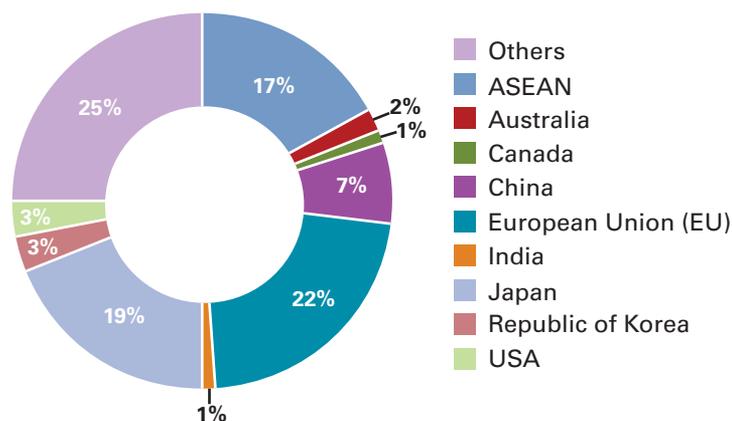
Figure 1. Annual FDI Flows to China, ASEAN, India and Japan (in US\$ millions)



Source: UNCTAD as cited by Wood in J. Wood in *Re-drawing the ASEAN map: How companies are crafting new strategies in South-east Asia*. The Economist Intelligence Unit, 2014

Most of the FDIs went to the manufacturing industry and services sectors³. Investments in manufacturing rose to US\$41 billion from only US\$18 billion in 2012. The significant recipient industries were electronics and automotive and automotive parts. The top investors were companies from the European Union (EU), Japan and intra-ASEAN⁴. In total, 82.7 percent of the FDI inflows are extra-ASEAN while 17.3 percent are intra-ASEAN. Intra-ASEAN investment is a major source of FDI for member states. It ranks third next to the European Union (22.2 percent) and Japan (18.8 percent) (Figure 2).

Figure 2. Sources of FDI Inflows to ASEAN



Source: ASEAN Secretariat, ASEAN FDI Statistics, 2015
<http://www.asean.org/news/item/foreign-direct-investment-statistics>

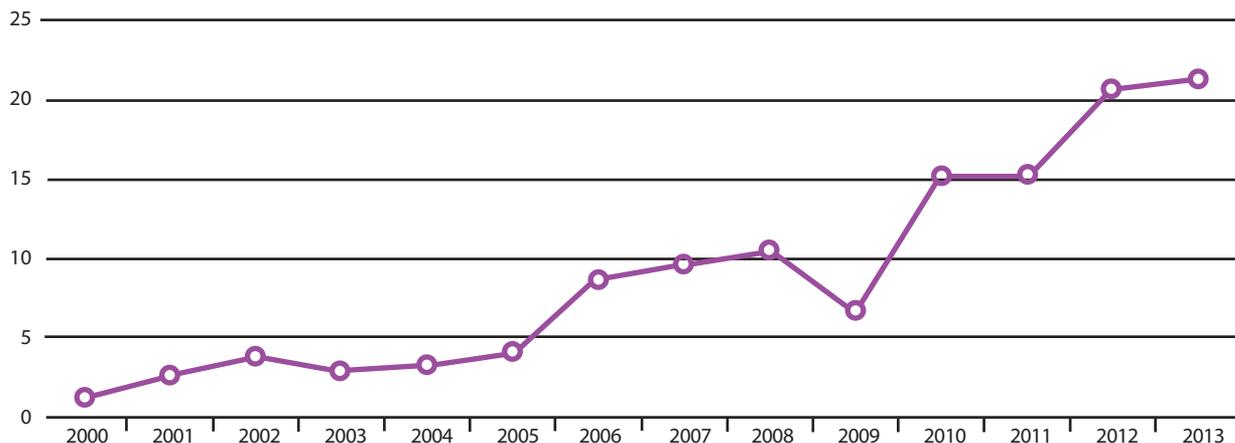
² United Nations Conference on Trade and Development. World Investment Report 2014: Investing on the SDGs: An Action Plan. New York and Geneva: United Nations Publication, 2014

³ Invest in ASEAN. FDI 2011 & 2013 Highlights. Retrieved June 13, 2015 from <http://investasean.asean.org/index.php/page/view/facts-and-figures/2015>, 2015

⁴ ASEAN Secretariat (2014). ASEAN Investment Report 2013-2014: FDI Development and Regional Value Chains. Jakarta: ASEAN Secretariat

Intra-ASEAN investment has been steadily growing over the years with the realization of the ASEAN Free Trade Agreement (AFTA) in 2010. The tariff reduction lowers transaction costs in doing business thereby encouraging both ASEAN and non-ASEAN companies to expand in the region. In 2013, ASEAN companies invested some US\$21 billion in the member countries. This is 13 percent higher than the total intraregional investment from 2000 to 2005 (Figure 3). The rise in intra-ASEAN FDI is supported by the growing corporate income and cash reserves of ASEAN companies that brought financial capacity to invest and undertake M&As in the region⁵.

Figure 3. Intra-ASEAN Investments (In US\$ Billion), 2000-2013



Source: ASEAN Secretariat, ASEAN FDI Statistics, 2015 <http://www.asean.org/news/item/foreign-direct-investment-statistics>

Investor's Strategy: Pan-Region

Along with the positive trends in FDIs is the integrated supply chain of the region. Greater complementation among the local and multinational companies is possible with the varying degrees of economic growth and comparative advantage of the ASEAN countries. Consequently, in terms of manufacturing, firms adopt a two-pronged strategy. The first is the consolidation of operations. Instead of having different production sites, a company can just fully produce in one place and serve the whole region from that area. This allows them to reap the benefits of economies of scale. Similarly, the reverse approach is also plausible. A company can fragment its supply value chains so as to allocate the manufacturing process depending on the most efficient country⁶. Again, this allows scale economies but in the production of parts and components. This is where attention to the strengths of each country is magnified. Countries with the appropriate skills, costs, resources and connectivity to the region are more preferred than others. For instance, ASEAN Investment Report 2012 highlights the cases of Cambodia, Indonesia, and Vietnam. In recent years, they benefited from FDI coming from Malaysian or Thai companies in textiles and garments which require an ample supply of low-cost labor. Likewise, some land-constrained ASEAN countries encourage investors from agriculture and plantation

industries to operate in neighboring countries in ASEAN that have abundant land.

Regional value chains (RVCs) in ASEAN are increasingly involving more companies, countries and products. The ability of companies to distribute and coordinate the different value chain segments and functions is a strong factor that facilitated RVCs in ASEAN. ASEAN integration further accentuates the interconnection between member states through FDI, non-equity modalities, trade in intermediate inputs, finished goods and facilitated transactions. ASEAN policies based on the three pillars of connectivity through physical, people and institutional connections support the proliferation of the global value chain (Figure 4). Furthermore, ASEAN's free trade agreements allow companies to tap and trade with supporting industries and suppliers based in the region and in partner countries. Access to goods, raw materials or product components for final assembly and production improved as tariff for more than 5,000 product lines were reduced to 0-5 percent⁷.

The ability of companies to distribute and coordinate the different value chain segments and functions is a strong factor that facilitated RVCs in ASEAN.

⁵ ASEAN Secretariat (2014). ASEAN Investment Report 2013-2014: FDI Development and Regional Value Chains. Jakarta: ASEAN Secretariat

⁶ Justin Wood. Redrawing the ASEAN Map: How companies are crafting new strategies in South-east Asia. The Economist Intelligence Unit, November 2014

⁷ The ASEAN Secretariat in ASEAN Investment Report 2013-2014 FDI Development and Regional Value Chains <http://www.foundry-planet.com/fileadmin/redakteur/pdf-dateien/24-11-14-Report-AseanNov2014.pdf>

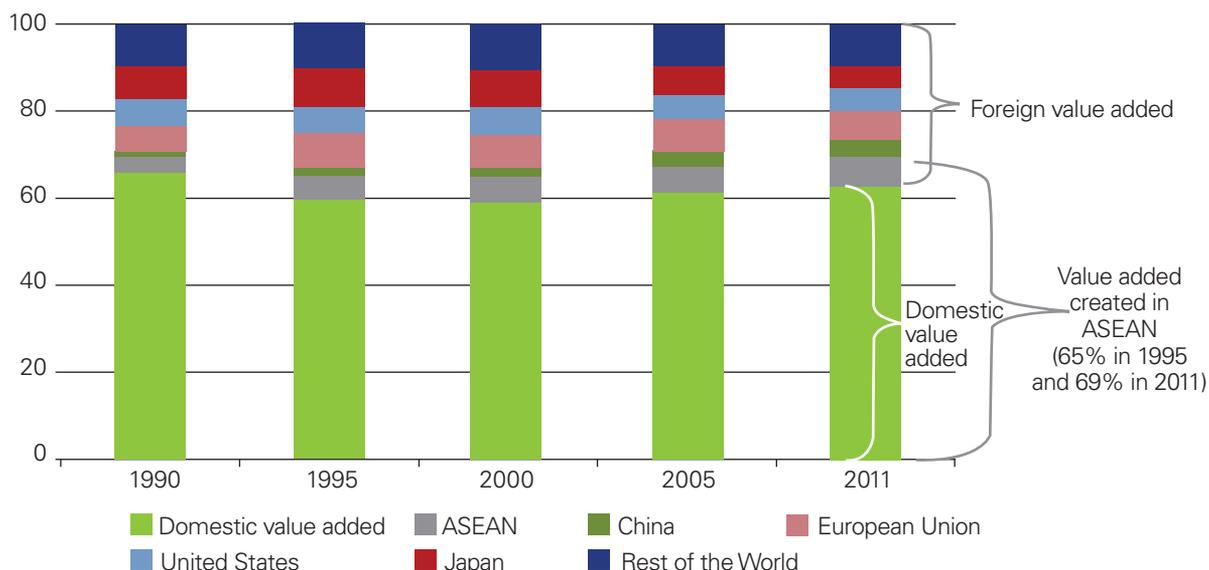
Figure 4. Regional Integration, RVCs and ASEAN's connectivity



Source: UNCTAD, 2014 as cited by The ASEAN Secretariat in ASEAN Investment Report 2013-2014 FDI Development and Regional Value Chains <http://www.foundry-planet.com/fileadmin/redakteur/pdf-dateien/24-11-14-Report-AseanNov2014.pdf>

Given the wide regional supply chain, it is not surprising that ASEAN value added inputs in the region's total exports are huge and have grown from 65 percent in 1995 to 69 percent in 2011 (Figure 5). This suggests that export-oriented foreign and local companies operating in the region sourced majority of their inputs from ASEAN in order to produce components or final products.

Figure 5. Value added Exports from ASEAN, by creators of value added (in %)



Source: UNCTAD-Eora GVC Database as cited by The ASEAN Secretariat in ASEAN Investment Report 2013-2014 FDI Development and Regional Value Chains <http://www.foundry-planet.com/fileadmin/redakteur/pdf-dateien/24-11-14-Report-AseanNov2014.pdf>



Integrated regional or global supply chains are used in the production of fast-moving consumer goods (FMCG), garments, automobiles, and electronics industries. Success stories of Toyota and Unilever, for example, reflect the effective connectivity in the region brought about by the AEC integration. Toyota is well-established in a number of ASEAN member states. It is expected to expand its operation in Indonesia with an investment plan of US\$1.1 billion between 2012 and 2017. In the Philippines, the company also announced that it will expand its production capacity of Toyota Motor unit by 20 percent in the next two years to take advantage of new government incentives⁸. Another case would be Unilever. The company launched its full business operations in Myanmar in 2013 and over the next decade, plans to invest US\$656 million in the country to expand its product line coverage. In the same year, it also invested in a palm kernel fractionation facility in Indonesia which started its production in 2014⁹. Finally, it will open a US\$56 million global leadership development center in Singapore and will build a US\$90 million home-care liquids and distribution facility in Thailand¹⁰. These stories, coupled with excellent fundamental macros, highlight how ASEAN is a good production hub for companies in which to locate and expand their businesses.

When it comes to services, however, companies face a more complex environment. As services become more important in enhancing the competitiveness of the goods sectors, there should be greater emphasis by policymakers on how to manage the trade and investments in the services sector. The usual constraints would be foreign ownership, labor mobility and standardization of regulations. This is what the AEC blueprint aims to address as it develops the

ASEAN Framework Agreement on Services (AFAS). The AFAS aims to enhance cooperation in services among ASEAN member states in order to improve the efficiency and competitiveness of services industries, diversify production capacity and supply, and distribution of services; to eliminate substantial barriers to trade in services; and to liberalize trade in services by expanding the depth and scope of liberalization beyond those undertaken under the General Agreement on Trade in Services of the World Trade Organization (WTO).

To push this mode of services trade for further liberalization, MRAs have been initiated. Members who signed and committed to this arrangement agreed to recognize the authorization, licensing, or certification of professional services suppliers in order to facilitate the easier flow of foreign professionals while still considering relevant domestic regulations and market demand conditions. Currently, there are seven concluded MRAs: Engineering Services, Nursing Services, Architectural Services, Framework Arrangement for the Mutual Recognition of Surveying Qualifications, Medical Practitioners, Dental Practitioners and Framework on Accountancy Services. The idea is for professionals to be able to move freely from one country to another and offer their services. But, agreeing to an MRA framework agreement and implementing it are two different things.

One feedback from companies is the slow progress of services integration. Standards and regulations governing professional qualifications of professionals across ASEAN are also deemed inconsistent¹¹. This consequently impedes any regional strategy on the part of investors. Investments made for services

⁸ Neil Jerome Morales. Philippine unit of Toyota Motor to expand production capacity. Reuters.

<http://uk.reuters.com/article/2015/06/09/philippines-toyota-motor-idUKL3N0YV36420150609>, June 9 2015.

⁹ Unilever. Roundtable on Sustainable Palm Oil. Retrieved June 28, 2015 from <http://www.rspo.org/file/acop2014/submissions/unilever-ACOP2014.pdf>, 2014

¹⁰ ASEAN Secretariat (2014). ASEAN Investment Report 2013-2014: FDI Development and Regional Value Chains. Jakarta: ASEAN Secretariat

¹¹ Justin Wood. Redrawing the ASEAN Map: How companies are crafting new strategies in South-east Asia. The Economist Intelligence Unit, November 2014

embodied in manufacturing are further influenced by local considerations more than regional. It is important to understand the differences in terms of production factors of the ASEAN member states. How then is the Philippines valuable in the regional value chain?

Human Resources: The Ultimate Resource

By and large, labor determines the productive capacity and economic performance of a country. A large and high quality workforce emits a positive signal to investors. As the article on Labor Mobility (page 18) emphasizes, in terms of working population, net exporters of labor in the ASEAN are also the countries with the largest workforce and the youngest median age. Measured in number of workers, the Philippines has the third largest workforce in the ASEAN as of 2010, next only to Indonesia, which also has the biggest population, and Vietnam.

Filipinos are among the youngest in the ASEAN. This brings a lot of opportunities, especially with the rest of the region aging quite rapidly (China included). Naturally, a country with a youthful population is more productive¹². A young population serves as a pool of potentially outstanding, highly effective and more productive workers, thereby energizing the economy. As Villegas¹³ comments, they are “magnets for foreign investors from developed countries that are looking for lower labor costs.” A younger workforce promises openness to technology which is yet to be reaped in the ASEAN. Since the Philippines has a young and flourishing population, it has more human resources for all sectors of an emerging market. Some of these include farmers and farm workers to work more productively in the countryside; factory workers in the increased number of manufacturing enterprises that are relocating to the Philippines from Northeast Asia, service workers for the business process outsourcing (BPO) and tourism sectors; and highly skilled engineers and scientists who will be employed in the knowledge industries such as in IT and software, biotechnology and material sciences¹⁴ the three areas that will define the technological breakthroughs in the twenty first century¹⁵.

Interestingly, Lao PDR and Cambodia, which are among the poorer nations in the ASEAN, are also

composed of a young workforce with median ages of 21.5 and 22.9, respectively. Conversely, Singapore and Thailand, two of the better performing ASEAN countries in terms of income, have higher median ages. The problem with their aging workforce population is already being felt. In 2009 to 2010, Singapore’s labor market was characterized by job vacancies rising by almost 14,000 and the job vacancy rate climbing by 0.7 percentage point. By occupational group, the largest numbers of job vacancies as of September 2010 was in service and sales workers, then professionals and associate professionals¹⁶. Thailand, on the other hand, expects a long-term labor shortage which will lead to the country’s sub-par economic growth. The nationwide survey of companies of the Siam Commercial Bank’s Economic Intelligence¹⁷ shows that there was a 23 percent shortfall of hires in six key sectors in 2014.

Other ASEAN countries who suffer from such labor imbalance can emulate the strategy of Indonesia and open their economies to foreign labor. Indonesia has been quite open to Filipino professionals (especially accountants and other financial services professionals) in the last century. There is no doubt that the Philippines can supply high quality professional manpower to labor-short ASEAN countries that show signs of rapid aging¹⁸. Figure 6 shows the stark contrast between the Philippine labor force projection and the rest of the region. The Philippines has the highest labor growth rate projection with 2.31 percent annual growth rate from 2015 to 2020. On the other hand, Figure 7 illustrates the demographic structure of the country as compared to countries who are suffering from a demographic winter. The Philippines has the widest base of younger people compared to Thailand, China and Malaysia. This shall be an advantage to the Philippines particularly when freer flow of professionals across the region occurs.

A young population serves as a pool of potentially outstanding, highly effective and more productive workers, thereby energizing the economy.

¹² KPMG. ASEAN: Poised for Accelerated Economic Growth. KPMG International,

¹³ Benefits of Large and Young Population.

https://www.google.com.ph/url?sa=t&rct=j&q=&esrc=s&source=web&cd=1&cad=rja&uact=8&ved=0CB0QFjAA&url=http%3A%2F%2Fwww.bernardovillegas.org%2Fresources%2FBenefits%2520of%2520Large%2520and%2520Young%2520Population.doc&ei=wBWivbbNNMn9oQTNsoXQCg&usq=AFQjCNF8dSTduL4OR0f_q_Dn1JGC0lhKzqA&bvm=bv.97653015,d.cGU, 2009

¹⁴ Bernardo Villegas. Preparing Knowledge Workers for ASEAN. Business and Society Section. Philippines: Manila Bulletin, August 26, 2013

¹⁵ See Article on Labor Mobility for other skilled labor which Philippines offers

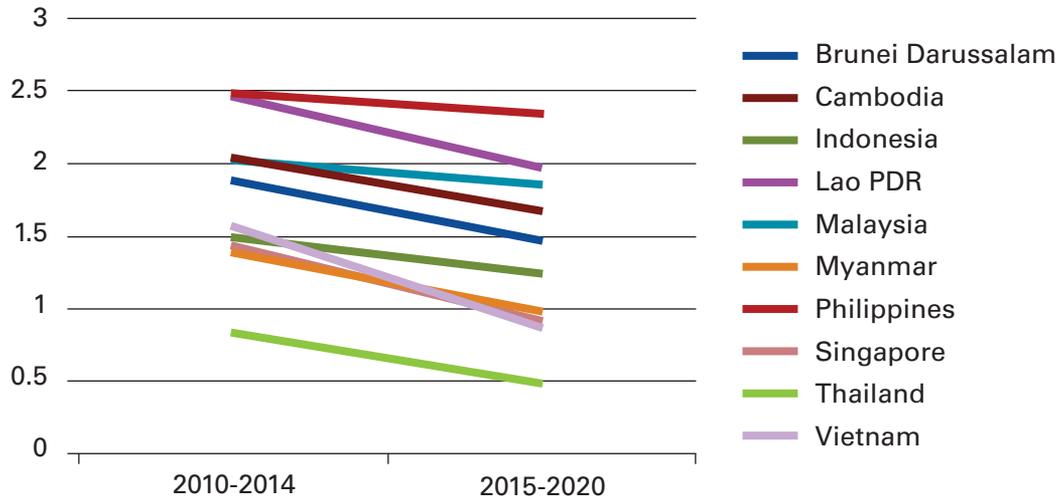
¹⁶ Geoffrey Duane. Labour shortages, foreign migrant recruitment and the portability of qualifications in East and South-East Asia. ISBN 9789221279280. Bangkok:

¹⁷ Labour shortages leave Thailand’s growth stuck in the starting gate. Newspaper Section: Asia Focus. Retrieved June 5, 2015 from

<http://www.bangkokpost.com/business/news/519475/labour-shortages-leave-thailand-growth-stuck-in-the-starting-gate>, 2015 International Labour Organization, 2013

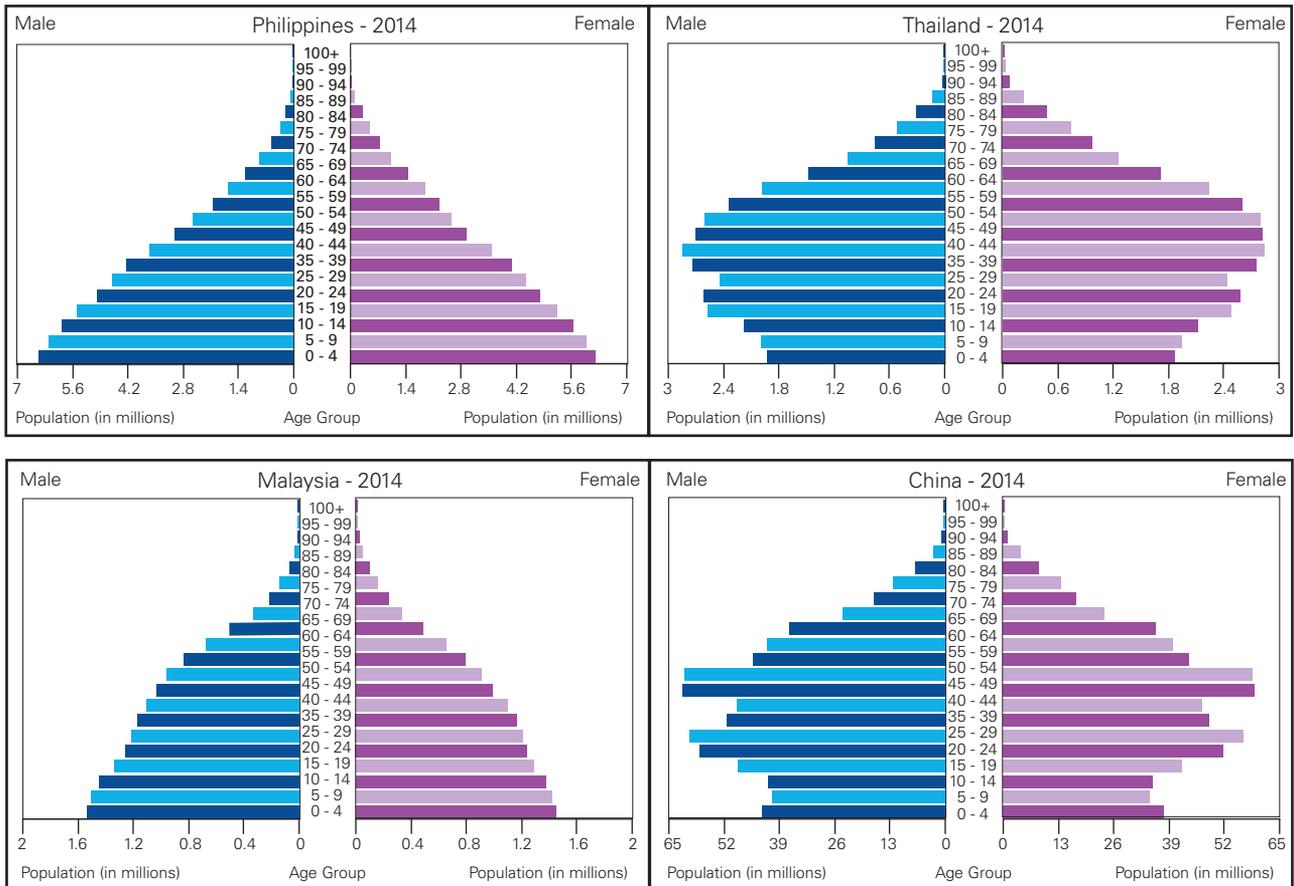
¹⁸ Bernardo Villegas. ASEAN Framework Agreement on Services. Business and Society Section. Philippines: Manila Bulletin, July 1, 2013

Figure 6. Average Annual Growth Rate of Labor Force Projection



Source: ILO (1996-2010). *Economically Active Population, Estimates and Projections (6th edition, October 2011)*. LABORSTA Internet. Retrieved June 1, 2015 from http://laborsta.ilo.org/applv8/data/EAPEP/eapep_E.html

Figure 7. Demographic Structure of the Philippines, Thailand, Malaysia and China, 2014



Source: Index Mundi, 2014. *Population Pyramids: Philippines, Thailand, Malaysia and China*. http://www.indexmundi.com/philippines/age_structure.html;
<http://www.indexmundi.com/graphs/population-pyramids/thailand-population-pyramid-2014.gif>;
<http://www.indexmundi.com/graphs/population-pyramids/malaysia-population-pyramid-2014.gif>;
<http://www.indexmundi.com/graphs/population-pyramids/china-population-pyramid-2014.gif>

Apart from the basic supply issue, the potentials of countries as an investment site from a human resource perspective could be evaluated on the basis of stability of the workforce. On this note, the Philippines compares favorably given the high turnover rate of Chinese workers, known as “churning”. Since turnover and rising wages affect labor productivity in China, companies may opt to locate production in other countries like the Philippines. A recent survey¹⁹ revealed that 19 percent of ASEAN businesses plan to shift investment or business from China into their own region. This poses an opportunity for countries such as the Philippines and Indonesia.

How do the ASEAN members compare in terms of labor costs? Table 1 indicates that Cambodia and Myanmar offer the cheapest labor in the region at US\$0.5 and US\$2.03, respectively. This is followed by Vietnam with a range of US\$2.6 to US\$3.7. Minimum wages in Indonesia range from US\$2.27 to US\$6.02. In the Philippines, the minimum wages in some key regions (Central Luzon, CALABARZON and Central Visayas) are almost at par with those in Thailand and Malaysia. However, the minimum wage in the National Capital Region (NCR) is higher.

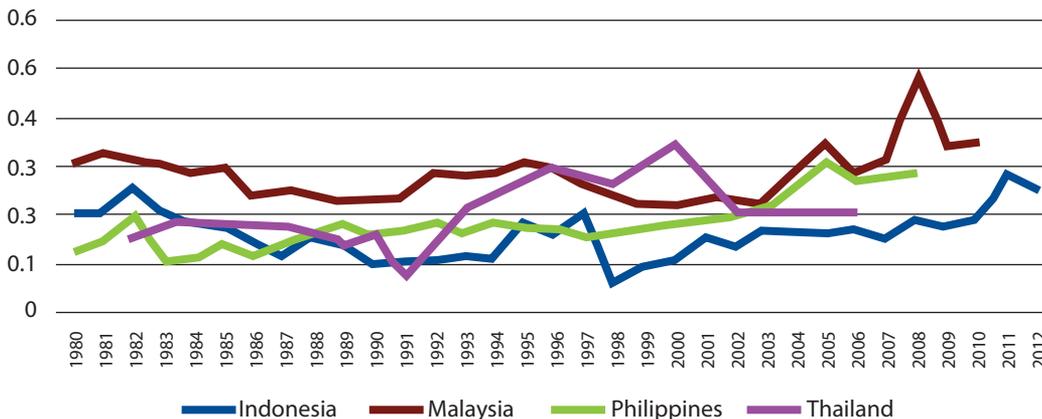
Table 1. Daily Minimum Wages in 2013

| Country | Daily Minimum Wages in US\$ (range) |
|--|-------------------------------------|
| Cambodia | 2.03 |
| Indonesia | 2.27-6.02 |
| Malaysia | 8.08-9.09 |
| Myanmar | 0.5 |
| Thailand | 6.75-9.12 |
| Vietnam | 2.6-3.7 |
| Philippines: | |
| National Capital Region - Metro Manila | 9.65-10.48 |
| Region 3 – Central Luzon | 6.41-7.55 |
| Region 4A – CALABARZON | 5.9-8.09 |
| Region 7 – Central Visayas | 6.34-7.35 |

Source: BLES-DOLE, http://www.nwpc.dole.gov.ph/pages/statistics/stat_comparative.html

High wages are not really a problem if accompanied by high labor productivity. It is helpful to look at unit labor costs that measure the average cost of labor per unit of output because this reflects cost competitiveness or the unit labor cost that is a direct link between productivity and the cost of labor used in generating output. It is calculated as the ratio of the total cost of labor to real output or value-added. Higher labor costs may either mean increased reward for labor’s contribution to output or an increase in labor cost that was not accompanied by corresponding increase in labor productivity²⁰. The latter implication serves as a threat to an economy’s cost competitiveness. Among the middle-income countries in the ASEAN, the Philippines has the second highest unit labor cost, next to Malaysia²¹. In fact, based on Figure 8, the cost of labor in the country has been increasing over time. In the 1990s, Philippines was still one of the most labor cost effective country in the region but somehow, such advantage was lost in 2002 when Thailand and Indonesia began to have lower labor unit costs.

Figure 8. Comparative Data on Unit Labor Costs in the Manufacturing Sector²²



Source: Haryo Aswicahyono and Hal Hill (2014) “Does Indonesia have a competitiveness problem?” A Presentation at the ADEW Conference in Perth, Australia on June 5-6, 2014. Presentation

¹⁹ Oliver Tonby, Jonathan Ng and Matteo Mancini. Understanding ASEAN: The manufacturing opportunity. McKinsey Productivity Sciences Center. McKinsey & Company, 2014

²⁰ Organisation for Economic Co-operation and Development . Glossary of Statistical Terms. Retrieved September 10, 2014 from <http://stats.oecd.org/glossary/detail.asp?ID=2809>, 2015

²¹ Haryo Aswicahyono and Hal Hill (2014) “Does Indonesia have a competitiveness problem?” A Presentation at the ADEW Conference in Perth, Australia on June 5-6, 2014. Presentation

²² As presented by Aswicahyono and Hill based on UNIDO industrial statistics. Computed using nominal value added deflated by the GDP deflator for the manufacturing sector, total compensation divided by total employment, as reported in UNIDO industrial statistics, and total employment as reported in UNIDO industrial statistics

Aside from workforce size, median age and labor cost, quality is another important labor feature. An educated workforce is advantageous in the sense that it helps attract investments in knowledge intensive production. This encourages higher value added sectors. According to the United Nations Development Programme (UNDP) Education 2013 Global Ranking (as shown in Table 2), the Philippines is one of the top five ASEAN countries with the highest education global rank. Singapore has the highest rank in the region, followed by Brunei and then Malaysia. The countries with the lowest global rank in education, on the other hand, are Cambodia, Lao PDR and Myanmar.

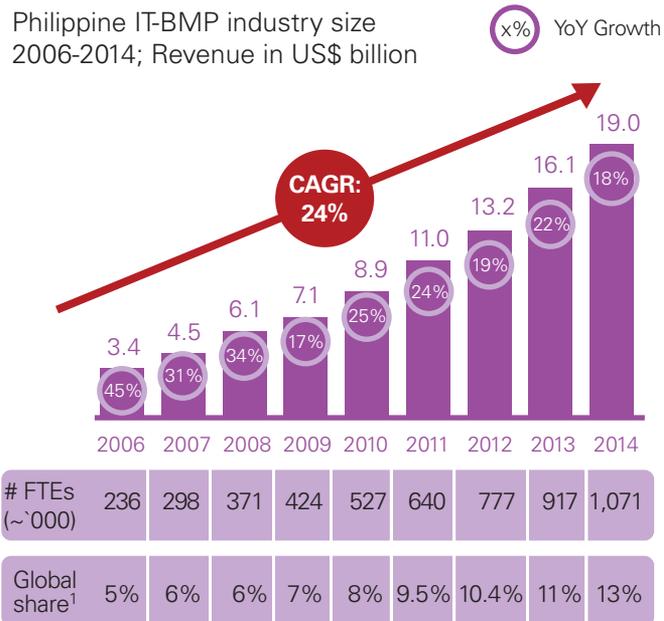
Table 2. ASEAN Education Global Rank, 2013

| | ASEAN Country | Education Global Ranking |
|----|-------------------|--------------------------|
| 1 | Singapore | 18 |
| 2 | Brunei Darussalam | 30 |
| 3 | Malaysia | 64 |
| 4 | Thailand | 103 |
| 5 | Philippines | 114 |
| 6 | Indonesia | 121 |
| 7 | Vietnam | 127 |
| 8 | Cambodia | 138 |
| 9 | Lao PDR | 138 |
| 10 | Myanmar | 149 |

Source: UNDP, 2013, <http://hdr.undp.org/en/content/education-index>

The English proficiency of Filipino workers is another advantage of the Philippines in the region. According to the recent survey of Global English Corporation, a cloud-based advance English literacy software provider, the Philippines ranked as the best in the world in terms of Business English Proficiency. This consequently attracts service industries like the BPOs and other sectors requiring highly-skilled professionals. Figure 9 stresses how big the information technology and business process management (IT-BPM) industry in the Philippines.

Figure 9. Philippine IT-BPM Performance in 2014



| | FTEs | Revenue (US\$M) | Rev % inc. fr '13 |
|------------------------|--------------|-----------------|-------------------|
| Voice BPO | 685,000 | 11,700 | 17% |
| Non voice NPO/KPO | 186,000 | 3,440 | 18% |
| ITO | 85,000 | 2,122 | 20% |
| Health Info Mgt & Care | 86,867 | 1,304 | 32% |
| Engineering Services | 13,112 | 227 | 5% |
| Animation | 10,304 | 142 | 8% |
| Game Development | 3,850 | 55 | 10% |
| Total | 1,071 | 18,989 | 18% |

Source: IT and Business Process Association of the Philippines, "The Philippine IT-BPM 2014 Performance." Power point Presentation

Arguably, the Philippine services sector has the competitive advantage within the ASEAN because of its above-average quality of manpower²³. Table 3 presents the top supply capabilities of Filipino graduates.

Table 3. Top 5 Disciplines/Fields of Study with Highest Graduates: AY 2010/11

| Discipline/ Field of Study | Graduates | % Share |
|--------------------------------|----------------|---------------|
| Business Admin and Related | 124,754 | 25.03 |
| Medical and Allied | 102,782 | 20.62 |
| Education and Teacher Training | 62,834 | 12.61 |
| Engineering and Technology | 58,637 | 11.76 |
| Information Technology | 54,113 | 10.86 |
| All Other Disciplines | 95,298 | 19.12 |
| Total | 498,418 | 100.00 |

Note: For the full list, see <http://www.ched.gov.ph/index.php/higher-education-in-numbers/graduates/>
Source: Commission on Higher Education, 2015

Costs and Quality of Doing Business

The cost of doing business is another important feature that should be considered in assessing attractiveness of an investment site. As ASEAN is home to many multinational companies, it is crucial to have stable overall prices, less investment risks, cheap electricity and transportation costs, and high quality of hard and soft infrastructures.

The investment risk in the ASEAN can be gleaned from the credit ratings of each ASEAN country. Based on the available Standard and Poor's (S&P) data shown in Table 4, all ASEAN countries have good credit ratings. Singapore and Malaysia top the region with AAA stable and A- stable outlooks, respectively. Thailand (BBB+ stable), the Philippines (BBB stable), Indonesia (BB+ positive), Vietnam (BB- negative) and Cambodia (B stable), on the other hand, have B status or higher. Philippine credit rating at present is an upgrade from its BBB- stable in 2013. This is an impressive improvement from 2005 in which the country was rated as BB-. A BBB Stable credit rating means that the country has adequate capacity to pay its debts fully and on time²⁴. This rating is projected to be sustained and further upgraded in the coming months due to the country's stable economic progress. Such rating signals a good financial reputation to potential foreign investors which in turn attracts investments.

Table 4. S&P Credit Rating for ASEAN members

| Country | Rating | Outlook | Date |
|-------------|--------|----------|------------|
| Vietnam | BB- | Negative | 5/20/2014 |
| Philippines | BBB | Stable | 5/8/2014 |
| Cambodia | B | Stable | 2/20/2012 |
| Indonesia | BB+ | Positive | 11/29/2011 |
| Malaysia | A- | Stable | 11/29/2011 |
| Singapore | AAA | Stable | 11/29/2011 |
| Thailand | BBB+ | Stable | 11/29/2011 |

Source: Standard & Poors, as of June 14, 2015. Sovereigns Ratings List; Standard & Poor's. Standardandpoors.com



²³ See the Article on "The Philippines in the ASEAN Economic Community"

²⁴ Standard & Poors. Sovereigns Ratings List; Standard & Poor's. Standardandpoors.com, 2015

Aside from a stable business environment, the cost of capital is also an important factor in choosing a production site. Competitive lending rates mean lesser financing cost and greater liquidity. Table 5 reports the effective real interest rates of ASEAN countries from 2010 to 2014. It shows that Myanmar, Indonesia and Vietnam have the highest lending rates in the region. Meanwhile, the Philippines, together with Thailand, Singapore, Malaysia and Brunei, showed more competitive lending rates at around five percent in 2014.

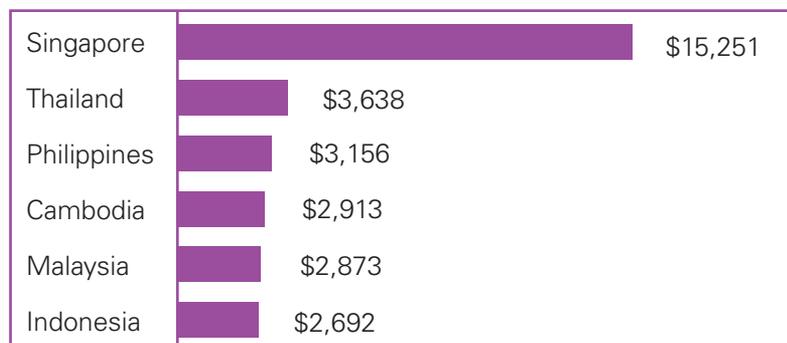
Table 5. Lending Interest Rates of ASEAN Countries, Annual Average (in %)

| Country | 2010 | 2011 | 2012 | 2013 | 2014 |
|-------------------|------|------|------|------|------|
| Brunei Darussalam | 5.5 | 5.5 | 5.5 | 5.5 | 5.5 |
| Cambodia | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Indonesia | 13.3 | 12.4 | 11.8 | 11.7 | 12.6 |
| Lao PDR | 22.6 | N/A | N/A | N/A | N/A |
| Malaysia | 5.0 | 4.9 | 4.8 | 4.6 | 4.6 |
| Myanmar | 17.0 | 16.3 | 13.0 | 13 | 13.0 |
| Philippines | 7.7 | 6.7 | 5.7 | 5.8 | 5.5 |
| Singapore | 5.4 | 5.4 | 5.4 | 5.4 | 5.4 |
| Thailand | 5.9 | 6.9 | 7.1 | 7 | 6.8 |
| Vietnam | 13.1 | 17.0 | 13.5 | 10.4 | 8.7 |

Source: World Bank, 2015. <http://data.worldbank.org/indicator/FR.INR.LEND/countries>

The cost of real estate is another factor that has to be considered. Figure 10 shows the prices (per square meter) of land in the premier city center in each ASEAN member. As expected, Singapore has the highest cost per square meter at US\$15,251. On the other hand, Thailand, the Philippines, Cambodia, Malaysia and Indonesia all show more competitive prices per square meter of land. On average, a square meter in these countries costs a fraction of Singapore's at US\$3,054 only.

Figure 10. ASEAN Square Meter Prices

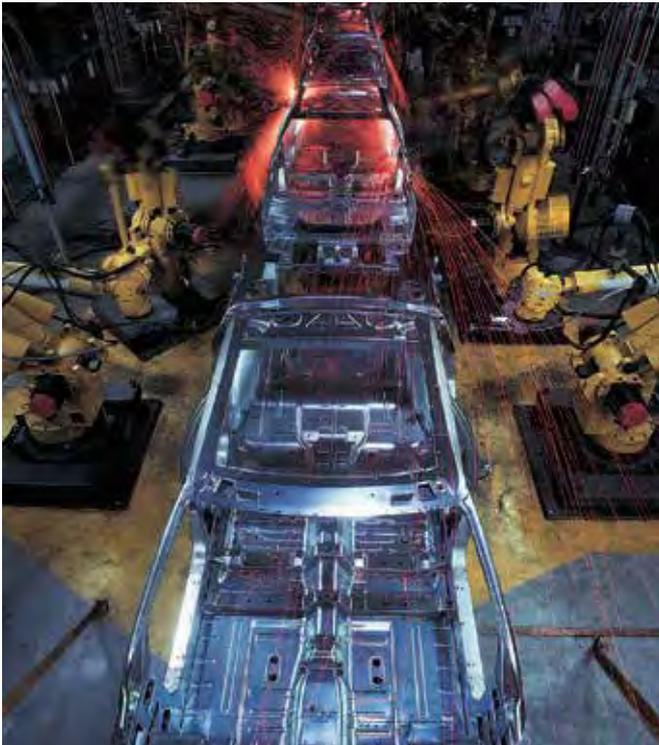


Source: Singapore Urban Redevelopment Authority (2015), Bank of Thailand (2015), Philippine Colliers International (2014), Bank Indonesia, Malaysia Valuation and Property Services Department, Global Property Guide (2015)

To further assess the competitiveness of the ASEAN members, one can also look at global competitiveness indices. A recently developed competitiveness index by McKinsey & Company (2014) examines a country's competitiveness per manufacturing activity. It is divided into two: cost and quality index.

The cost index encompasses factors that have a tangible impact on a manufacturing operation's profitability (e.g., utility rates, wages, property prices and taxes, and fiscal or tax incentives). It is calculated by estimating the costs for key indicators such as the number of employees, utilities, and industrial space required, and comparing each location's total costs with the average of all other locations under consideration. A higher cost index indicates a more expensive location.

The quality index, on the other hand, captures the overall infrastructure and ecosystem that facilitate and enable manufacturing operations. It is composed of labor or talent pool factors, business environment, quality of life, infrastructure such as roads, utilities, and internet access for improved connectivity, physical access to other markets, and the current ecosystem or linkages for a given industry. The quality index is a weighted index of selected quality indicators depending on factors most relevant to the particular sector and project requirements. A high score indicates a better quality location.



In the McKinsey and Company report²⁵, the authors discuss three manufacturing sectors, namely, chemicals; motor vehicles and components manufacturing; and beverage and food manufacturing. In each sector, the combination of the two indicators gives a picture where to best locate one's production. Let us take a closer look on the latter two sectors.

In the auto original equipment and components manufacturing, cost optimization is significant for locating operations. Companies must balance low manufacturing costs with overall supply chain costs such as transportation and components supply. In ASEAN, Thailand is seen as the best positioned country to capture the opportunity and attract manufacturing FDI because of the quality it offers (Figure 11). Although Thailand's overall cost index (energy, labor, and property) is 20 to 25 percent higher than Indonesia, Vietnam and the Philippines (which have the lowest cost), its quality index, nevertheless, has the strongest weighted score. This is mainly because of a high quality and mature automotive manufacturing ecosystem such as tiered suppliers of auto components.

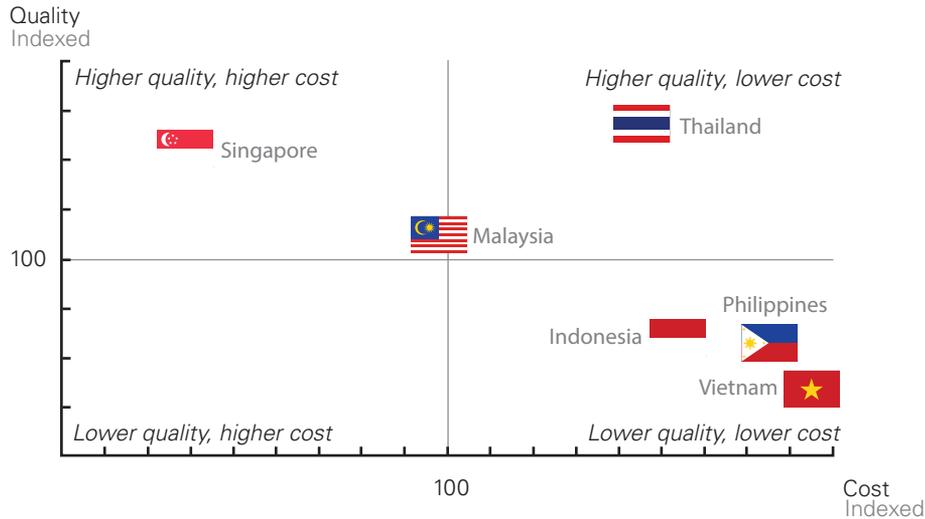
Although its quality index lags far behind that of Thailand, Indonesia can still expect an increase in FDI in the coming years given strong local demand for automobiles. Its low cost can be a stepping stone in competing with Thailand. It just needs to develop a robust auto ecosystem. For the Philippines and Vietnam while they already are a destination for cheap cost of production, they lack a sizeable motor vehicle and components manufacturing base in the automotive manufacturing sector. Still, if the average weighted competitive index is computed, the Philippines ranks fourth as the most attractive investment destination for manufacturers of motor vehicles and components next to Thailand, Vietnam and Indonesia²⁶. Given the 2015 Executive Order 182 on Comprehensive Automotive Resurgence Strategy (CARS) Program, which provides time-bound, and output- or performance-based fiscal support to attract strategic investments in the manufacturing of motor vehicles and parts thereof, the Philippines is expected to be more competitive in the ASEAN automotive manufacturing industry in the future²⁷.

²⁵ Oliver Tonby, Jonathan Ng and Matteo Mancini. Understanding ASEAN: The manufacturing opportunity. McKinsey Productivity Sciences Center. McKinsey & Company, 2014

²⁶ Oliver Tonby, Jonathan Ng and Matteo Mancini. Understanding ASEAN: The manufacturing opportunity. McKinsey Productivity Sciences Center. McKinsey & Company, 2014

²⁷ Official Gazette. Executive Order No. 182, s. 201. Retrieved June 25, 2015 from <http://www.gov.ph/2015/05/29/executive-order-no-182-s-2015/>

Figure 11. Auto original equipment and components manufacturing

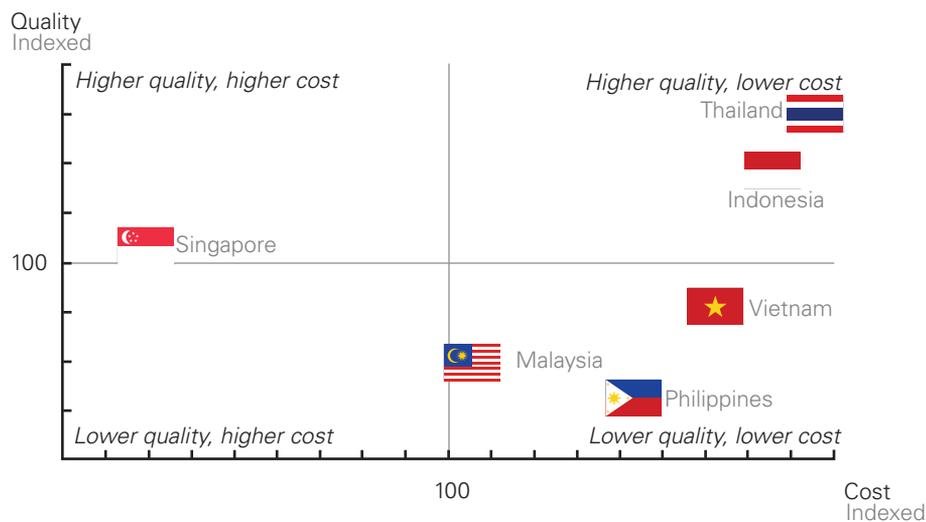


Source: Oliver Tonby, Jonathan Ng and Matteo Mancini. *Understanding ASEAN: The manufacturing opportunity*. McKinsey Productivity Sciences Center. McKinsey & Company, 2014

In the food, beverage and tobacco sector, cost and quality factors are equally important. In order to serve the ASEAN market, operating with low costs and producing affordable products are imperative for manufacturers. Based on the competitiveness index, Thailand's agricultural resources, sophisticated farming technology, and international quality standards make it a particularly attractive location for investment. Indonesia ranks second as the most attractive location²⁸. The Philippines, albeit belonging to the low cost-low quality category together with Vietnam and Malaysia, ranks fourth as the most attractive country for food, beverage, and tobacco manufacturing (Figure 12).

The analysis of these two sectors shows that the Philippines tends to dominate in the lower quality, lower cost quadrant. The challenge now is to move up to the higher quality and lower cost category.

Figure 12. Food, Beverage and Tobacco



Source: Oliver Tonby, Jonathan Ng and Matteo Mancini. *Understanding ASEAN: The manufacturing opportunity*. McKinsey Productivity Sciences Center. McKinsey & Company, 2014

²⁸ Oliver Tonby, Jonathan Ng and Matteo Mancini. *Understanding ASEAN: The manufacturing opportunity*. McKinsey Productivity Sciences Center. McKinsey & Company, 2014

The World Bank's Doing Business framework provides another perspective in ranking relative competitiveness of countries. The set of World Bank indicators evaluates business regulations that may affect domestic small and medium-size firms across 189 economies. It does so by providing quantitative measures of regulations for starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting minority investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency and labor market regulation. The description of each indicator is presented in Table 6.

Table 6. Areas of Business Regulation in the Doing Business Indicator

| Indicator | Description |
|-----------------------------------|--|
| Starting a business | Procedures, time, cost and paid-in minimum capital to start a limited liability company |
| Dealing with construction permits | Procedures, time and cost to complete all formalities to build a warehouse |
| Getting electricity | Procedures, time and cost to get connected to the electrical grid |
| Registering property | Procedures, time and cost to transfer a property |
| Paying Taxes | Payments, time and total tax rate for a firm to comply with all tax regulations |
| Trading across borders | Documents, time and cost to export and import by seaport |
| Getting credit | Movable collateral laws and credit information systems |
| Protecting minority investors | Minority shareholders' rights in related-party transactions and in corporate governance |
| Enforcing contracts | Procedures, time and cost to resolve a commercial dispute |
| Resolving insolvency | Time, cost, outcome and recovery rate for a commercial insolvency and the strength of the insolvency legal framework |
| Labor market regulation | Flexibility in employment regulation, benefits for workers and labor dispute resolution |

Source: World Bank Ease of Doing Business, 2014 <http://www.doingbusiness.org/data>

Table 7 presents the doing business indicator rank and the business snapshots of each ASEAN country. According to the table, in general, Malaysia is the most promising ASEAN country to locate one's business. It has the highest rank among the region (12 out of 185 countries). Still, it needs to enhance its workforce education and business and tax processes (as suggested by the Enterprise survey²⁹ in 2009) in order to further attract investment. Thailand also has a high doing business indicator score. According to the criteria, the constraint in this country however is the stringent policy in foreign equity ownership restrictions.

Table 7. ASEAN Business Snapshots

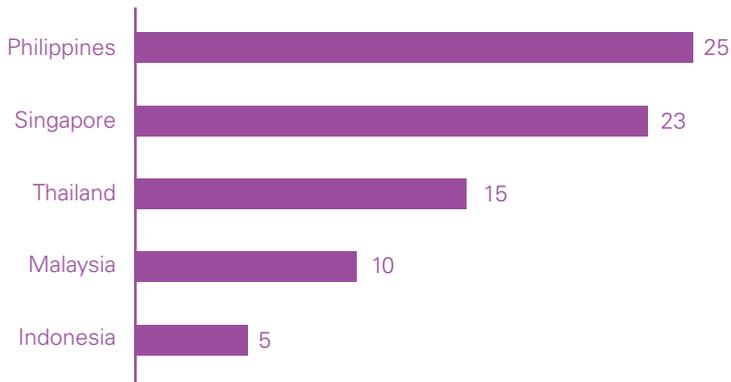
| Country | Doing Business Indicator (2013) | Top Obstacles |
|-------------|--|--|
| Cambodia | 133 from 141 due to improvement of getting credit indicator | Corruption, electricity, political instability |
| Indonesia | 128 from 130 due to improvement of getting electricity indicator | Access to Finance, Practices of Informal Sector, Political Instability |
| Lao PDR | 163 from 166 due to improvement of starting a business indicator | Tax Rates, Access to Finance, Inadequately Educated Work force |
| Malaysia | 12 from 14 due to improvement in registering a property indicator and dealing with construction permit indicator | Inadequately Educated Workforce, Tax Administration, Business Licenses and Permits |
| Philippines | 138 from 136 due to lower scores in the sub-indicators of doing business (getting credit, etc.) | Practices of the Informal Sector, Access to Finance and; Tax rates |
| Thailand | 18 from 17 due to lower scores for all six sub-indicators of doing business | Thailand's restrictions on foreign equity ownership are among the most stringent |
| Vietnam | 99 (no change in overall ranking) | Access to Finance, Practices of the Informal Sector, Transportation |

Source: World Bank Business Snapshots, 2014 <http://www.doingbusiness.org/data/exploreconomies>

²⁹ Enterprise Survey, developed by the World Bank, is a firm-level survey of a representative sample of an economy's private sector. The surveys cover a broad range of business environment topics including access to finance, corruption, infrastructure, crime, competition, and performance measures.

Unlike the other ASEAN countries whose ranks improved, the perception of doing business in the Philippines actually worsened in 2013. The analysis showed that businessmen continue to face high tax rates and have difficulty in adjusting to the practices of the informal sector players. In addition, the Philippines has the highest electricity power rate in the region. As presented in Figure 13, the price per kilowatt hour in the Philippines is US\$0.25. This is 1.6 times higher than Thailand's, 2.5 times larger than Malaysia's and five times more than Indonesia's electricity power rates. Clearly, these challenges have to be addressed to make the country one of the most competitive manufacturing sites in the region. Improvement of its manufacturing facilities, hard infrastructures, and government regulations are very much needed.

Figure 13. Electricity Rates in Selected ASEAN Countries, 2013
(in US cents per kilowatt hour)



Source: ASEAN Center for Energy, 2015. <http://www.aseanenergy.org>

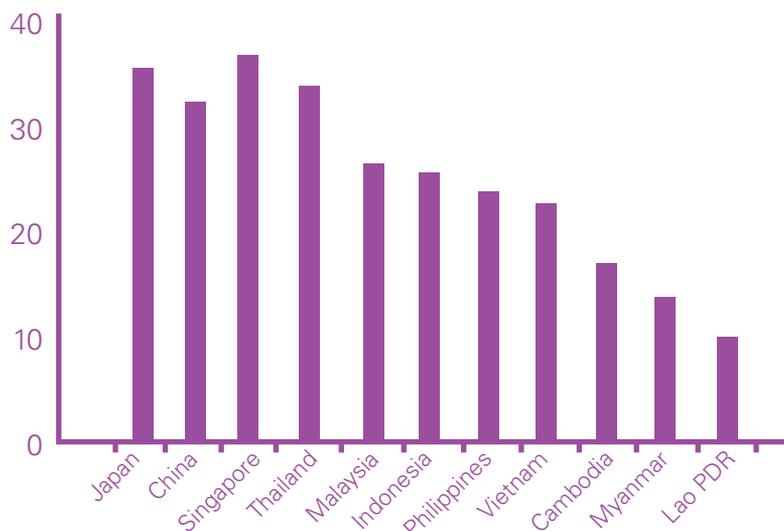


Ease of Trading

Trade facilitation has an important policy role in enhancing competitiveness. Trade facilitation covers any measure that lowers the costs of international transactions. Wang and Duval³⁰ estimate and monitor the countries' implementation of trade facilitation via the paperless trade implementation score.

In Figure 14, one can note that among ASEAN, only Singapore scored high on the implementation of trade facilitation measures, even exceeding the scores of China and Japan. Philippines is the 5th among ASEAN with the highest implementing trade facilitation score, suggesting a fairly good record in trade facilitation.

Figure 14. Trade facilitation and Paperless trade Implementation score

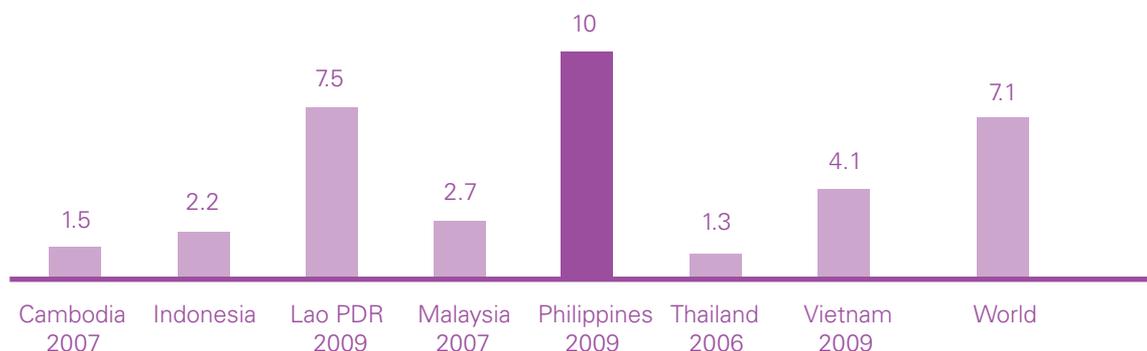


Source: Tengfei Wang, and Yann Duval. 2013. Trade facilitation and paperless trade in Asia: Results from an expert survey. ESCAP Trade and Investment Division Sta, Working Paper. No. 01/13, Revised in May. Bangkok: ESCAP. Available from www.unescap.org/tid/publication/swp113.pdf

³⁰ Tengfei Wang, and Yann Duval. 2013. Trade facilitation and paperless trade in Asia: Results from an expert survey. ESCAP Trade and Investment Division Sta Working Paper. No. 01/13, Revised in May. Bangkok: ESCAP. Available from www.unescap.org/tid/publication/swp113.pdf

Nevertheless, according to World Bank data on World Governance, businesses take a long time to clear direct exports through the Philippine customs (see Figure 15). Although this is not a barrier to trade, it still translates to higher transaction costs. The country needs to reassess its existing clearing procedures in order to make it competitive in the region.

Figure 15. Average Number of days to Clear Direct Exports through Customs



Source: World Governance Indicators; World Bank Business Snapshots, Enterprise Survey <http://www.doingbusiness.org/data>

Enhancing the Philippines as a Cog in the ASEAN Production Hub: Way Forward

The AEC blueprint situates ASEAN in a favorable position to attract FDIs. It does so by enhancing the set of elements that will truly transform the region into a cost effective production hub. Apart from fostering the free flow of goods and service to promote market integration, the AEC also incorporates facilitation and connectivity measures to bring down costs of transaction. In addition, the blueprint puts into place competition policy to anchor the second pillar of the AEC – competitive economic region.

Indeed, ASEAN has been a very attractive investment destination in the recent years as seen in the increasing investment flows into the region. The magnitude of FDI inflows overtook that of China in 2013 due to a number of factors including the cooling down of the Chinese economy and the anticipation of ASEAN integration. The policy thrust to create an integrated production hub under the AEC 2015 further heightens the interest of businesses. The AEC Blueprint has been putting into place necessary steps that will not only lower business transaction costs but will also make the regional supply chain smoother and easier to tap.

Despite the bold and forward looking elements, the AEC remains just a strategic plan. It is not a legal instrument that could compel all the signatories to implement all the provisions. Given the nature of the ASEAN, implementation has to be carried out at the level of the members – viz., through their domestic laws. In fact, compliance with the AEC could be gleaned from the rate of adoption of domestic laws or regulations by the members that support the AEC.

The Philippines has made strides in advancing the AEC vision, particularly in the competition area. Just recently, after being tabled and debated for more than a decade, a competition law was passed by Congress. The features of the competition legislation include the formation of the Philippine Competition Commission (PCC) as an independent quasi-judicial body attached to the Office of the President which would enforce a national competition policy by prohibiting anti-competitive agreements, abuse of dominant position, and anti-competitive mergers and acquisitions. The PCC may levy fines of up to PhP 100 million (US\$2.2 million) for business entities found engaging in unfair business practices for the first offense, and up to PhP 250 million (US\$5.5 million) for the second offense. Fines will be reviewed every five years, to keep them income and inflation adjusted³¹. To the extent that competition law can help create a business environment that is fair, it could enhance the confidence of investors in the Philippine market. The law gives legal recourse for investors against uncompetitive behavior of incumbents thus leveling the field.

Though the Philippines has made advances to attract foreign investors through market oriented policies and general improvement of governance, there are still

To the extent that competition law could help create a business environment that is fair, it could enhance the confidence of investors in the Philippine market.

³¹ <http://www.bamaquino.com/wp-content/uploads/2015/06/Phil-Competition-Act-Ratified.compressed.pdf>



some roadblocks that persist. Observers³² are quick to point out that constitutional restrictions such as limits to foreign equity in the exploration, development and utilization of natural resources, public utilities, build-operate-transfer projects, operation of deep-sea commercial vessels, among others, serve to constrain FDI. In addition, constitutional restraints on land ownership for foreigners, practice of professions, and equity in mass media could also discourage FDI. For example, while all ASEAN companies can own 100 percent of companies in other ASEAN countries under the AEC³³, foreign companies can only own at most 40 percent of real properties and businesses in the Philippines. Llanto comments that by adding the phrase “unless specified by law” to the foreign ownership restrictions of the Constitution in public utilities, land, mass media and advertising, educational institutions, and development of natural resources (particularly on Articles XII, XIV and XVI) would introduce flexibility for Congress to define and determine sectors or industries that could be opened up for greater foreign participation (ownership). This consequently encourages a more open economy to foreign direct investments³⁴.

The lower FDI performance of the Philippines compared to other ASEAN members such as Singapore, Indonesia, Thailand and Vietnam, could be tied up partially with constitutional restrictions. Therefore, amending the economic provisions of the

constitution is deemed as an ideal recourse for the Philippines for it to fully benefit from the ASEAN Economic Community (AEC) in 2015. The experience of the other ASEAN countries indicates that adding flexibility to investment limitations could further attract FDI. Buoyed by positive macroeconomic conditions in the coming years, the potential of the Philippines for substantially increasing FDI can be enhanced by, among others, addressing the aforementioned constitutional restraints.

Although the Philippines faces challenges, it still remains as one of the most promising countries poised to attract investments. As emphasized by the Department of Trade and Investment (DTI) Secretary Gregorio Domingo³⁵, the robust and fast economic growth of the Philippine has set the pace for the rest of ASEAN. This is coupled with the country’s stable and manageable inflation, competitive lending rates, reasonable and low real estate prices, and greater investor confidence. The Philippine demographics is another feature that makes the country stand out among its ASEAN peers. It has a young, vibrant and active population. It also has a workforce with high English proficiency and a globally recognized education. The country can consequently take advantage of the region’s demographic dividend. Given all of these, investors can view the Philippines as a gateway to the rest of region as well as to ASEAN’s six free trade partners in East Asia.

³² Claudette Malana “Amending the economic provisions of the 1987 Constitution,” Economic Issue of the Day, PIDS, Vol XIV, No. 2, December 2014.

³³ Danilo Israel, Reiner de Guzman, Adoracion Navarro, Myka Ivory, Maureen Ane Rosellon, Gilberto Llanto, Roehlano Briones, Rafaelita Aldaba, Melanie Milo, Erlinda Medalla and Veredigna Ledda. The ASEAN Economic Community and the Philippines: Implementation, outcomes, impacts, and ways forward. Philippine Institute for Development Studies. Makati City: Philippine Institute for Development Studies, 2013.

³⁴ Gilberto Llanto. Comments on the proposal to amend certain economic provisions of the 1987 Constitution.

<http://www.pids.gov.ph/files/outreach/Llanto-Constitutional%20amendments.pdf>. Submitted to the House of Representatives, February 18, 2014

³⁵ Department of Trade and Industry. DTI Secretary Domingo Bullish on Trade and Investment Prospects with Germany.

<http://berlinpe.dfa.gov.ph/index.php/embassy-news/163-dti-secretary-domingo-bullish-on-trade-and-investment-prospects-with-germany>, October 9, 2013.



Navigating through the Single Window

Emmanuel P. Bonoan, Vice Chairman and Head of Tax, Chief Operating Officer, KPMG in the Philippines
Andrew James Gerard D. Ruiz, Tax Director, KPMG in the Philippines

In 1992 the Heads of State and Government of the ASEAN member states established the ASEAN Free Trade Area (AFTA). It became the building blocks for the development of trade and manufacturing support throughout the region. One of the salient features of AFTA is the liberalization of trade through the elimination of tariffs and non-tariff barriers among the member-countries. This has paved the way for efficiency as well as competitiveness in production and trading.

In line with the AFTA, ASEAN member states adopted the Agreement on the Common Effective Preferential Tariff Scheme (CEPT). The CEPT Scheme mandates an agreed effective tariff (reduced to 0-5%), excepting those belonging to the Sensitive/Highly Sensitive List and General Exception (GE) List, to be applied to goods originating from ASEAN Member States¹. Aside from this, quantitative restrictions on products which are traded as well as non-tariff barriers must have been eliminated over a gradual period of 5 years from 1997. Furthermore, member states agreed to lift

foreign exchange restrictions relating to payment of products and the repatriation thereof, as well as the installation of measures to liberalize trade through the harmonization of customs standards, reciprocal recognition of tests and certification of products, removal of barriers to foreign investment, macroeconomic consultation, rules for fair competition, and promotion of venture capital.

During the 12th ASEAN Summit in 2007, the member states signed the Declaration on the ASEAN Economic Community Blueprint, aimed at transforming ASEAN into a region with free movement of goods, services, investment, skilled labor, and freer flow of capital. One of the core elements of the AEC is the institution of a single market and production base making it more dynamic and competitive. An ASEAN single market and production base shall comprise five core elements: (1) free flow of goods; (2) free flow of services; (3) free flow of investment; (4) freer flow of capital; and (5) free flow of skilled labor. The 2015 AEC Blueprint prescribes the elimination of tariffs in

¹ Article 1, 1992 Agreement on the Common Effective Preferential Tariff Scheme for the ASEAN Free Trade Area. Signed 28 January 1992.

all intra-ASEAN goods, with due regard to the CEPT-AFTA Agreement and other agreements/protocols.

A main component of single market and production base model is the establishment of means and measures to eliminate tariff and non-tariff barriers in the flow of goods. The ASEAN Single Window was therefore created to simplify, harmonize, and standardize trade and customs processes, procedures and the application of information, communication and technology (ICT) in all areas related to trade facilitation.

Earlier, in 1994, ASEAN countries signed the General Agreement on Tariffs and Trade (GATT 1994), which stipulates for the adoption of international best practices in trade facilitation, such as the use of single windows. Member countries have also acceded to the Revised Kyoto Convention on the Simplification and Harmonization of Customs Procedures, which includes the installation of single windows.

Defining the single window approach

In the past, the conduct of international trade has been primarily paper-based. To comply with import and export regulatory requirements, companies involved in trade have to prepare and submit an immense number of documents to several governmental agencies and financial institutions who have varying documentation systems. The multiplicity of these paper forms and regulatory agencies contribute much to delay and cost of trading².

Seen as a valuable lesson from the European Union (EU), the ASEAN Single Window was born out of need and innovation to expedite and simplify the trade system in cross-border transactions amongst ASEAN member states. The United Nations Economic Commission for Europe (UNECE) defines a single window as “a system that allows traders to lodge information with a single body to fulfill (l) all import or export-related regulatory requirement³.” Furthermore, it described the single window as an “environment [that] provides one entrance, either physical or electronic, for the submission and handling of all data and documents related to the release and clearance of an international transaction. This entrance is managed by one agency, which informs the appropriate agencies and/or directs combined controls⁴.”

The ASEAN Single Window

According to the World Bank’s Trading Across Borders 2012 report, out of 150 economies surveyed, 49 have introduced a Single Window, of which only 20 have a Single Window system that links all relevant government agencies. The remaining 29 have a Single Window that hasn’t yet linked the government agencies.

In Singapore alone, the single window approach led to higher government efficiency. In 1989, its government established the world’s first national single window, called TradeNet, which linked more than 35 border agencies. Singaporean Customs claims that for every US\$1 in generated in customs revenue, the expense is only 1 cent, translating into a profit margin of 9,900%⁵.

Jonathan Koh Tat Tsen⁶, in his paper Ten Years of Single Window Implementation: Lessons Learned for the Future, writes that “government agencies are traditionally organized through a variety of separate departments, which may have limited connection with each other or technologically or in the way their services are delivered. The implementing entities of the Single Window system now find themselves to be pioneers in establishing an unprecedented connected government framework.”

More often than not, trade facilitation processes in some countries, including the Philippines, is still very much paper-based. Many of the government agencies that regulate trade and private companies, such as banks, still require paper-based documentation⁷. As such, it is a challenge for modern Single Window systems to offer paperless trading through a one-stop-shop venue. Koh Tat Tsen argues that the Single Window projects “simplified and automated business procedures, introduced change and brought about collaboration between the government agencies and the private sector.”

ASEAN has been determined to launch a regional single window for all member-states. The greater scheme is to integrate the members-states’ national single windows (NSW) to give way for a single submission of data and information across the entire region⁸.

² United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT) (2005). Recommendation No. 33: Recommendation and Guidelines on Establishing a Single Window. United Nations: 2005.

³ United Nations Economic Commission for Europe (April 2003). Brochure on the Single Window Concept, United Nations, Geneva, Switzerland. Retrieved from <http://unpan1.un.org/intradoc/groups/public/documents/UNECE/UNPAN019892.pdf>

⁴ Ibid.

⁵ Singapore Customs Service 2007.

⁶ Koh Tat Tsen, Jonathan (2011). Ten years of Single Window Implementation: Lessons Learned for the Future. Global Trade Facilitation Conference 2011.

⁷ Supra.

⁸ World Bank (2012). Doing Business: Trading Across Borders.

In 9 December 2005, the ASEAN member states signed the Agreement to Establish and Implement the ASEAN Single Window (ASW). The ASEAN Single Window is described as “a mechanism where National Single Windows (NSW) of Member Countries operate and integrate.” Activities include exchange of information of ASEAN Customs Declaration Document and Certificate of Origin under the CEPT scheme of the AFTA⁹.

Under the ASW Conceptual Model, the NSW’s of member countries are linked through a secure connection on a one-to-many and bottom-to-top strategy.

Through a protocol in 2006, ASEAN¹⁰ has expanded the definition of a “National Single Window” by introducing the concept of “submitting once at a single entry point,” viz:

1. A single submission of data and information;
2. A single and synchronous processing of data and information;
3. A single decision-making for customs release and clearance; and
4. A single decision-making shall be uniformly interpreted as a single point of decision for the release of cargoes by the Customs on the basis of decisions, if required, taken by line ministries and agencies and communicated in a timely manner to the Customs.

ASEAN Single Window (ASW) aims to:

1. expedite and simplify information flow between government and trade and bring meaningful gain to all parties involved in international trade;
2. establish the viable, simplified, standardized and integrated environment for cargo clearance in line with international best practices; and
3. reduce time and resources needed for cargo clearance.

The ASW shall operate in an open environment of required relationships and linkages between economic operators and governments, for a completion of a transaction, such as Government-to-Business, Business-to-Business, or

Government-to-Government, and others of such nature, through a secure infrastructure¹¹.

Currently, most ASEAN countries implemented customs reforms by establishing their own National Single Window platforms¹²:

1. Singapore¹³ was an early starter to develop a countrywide system. They initiated their plan in 1986 and launched a fully automated national system for trade facilitation, called TradeNet, in January 1989. TradeNet allows for 24-hour access to services for the electronic transmission of trade documents. In January 1999, it was modernized to embrace web-based technologies. It currently connects 35 government agencies to facilitate the processing and approvals of trade permits, reducing the processing time per application to less than 3 minutes.
2. Indonesia¹⁴ NSW (INSW) was officially launched in 2010, although the Customs Electronic Data Interchange (EDI) has been developed since 1996. In 2010, the INSW got into real operation in 5 principal ports, and expanded to 10 major ports in 2012. At present, approximately 20,000 documents a day are exchanged in INSW by over 18,000 registered companies. Usage of INSW is free of charge.
3. Thailand’s¹⁵ NSW started in July 2008 as “e-Logistics,” and revamped as “National Single Window” in July 2011. Customs declaration service is available at 660 Customs Offices all over the country (seaports, airports, container yards, freezone, bonded manufacturing plants, warehouses). The use of Thai NSW is free of charge. However, when used through service providers, a charge of 25Baht/25kb is levied. In 2002, the Electronic Transaction Act of 2001 was promulgated. Now, commercial transactions carried out by means of electronic documents, are guaranteed to have the same effectiveness as the ones carried out by means of paper documents. At present, digital signature is normally required for the use of the Thai NSW.

⁹ *Infra*, Ibrahim (2011).

¹⁰ Article 1, Protocol to Establish and Implement the ASEAN Single Window, 20 December 2006.

¹¹ Article 4, Protocol to Establish and Implement the ASEAN Single Window, 20 December 2006.

¹² Japan Association for Simplification of International Trade Procedures (JASTPRO) (December 2012). ASEAN Single Window: Hearing Survey in 2012, Issues to be Studied.

¹³ *Supra*, Koh Tat Tsen (2011).

¹⁴ *Supra*, JASTPRO (2012).

¹⁵ *Supra*, JASTPRO (2012).



Current Status of Philippine National Single Window (NSW)

The Philippines pioneered the ASEAN efforts in establishing NSW's throughout the region. In the 3rd Inter-Agency Task Force Meeting on ASW in April 2005, it volunteered to be the pilot country for the implementation of the National Single Window (NSW) for Cargo Clearance.

On 27 December 2005, then President Gloria Macapagal-Arroyo issued Executive Order No. 482, creating the National Single Window Task Force for Cargo Clearance. The issuance defines NSW as a "system that enables a single submission of data and information that is synchronously processed, resulting in a single point of decision for the release of cargoes by Customs, based on decision made by other Departments and Agencies of government and communicated in a timely manner to Customs." Harboring on the confluence on the different agencies in communication with the Bureau of Customs (BOC), the issuance envisions the Philippine NSW as an avenue to "increase transparency in cargo processing, provide a more accurate, timely and cost-efficient exchange of information, reduce customs operational costs and improve revenue collection." The NSW Task Force is composed of the (1) Steering Committee and (2) Technical Working Group comprised by various government agencies.

It should be noted that the timeline of the implementation of NSW's all over ASEAN has been accelerated since the signing of the ASEAN Framework (Amendment) Agreement for the Integration of Priority

Sectors, signed by the ASEAN Economic Ministers in Cebu, Philippines on 8 December 2006, whereby Article 6 thereof states that the implementation of the ASEAN Single Window shall be had by 1 January 2008 for ASEAN-6 and by 1 January 2012 for CMLV¹⁶.

So, in compliance with national law on procurement, a public tender was called to develop the Philippine NSW. The project was awarded to British Company, Crown Agents for Oversea Governments and Administrations, Ltd.¹⁷ The configuration of the product was started in November 2009 and within a short time frame, the National Single Window was set up in the 30 government agencies making more transactions each day and ready for use of the 10 monitoring and accrediting government agencies¹⁸.

In August 2010, PNSW's project team started implementation and roll-out to seven (7) pilot agencies with regional offices such as the Bureau of Internal Revenue (BIR), Bureau of Quarantine (BOQ), Bureau of Product Standards (BPS), Fertilizer and Pesticide Authority (FPA), Food and Drug Administration (FDA), National Meat Inspection Service (NMIS) and National Telecommunication Commissions (NTC)¹⁹.

Trading has become convenient as traders can now transact at the comfort of their home and office. One advantage about the PNSW is that traders from provinces can transact at the nearest office; it will not be necessary to head to Manila to secure permit/clearances. As such, costs of trading and the probability of delays are significantly reduced.

¹⁶ Cambodia, Myanmar, Lao PDR and Vietnam

¹⁷Supra, JASTPRO (2012).

¹⁸Ibrahim, Monchito (2011). Status and Challenges of Trade Facilitation and Supply Chain Efficiency Improvements in the Philippines: Economic Corridors for Trade Facilitation. Asia Pacific Trade Facilitation Forum 2011.

¹⁹Supra.

In 2012, the PNSW had about 3,000 applications per day by over 2,800 entities. The use of the system of PNSW is free of charge. It is implemented in over 3 major, 12 provincial and 32 sub-ports all over the country.

With the full implementation of NSW, the BOC planned to impose that only import/export clearance and permits in electronic form via the NSW system will be accepted, with a phase out of all paper permits and clearance initially planned for first quarter of 2011²⁰.

Since the inception of the Philippine NSW, several legislations and government guidelines were issued to support the project, directly or indirectly by promoting paperless trading, namely:

1. In 2000, the Electronic Commerce Act (Republic Act No. 8792) was signed to regulate electronic document related issues. Under the said law, electronic documents shall have the effect, validity and enforceability as any other document or legal writing, as long as the electronic document maintains its integrity and reliability and can be authenticated so as to be usable for subsequent reference²¹. The law also sanctions the use of digital signature, rendering it equivalent to the signature of a person on written document.
2. Department of Trade and Industry (DTI) Administrative Order No. 8 (Series of 2006) which prescribes the Guidelines for the Protection of Personal Data in ICT in the private sector;
3. *Bangko Sentral ng Pilipinas* (BSP) Circular No. 542 (2006) providing for consumer protection in banking;
4. In 2002, the Philippine Senate ratified the World Intellectual Property Organization (WIPO) Copyright Treaty (WCT) and the WIPO Performances and Phonograms Treaty (WPPT) for the recognition and protection of IP rights of those who use the internet for their commerce; and
5. In 2012, Republic Act No. 10175 or the Cybercrime Prevention Act of 2012 was signed to curb illegal activities committed in cyberspace, including computer fraud, forgery, sabotage and unauthorized access.

Currently, there are 40 government agencies²² involved in implementing the NSW system.

The Philippines has shown promising reforms in planning to integrate NSW in its customs procedures. In an official news feature²³ released by the Department of Agriculture in May 2014, it reported that the PNSW is operational in 30 government agencies that are directly concerned with the processing of imports and export documentation.

Notwithstanding earlier gains, the PNSW admittedly faces several challenges in terms of rationalization and harmonization of NSW procedures, considering most regulatory government agencies have varying policies. To resolve this, the BOC, in partnership with the United States Agency for International Development (USAID) Trade-Related Assistance for Development Project, released the master list of regulated imports which contains information on 7,400 products, including their corresponding import requirements. The list provides common reference on regulated importations and can be downloaded at their website (customs.gov.ph). Also, the Bureau ensures that NSW downtime is immediately responded to by providing proper measures and key performance indicators (KPI) on the technical team. As a workaround measure due to issues on the performance of the NSW system, then Commissioner of Customs John P. Sevilla on 08 October 2014 ordered the BOC to temporarily accept/recognize paper or manually-processed commodity clearances and permits while the NSW was undergoing corrective maintenance. However, the processing of permits in the NSW System was still being continued while maintenance was carried out. In an official communication²⁴ dated 13 October 2014 addressed to the American Chamber of Commerce of the Philippines, Inc., Sevilla announced they were pushing for the immediate implementation of the PNSW Phase 2, as well as the Integrated Enhanced Customs Processing System. At that time, there were eleven government agencies that completed integration into the PNSW, nine that were partially connected, seven that stopped integration and thirteen that were not connected at all. Ironically, among the agencies that were not connected at all was the BOC.

²⁰Infra at 22.

²¹ Section 7, REPUBLIC ACT NO. 8792.

²² Board of Investments, Bureau of Animal Industry, Bureau of Customs, Bureau of Export Trade Promotion, Bureau of Fisheries and Aquatic Resources, Bureau of Import Services, Bureau of Internal Revenue, Bureau of Quarantine, Bureau of Plant Industry, Bureau of Product Standards, Dangerous Drugs Board, Department of Health, Civil Aviation Authority of the Philippines, Environment Management Bureau, Fertilizer and Pesticide Authority, Firearms and Explosive Office, Food and Drug Administration, Forest Management Bureau, Maritime Industry Authority, National Food Authority, National Meat Inspection Service, National Telecommunications Commission, Optical Media Board, Philippine Coconut Authority, Philippine Drug Enforcement Agency, Philippine Economic Zone Authority, Philippine National Police, Philippine Nuclear Research Institute, Philippine Ozone Desk and the Sugar Regulatory Administration

²³ Department of Agriculture (2014). News Feature: Philippine National Single Window. Retrieved from http://www.da.gov.ph/images/PDFFiles/otherspdf/nsw_rel1.pdf

²⁴ Retrieved from <http://customs.gov.ph/wp-content/uploads/2014/10/PNSW-RESPONSE-TO-JFC.pdf>

The present Commissioner of Customs Alberto D. Lina has also instructed the BOC to acquire new servers to fully eliminate cases of performance degradation in the NSW system.

On 02 June 2015, Commissioner Lina released an official statement²⁵ announcing the abandonment of the Integrated Electronic Customs Processing System (i-ECPS) Project due to change in market conditions and availability of other efficient, cost-effective, and advantageous customs data systems. As an update to the PNSW, he stated that 37 of the 40 permitting and oversight agencies are already connected to the system in varying levels of utilization: eleven agencies are completely connected, nine agencies are connected but only partially utilize the system, and ten oversight agencies already have viewing capacity. Meanwhile, the BOC is fixing systems issues in the three other oversight and permitting agencies that still need to be fully connected.

In line with this development, Commissioner Lina spearheaded a campaign to call for the support of NSW agencies to collaborate and work together – especially on the impending economic integration through the effective and efficient implementation of the PNSW. Activities on NSW roll-out shall commence to increase the utilization rate among agencies.

The Philippine government has done a significant amount of work to set up the NSW. Nonetheless, challenges still remain to ensure that all relevant government agencies are linked to the NSW. As the time for integration draws closer, the government must find ways to make good on its commitments under the ASEAN. The vision of a better method of carrying out business transactions is already there, and its importance to the country's economic development is already acknowledged. This change in the way trade and customs processes are done in the Philippines may yet be achieved, if the leadership sees it through.



²⁵ Retrieved from <http://customs.gov.ph/statement-of-commissioner-lina-on-the-cancellation-of-the-procurement-of-the-integrated-electronic-customs-processing-system/>

Glossary

| | | | |
|-----------|--|---------|--|
| ACCSQ | ASEAN Consultative Committee on Standards and Quality | HAPUA | Heads of ASEAN Power Utilities Authorities |
| ACIA | ASEAN Comprehensive Investment Agreement | HSBC | Hong Kong Shanghai Banking Corporation |
| ACPE | ASEAN Chartered Professional Engineer | ICT | Information, Communications and Technology |
| ADB | Asian Development Bank | IMF | International Monetary Fund |
| AEC | ASEAN Economic Community | IOM | International Organization for Migration |
| AEM | ASEAN Economic Ministers | JETRO | Japan External Trade Organization |
| AFAS | ASEAN Framework Agreement on Services | KPI | Key Performance Indicator |
| AHN | ASEAN Highway Network | LPI | Logistics Performance Index |
| AFTA | ASEAN Free Trade Area | M&A | mergers and acquisitions |
| ALTID | Asian Land Transportation Infrastructure Development | MPAC | Master Plan of ASEAN Connectivity |
| AMCASP | ASEAN Monitoring Committee on Architectural Services for the Philippines | MRA | mutual recognition arrangement |
| AMCESP | ASEAN Monitoring Committee on Engineering Services of the Philippines | NLEx | North Luzon Expressway |
| APEC | Asia-Pacific Economic Cooperation | NSW | national single window |
| APG | ASEAN Power Grid | NTR | National Trade Repository |
| ASEAN | Association of Southeast Asian Nations | OECD | Organisation for Economic Co-operation and Development |
| ASW | ASEAN Single Window | OFW | Overseas Filipino workers |
| ATR | ASEAN Trade Repository | OSEDC | One-Stop Export Documentation Center |
| BIMP-EAGA | Brunei-Indonesia-Malaysia-Philippines East Asia Growth Area | PEZA | Philippine Economic Zone Authority |
| BPO | business process outsourcing | PNSW | Philippine National Single Window |
| BOC | Bureau of Customs | PPC | private-public partnerships |
| BSP | Bangko Sentral ng Pilipinas | PRC | Professional Regulation Commission |
| CARICOM | Caribbean Community | RFPE | Registered Foreign Professional Engineer |
| CEPT | Common Effective Preferential Tariff | RO | Rules of Origin |
| CHED | Commission on Higher Education | RORO | Roll-On/Roll-Off |
| CIQS | Customs, Immigration, Quarantine and Security | SLEx | South Luzon Expressway |
| CMLV | Cambodia, Lao PDR, Myanmar, Vietnam | SME | small and medium enterprises |
| CO | Certificate of Origin | STRI | Service Trade Restrictiveness Index |
| COO | Certificate of Origin | TIVA | Trade in Value-Added |
| DTF | Distance to Frontier | TPP | Trans-Pacific Partnership |
| DOF | Department of Finance | UAP | United Architects of the Philippines |
| DTI | Department of Trade and Investment | UNCTAD | United Nations Conference on Trade and Development |
| EEC | European Economic Community | UNECE | United Nations Economic Commission of Europe |
| EIU | Economist Intelligence Unit | UNESCAP | United Nations Economic and Social Commission for Asia and the Pacific |
| EU | European Union | USAID | United States Agency for International Development |
| FDI | foreign direct investment | VIP | Vietnam, Indonesia and the Philippines |
| GATT | General Agreement on Tariffs and Trade | WCT | WIPO Copyright Treaty |
| GDP | gross domestic product | WIPO | World Intellectual Property Organization |
| GPN | global production networks | WTO | World Trade Organization |

About the Philippines

Recent History: Democratization

- The Philippines officially became a republic in 1946.
- The year 1986 was a landmark year in the country's efforts to become a self-governing, full-fledged democratic country when President Ferdinand Marcos was ousted from power and President Corazon Aquino assumed the presidency.
- The Aquino Presidency (1986-1992) was marked by a revival of democratic institutions and the restoration of civil liberties.
- National reconciliation was the highlight of the Ramos presidency (1992-1998) as well as continuing political and economic reforms initiated by the previous administration.
- The short-lived Estrada presidency (1998-2001) governed via a platform of populism with poverty alleviation as its centerpiece.
- Former President Gloria Macapagal-Arroyo's presidency (2001-2010) has made the economy the focus of her presidency. Economic growth in terms of GDP averaged 4.6 percent during the Arroyo administration from 2001 up to the end of 2003, to 5.5 percent in 2006. 2007 saw the country's GDP grow by 7.3 percent as continuing fiscal reforms allowed the government to make headway in its development initiatives. The country's economic growth for 2009 is 4.6 percent.
- Benigno Aquino III is the current President of the Republic of the Philippines. His main platform is good governance and the elimination of corrupt practices in the government. Under his administration, the overall financial strength of the government has improved, owing to a more efficient tax administration and responsible government spending.
- The current Aquino regime posted a GDP growth of 7.6 percent in 2010 and slowed down to 3.6 percent in 2011. It then grew by 6.8 percent in 2012 and exceeded the government's expectations when the Philippine economy expanded to 7.2 percent in 2013. In 2014, it posted a 6.1 percent GDP growth, still within the 6 to 7 percent range which economists say is still realistic. The country remains as one of the strongest economies in the Asian region with infrastructure development encouraged to continue in the next administration.
- Different rating agencies have also consistently upgraded the credit ratings of the Philippines. Fitch affirmed a BBB- sovereign rating or a stable outlook in March 2015, followed by Standard & Poor's stable outlook of BBB in April 2015. Another vote of confidence was also seen from Moody's stable outlook of Baa2 in December 2014.

Languages

- Over 87 languages and dialects belonging to the Malayo-Polynesian linguistic family
- Three principal languages: Cebuano, Tagalog, and Ilocano. Filipino is the official language
- English is the language of business and government
- GlobalEnglish, an independent research group, ranked the Philippines number 1 in the world in terms of proficiency in business English for its 2012 study

Geography

- Located in Southeast Asia
- Area: 300,000 sq. km. (117,187 square miles)
- Three major geographical areas: Luzon, Visayas, Mindanao
- Major cities (2010 estimate): Capital - Manila (pop. 11.85 million in the metropolitan area with an average annual growth rate of 1.78%)
- Other cities - Cebu City (0.87 million); Davao City (1.45 million)
- Terrain: Archipelago composed of 7,107 islands, 65 percent mountainous, with narrow coastal lowlands

Climate

- Tropical, sitting astride a typhoon belt
- Three seasons: Rainy (June to October); Cool and Dry (November to February); Hot and Dry (March-May)
- Average temperature: 27 degrees Celsius (81 degrees Fahrenheit); Average Humidity: 78 percent
- Year-round average temperature range: 23-32 degrees Celsius

Population

- 92.34 million (National Statistics Office, May 2010 estimate;)
- Population growth rate of 1.81 percent per year (2014 estimate)
- Literacy Rate: 97.5 percent of total population

Education

- K-12: universal kindergarten, six years of elementary education (Grades 1-6), four years of junior high school with additional two years for senior high school (Grades 11 to 12)
- Public Elementary and High School education subsidized by the government
- English is part of the curriculum and is the medium of instruction for most subjects

Political

- Type: Republic
- Independence: 1946
- Current constitution: Ratified on 11 February 1987
- Branches: Executive; Legislative - Bicameral legislature; Judiciary
- Administrative Subdivisions: 17 regions including Metro Manila (National Capital Region), 80 provinces, 138 cities
- Suffrage: Universal, but not compulsory, at age 18

Sources: National Statistics Office, CIA World Factbook, www.gov.ph, www.nscb.gov.ph

Directory of Government Agencies

Bangko Sentral ng Pilipinas

Vito Cruz corner Mabini St., Malate, Manila
Tel. No.: +63 2 708 7206 / +63 2 708 7210
Website: bsp.gov.ph

Bureau of Customs

Bureau of Customs Building, Port Area,
South Harbor, Manila
Tel. No.: +63 2 526 6355
Website: customs.gov.ph

Center for International Trade Expositions and Missions

Golden Shell Pavilion Roxas Blvd., cor. Sen.
Gil Puyat Ave., Pasay City
Tel. No.: +63 2 831 2382 / +63 2 832 3956 /
+63 2 832 3965
Website: citem.gov.ph

Department of Finance

6/F DOF Bldg., Roxas Blvd. cor.
Pablo Ocampo St., Manila
Tel. No.: +63 2 523 9911 to 14
Website: dof.gov.ph

Department of Foreign Affairs

DFA Bldg., 2330 Roxas Boulevard, Pasay City
Tel. No.: +63 2 834 4000
Website: dfa.gov.ph

Department of Labor and Employment

DOLE Bldg., Muralla cor. Gen. Luna Sts.,
Intramuros, Manila
Tel. No.: +63 2 527 3000
Website: dole.gov.ph

Department of Tourism

DOT Bldg., T.M. Kalaw St., Agrifina Circle,
Rizal Park, Manila
Tel. No.: +63 2 523 8411
Website: tourism.gov.ph /
itsmorefuninthephilippines.com

Department of Trade and Industry

361 Trade and Industry Building,
Sen. Gil J. Puyat Avenue, Makati City
Tel. No.: +63 2 751 0384
Website: dti.gov.ph

National Economic and Development Authority

12 St., Josemaria Escriva Drive,
Ortigas Center, Pasig City
Tel. No.: + 63 2 631 0945 to 56
Website: neda.gov.ph

Philippine Economic Zone Authority

Roxas Blvd. corner San Luis St., Pasay City
Tel. No.: + 63 2 551 3451 loc. 612 / +63 2 551 3455 /
+63 2 551 3432 / +63 2 891 6380
Website: peza.gov.ph

Philippine Export-Import Credit Agency

17/F Citibank Tower, Valero St., Makati City
Tel. No.: + 63 2 893 4397 / +63 2 885 4700 /
+63 2 885 4713
Website: philexim.gov.ph

Public-Private Partnership Center

NEDA sa QC, EDSA, Diliman, Quezon City
Tel. No.: + 63 2 990 0721
Website: ppp.gov.ph



About KPMG

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Audit is an independent service that enhances the reliability of information used by investors and other stakeholders.

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Attitudes to tax are changing. Organizations of all sizes are ever more exposed to new trends in tax regulation, not just locally but globally.

Advisory

Advisory works with the world's leading organizations to create and protect the sustainable value of their business or organization – focusing in the areas of Management Consulting, Risk Consulting and Transactions & Restructuring.

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KPMG professionals understand what clients need to navigate through today's business, regulatory, social and economic complexity. That is because – every day – people from KPMG focus on the needs of member firm clients. KPMG carefully assesses exactly what clients require to achieve their objectives and then work across the globe to deploy the right skills and the right experience to help meet their unique requirements.

KPMG recognizes that clients are looking for the best solutions and advice, locally implemented with a global mindset. KPMG helps client-facing teams coalesce around the issues that matter most with support from KPMG Centers of Excellence and our global methodologies and approaches. KPMG Centers of Excellence are small groups of mobile, global specialists who support our member firms in bringing high quality industry and technical expertise to our clients.

KPMG in the Philippines

KPMG R.G. Manabat & Co. (KPMG RGM&Co.) is the Philippine member firm of KPMG International. It is one of the fastest-growing practices in the Philippines and among the KPMG practices in the Asia Pacific region. It has also been recognized as a Tier 1 tax practice*, Tier 1 transfer pricing practice**, Tier 1 leading tax transactional firm*** and Tier 1 transactional advisory firm in the Philippines**** by the International Tax Review.

KPMG RGM&Co. adopts a global approach spanning professional disciplines, industry sectors and national borders. It takes pride in imparting knowledge that adds value to its clients' businesses. The diverse public and private sector backgrounds of the partners and principals, coupled with their extensive training, and backed up by the wide knowledge resources and network of KPMG professionals, allows the firm to give real-world solutions to its clients' increasingly complex business and regulatory issues.

* International Tax Review's World Tax 2014 Guide

** International Tax Review's World Transfer Pricing 2016 Guide

*** International Tax Review 2014

**** International Tax Review 2013



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**Moving Across Borders:
The Philippines and
the ASEAN Economic Community**

2016 Investment Guide
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