

Key reforms for an effective Regional Comprehensive Economic Partnership

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Jin November 2012, at the 21st ASEAN Summit in Phnom Penh, Cambodia, the leaders of the ASEAN+6 member-states¹ agreed to establish a region-wide free trade agreement (FTA) called Regional Comprehensive Economic Partnership (RCEP). Amid rising protectionist sentiments globally and the continuing uncertainty in the recovery of major industrial economies, the Association of Southeast Asian Nations (ASEAN) is looking at the RCEP as an important step toward a deeper and integrated production base in the region that is also open to the rest of the world.²

If successfully negotiated, RCEP can be the world's biggest trading bloc covering at least 40 percent of world trade, offering significant benefits to participating countries, and producing an estimated gross

domestic product (GDP) of USD 26.2 trillion (32% of the world's GDP), which encompass approximately 3.5 billion people or 48 percent of the world population (Das 2013b).

In the run up to the envisaged ASEAN Economic Community, RCEP seems to offer a powerful vehicle to strengthen economic cooperation through robust trade and

¹ The ASEAN+6 nations include the ASEAN member-states, Australia, Japan, South Korea, India, and New Zealand.

² Regional Comprehensive Economic Partnership: A Statement by the ERIA Research Institute Network Meeting at Phnom Penh, October 2012.

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investment flows. This *Policy Note* points out key reform challenges facing the Philippines during the difficult period of negotiation and the necessary structural and institutional reforms that must be taken to ensure that the country will benefit from the RCEP.

Overview

In recent years, there has been a rapid proliferation of FTAs in Asia. In the ASEAN region alone, the member-states are currently engaged in 11 bilateral and multilateral FTAs that include, among others, seven ASEAN+1 FTAs, the Comprehensive Economic Partnership for East Asia (CEPEA), and the East Asia Free Trade Area (EAFTA). Several studies (e.g., Kawai and Wignaraja 2009) suggest that these FTAs have an overall positive, but also varying, impact on the economies of the member-countries.

However, the simultaneous existence of these FTAs has also created a “noodle-bowl” phenomenon or a situation of intertwined and overlapping rules and regulations due

to their (i) “varying modalities and timeframes for tariff concessions”; (ii) “different tariff preferences across products and FTAs”; and (iii) “varying rules of origin (ROOs) and administrative systems” (Kawai and Wignaraja 2009) that limit their potential benefits and potentially decrease the private sector’s usage of preferential systems (Fukunaga and Isono 2013).

Estimated impact of the RCEP

The RCEP aims to “attain a comprehensive and mutually beneficial economic partnership agreement that is expected to involve deeper engagement and improvement over the existing ASEAN FTAs.”³ It could be seen as a compromise between CEPEA (ASEAN+3), led by Japan, and EAFTA (ASEAN+6), led by China.

The RCEP is expected to strengthen the “ASEAN Centrality”, thereby showing that the ASEAN, together with non-ASEAN member-countries, are capable of bringing about economic growth through forging megabloc trade agreements (Das 2013b). If successfully negotiated, it can harmonize existing ASEAN FTAs (i.e., ASEAN+1 FTAs, CEPEA, EAFTA), potentially addressing the “noodle-bowl” effect of FTAs in East Asia.

RCEP negotiations will focus on eight key areas, namely, trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement, and other issues.⁴

³ Regional Comprehensive Economic Partnership: A Statement by the ERIA Research Institute Network Meeting at Phnom Penh, October 2012.

⁴ <http://www.asean.org/news/item/asean-framework-for-regional-comprehensive-economic-partnership>

Table 1. Regional Comprehensive Economic Partnership: at a glance

Regional Comprehensive Economic Partnership	
Date of establishment	November 19, 2011
Expected year of conclusion	End of 2015
Estimated contribution to the world economy	RCEP is expected to generate a GDP of USD 26.2 trillion (representing 32% of global GDP) by 2015.
Members	ASEAN member-states, Australia, China, India, Japan, South Korea, New Zealand
Leader of negotiations	India
Objective	<ul style="list-style-type: none"> • Achieve a comprehensive and mutually beneficial economic partnership agreement • Involve broader and deeper engagement with significant improvements over existing ASEAN FTAs/CEP with dialogue partners • Deepen "ASEAN Centrality" • Address the "noodle-bowl" effect of ASEAN+1 FTAs • Harmonization of ROOs • Contribute to ASEAN economic integration, equitable economic development, and strengthening economic cooperation between ASEAN member-states as well as between ASEAN and its partners
Areas of negotiation	Trade in goods, trade in services, investment, economic and technical cooperation, intellectual property, competition, dispute settlement, and other issues
Process	Can be accomplished in a sequential manner or single undertaking or through any other agreed modality
Some unique features	<ul style="list-style-type: none"> • Flexibility clause (Special and Differential Treatment) • Open-accessibility clause • "User friendly" and "business friendly" • Consistency with WTO agreement

Sources: Wignaraja (2013), ERIA RIN (2012), Das (2013a); ASEAN website – <http://www.asean.org/news/item/asean-framework-for-regional-comprehensive-economic-partnership>

Figure 1 from Itakura (2013) shows estimates of the potential impact of various FTAs and, more specifically, the RCEP on member-countries' GDP. All of the FTAs tend to raise economic welfare, with the RCEP (ASEAN+6 FTA) having the largest positive impact on real GDP for most of the ASEAN member-countries.

Key features of RCEP

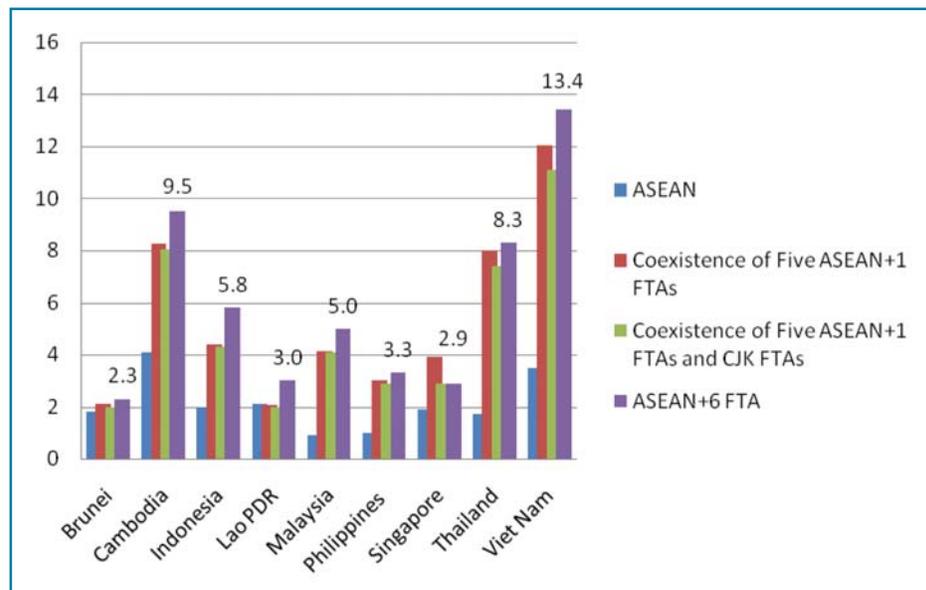
Some of the key features of RCEP that may not be present in the existing FTAs in Asia include:⁵

- Consideration of the different levels of development of the member-countries and provision of flexibility in adjustment toward agreed points
- Open accession clause that allows members to participate either at the beginning of the agreement or at a later date⁶

⁵ "Regional Comprehensive Economic Partnership: A Statement by the ERIA Research Institute Network Meeting" at Phnom Penh, October 2012; released on 22 November 2012. The interested reader can see the other features as listed in this document.

⁶ This also makes the RCEP open to external economic partners.

Figure 1. Potential impact of RCEP measures on ASEAN member-countries' GDP (percentage point, accumulated from 2011–2015)



Source: Itakura (2013)

- Encompassing all existing ASEAN+1 FTAs
- Enhancement of three kinds of connectivity: physical, institutional, and people-to-people connectivity
- Promoting economic cooperation that has a 'learning together' character to maintain the momentum toward its overall objectives
- User friendly and business friendly
- Special and differential treatment for CLMV countries (i.e., Cambodia, Lao PDR, Burma, Viet Nam) based on a longer transition period instead of a lower

ROOs determine the country of origin of products and their eligibility for preferential treatment in international trade. Rationalizing ROOs is important to prevent firms from incurring high transaction costs brought about by differing ROOs.

threshold to avoid inefficiency and misallocation of scarce resources.

One of the main challenges in negotiating an FTA is the harmonization of the provisions of all ASEAN+1 FTAs in the region. These include overlapping ROOs and FTA preferences, among others. The existing five ASEAN+1 and 23 ratified bilateral FTAs greatly vary in terms of almost everything up for negotiation.

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There are at least 22 different ROOs among ASEAN+1 FTAs, even after aggregating similar ones. Only about 30 percent of tariff lines across the ASEAN+1 FTAs share common ROOs. Within bilateral agreements such as the Japan-India FTA for instance, there are 12 types of ROOs, seven of which are unique from the ASEAN+1 FTAs. The sheer number of ROOs—and their lack of commonality across FTAs—makes the task of harmonizing and consolidating them more difficult.⁷

Key challenges facing the Philippines

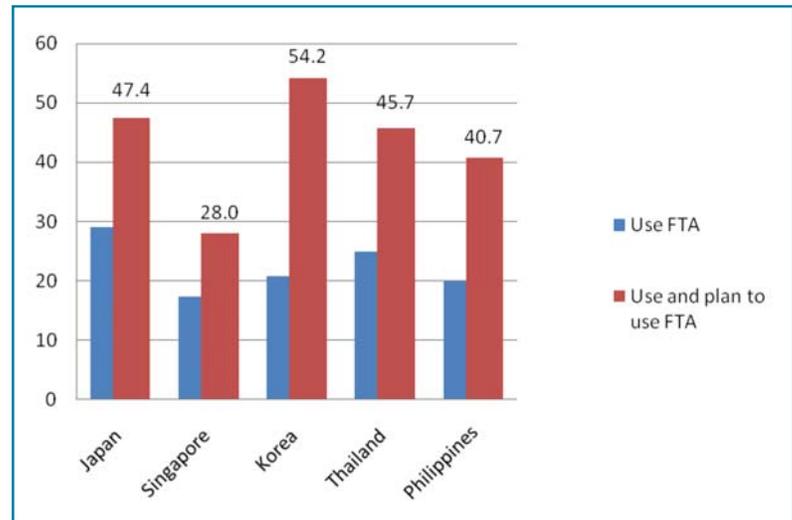
The value of trade between the Philippines and RCEP members is estimated at USD 60 billion.⁸ Once RCEP negotiations are concluded, it is expected that the Philippines would be able to realize significant economic gains. However, the Philippines has to address several challenges that, if ignored, could reduce expected gains.⁹

Low utilization of FTAs

The Philippines is involved in 15 FTAs, seven of which have already been signed and in effect, two are under negotiation, and six have just been recently proposed. Compared with other Asian countries, the Philippines has a low utilization of FTAs as Figure 2 shows.

In a survey by Kawai and Wignaraja (2009), Philippine firms reported the following reasons for the low utilization rate of FTA

Figure 2. Utilization of FTA preferences



Source: Kawai and Wignaraja (2009)

preferences: (1) lack of information (94 or 70.1% of the total firms surveyed); (2) use of EPZ schemes/ITA¹⁰ (36 or 26.9%); (3) delays and administration cost¹¹ (41 or 30.6%); (4) small margin of preference (18 or 13.4%); (5) too many exclusions (20 or 14.9%); (6) arbitrary classification of product origin (31 or 23.1%); (7) nontariff measures in FTA partners (12 or 9%); and (8) confidentiality of information required (17 or 12.7%).

Critical growth constraints

With the private sector as main growth driver, policymakers should address critical

⁷ This paragraph is from J. Menon (2013).

⁸ Estimates done by Medalla and Mantaring (2013).

⁹ There are other challenges but the focus here is on those that are necessary prerequisites for successful negotiation of the RCEP.

¹⁰ EPZ = export process zone; ITA = Information Technology Agreement; NTM = nontariff measure

¹¹ Rules of origin requirement

constraints to private investments. Some of the identified constraints include: (i) narrow fiscal space; (ii) inadequate infrastructure; (iii) weak investor confidence due to governance concerns; and (iv) market failures that have led to a small and narrow industrial and manufacturing base of the economy. These factors have already hampered the private sector's response to the opportunities provided by greater trade openness of the Philippines and can also constrain its utilization of FTAs or any regional FTA such as the RCEP.

In a report published by the World Economic Forum, the Philippines ranked 98th among 144 countries in terms of quality of overall infrastructure. This global ranking also showed that the country lags behind other ASEAN member-states. Greater economic openness and integration, and more liberal trade in goods and services under RCEP, will demand efficient transport and connectivity among the economic partners. The rule of thumb in the ASEAN for infrastructure investments is at least five percent of GDP. Philippine infrastructure investments barely reach three percent of GDP.

¹² Article XII, Section 10 of the Philippine Constitution provides that, "the Congress shall, upon recommendation of the economic and planning agency, when the national interest dictates, reserve to citizens of the Philippines or to corporations or associations at least sixty per centum of whose capital is owned by such citizens, or such higher percentage as Congress may prescribe, certain areas of investments."

Dealing with services liberalization

Services liberalization is a difficult area of reforms in the Philippines. Lack of information on opportunities in the service sector, resistance by local professional groups and associations, restrictions on the type of establishments and legal entities allowed, discrimination in favor of local services providers, and presence of discriminatory taxes on trade in services are critical barriers to service liberalization. Certain constitutional provisions also pose a serious challenge to successful FTAs on services liberalization.¹² Addressing these issues will lead to a better quality of service by enhancing competition among various service providers in the region.

Investment incentives packages

In the last two decades, the Philippines has liberalized foreign direct investment (FDI) policies and formulated various investment incentives measures to attract foreign investments. The grant of fiscal incentives is administered by different government bodies, e.g., Philippine Export Zone Authority, Board of Investments, Subic Bay Metropolitan Authority, and others under special laws. Investment incentive packages usually overlap leading to a "complicated investment incentive system" (Aldaba 2007) that have resulted in inefficiencies and overlapping promotional efforts. Reside (2006) noted that 80 percent of incentives given by the Board of Investments were redundant. As a result, despite several investment incentives packages administered by several

government bodies, FDI inflows to the Philippines have remained relatively low.

Concluding remarks

The RCEP is considered an important and logical step toward East Asian economic integration. Initial estimates show promising gains for the countries involved in the RCEP but the estimated gain accruing to the Philippines is much smaller than the benefits to be realized by other countries. This reflects the need to pursue key structural and institutional reforms so that the Philippines can realize the potential benefits from participation in the RCEP and to manage adjustment costs that may result from changes in rules and processes governing trade in goods and services, investments, and other critical areas. Policymakers should address constraints affecting utilization of FTAs, investments and growth, trade facilitation and customs administration and services liberalization, among others. Wider dissemination of information on FTAs, a public dialogue on RCEP, and further research on the RCEP's possible impact on the Philippine economy are equally important. Specific recommendations include the following:

On the low utilization of FTAs, undertake (i) awareness raising on concluded FTAs; (ii) information dissemination on the implication of FTAs for business; (iii) upgrading of technical standards and quality; (iv) adoption of electronic data interchange to speed up and simplify

procedures for ROO certification; and (v) financial support for upgrading technology and skills.

On critical growth constraints, make substantial investments in infrastructure, especially in power, transport, and logistics, and improve the institutional and regulatory frameworks of the ports and maritime sectors. For example, the cabotage policy should be reviewed with the objective of providing more efficient connectivity between domestic and foreign markets to reduce transaction costs, promote greater competition, and enhance the accessibility of goods and services by the population.

On trade facilitation and customs administration, pursue reforms related to transparency, standardization and harmonization, and electronic processing of customs requirements, most especially the implementation of an efficient National Single Window.

On services liberalization, review all constitutional and legal barriers to

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investments and trade, in particular addressing issues on limitation of foreign equity or the 60-40 rule in the ownership and operation of corporations.

On investment incentives, reform existing investment incentives laws and institutional framework for the grant of incentives. 📄

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