Building a More Robust U.S.-Philippines Alliance

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In May 2015, the Center for Strategic and International Studies (CSIS) Sumitro Chair for Southeast Asia Studies, with support from the Manila-based think tank the Albert del Rosario Institute (ADRI) and the Philippine Trade Foundation (Philippines Inc.), launched the U.S.-Philippines Strategic Initiative (USPSI) in Washington, DC.

The USPSI is a three-year project that will serve a leading role in advancing a high-level policy dialogue designed to add depth, creativity, and a greater sense of urgency in modernizing the U.S.-Philippine alliance in the context of Southeast Asia and the Indo-Pacific region. This report is the first major project under the aegis of the initiative.

The authors are thankful to the members of the ADRI and Philippines Inc. who offered their advice and valuable input during the writing of the report.
### Acronyms and Abbreviations

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<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>APEC</td>
<td>Asia-Pacific Economic Cooperation</td>
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<td>ARMM</td>
<td>Autonomous Region in Muslim Mindanao</td>
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<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<td>BBL</td>
<td>Bangsamoro Basic Law</td>
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<td>BIFF</td>
<td>Bangsamoro Islamic Freedom Fighters</td>
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<td>BPO</td>
<td>business processing outsourcing</td>
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<td>CDI</td>
<td>Cities Development Initiative</td>
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<td>EDCA</td>
<td>Enhanced Defense Cooperation Agreement</td>
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<tr>
<td>FDI</td>
<td>foreign direct investment</td>
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<td>FMF</td>
<td>Foreign Military Financing</td>
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<td>GDP</td>
<td>gross domestic product</td>
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<td>GES</td>
<td>Global Entrepreneurship Summit</td>
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<td>HADR</td>
<td>humanitarian assistance and disaster relief</td>
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<td>HEP</td>
<td>Higher Education and Productivity</td>
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<td>IPR</td>
<td>intellectual property rights</td>
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<td>ISIS</td>
<td>Islamic State in Iraq and Syria</td>
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<td>JSOTF-P</td>
<td>Joint Special Operations Task Force–Philippines</td>
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<td>MCC</td>
<td>Millennium Challenge Corporation</td>
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<tr>
<td>MILF</td>
<td>Moro Islamic Liberation Front</td>
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<td>MNLF</td>
<td>Moro National Liberation Front</td>
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<tr>
<td>MSMEs</td>
<td>micro, small, and medium-sized enterprises</td>
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<td>PEZA</td>
<td>Philippine Economic Zone Authority</td>
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<td>PFG</td>
<td>Partnership for Growth</td>
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<td>PPP(s)</td>
<td>public-private partnership(s)</td>
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<td>PSA</td>
<td>Philippine Sanitation Alliance</td>
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<td>RCEP</td>
<td>Regional Comprehensive Economic Partnership</td>
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<td>TPP</td>
<td>Trans-Pacific Partnership</td>
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<td>UNCLOS</td>
<td>UN Convention on the Law of the Sea</td>
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<td>USAID</td>
<td>U.S. Agency for International Development</td>
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<td>USTR</td>
<td>Office of the United States Trade Representative</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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Residents Barack Obama and Benigno Aquino have committed over the last five years to reinvigorate U.S.-Philippine relations. By building on progress made under their predecessors—for instance on counterterrorism cooperation in the southern Philippines—the two administrations have managed to raise bilateral political and security cooperation to a robust level not seen since the ouster of U.S. forces from Subic Bay and Clark Air Base more than 20 years ago. The U.S.-Philippine relationship is experiencing a renaissance both for its own sake and as a critical part of the Obama administration’s larger “rebalance” concerning Asia and the Pacific.

The Philippines, as much as any other partner in the Asia Pacific, is invested in its security relationship with the United States. The Aquino administration has committed to a new era of military modernization, but given the poor state of the armed forces of the Philippines compared to regional counterparts, there is no way for Manila to invest enough in armed forces modernization—especially the navy, coast guard, and air force—quickly enough to meet its external defense needs without constraining productive economic growth.

The realities of the Philippines’ capacity to pursue military modernization are now butting up against the harsher reality of Chinese assertiveness in the South China Sea. Philippine leaders recognize their situation and are committed to forging a new era of U.S.-Philippine security cooperation as their best means to ensure what Foreign Secretary Albert Del Rosario has termed a “minimum credible defense” capability.

The key to this new era of U.S.-Philippine security cooperation is the Enhanced Defense Cooperation Agreement (EDCA) that the two nations concluded in early 2014. Under that accord, the United States would be able to deploy larger numbers of U.S. troops, ships, and planes to the Philippines on a rotational basis, improve military infrastructure at Philippine bases to support those deployments, and preposition equipment in the Philippines to better respond to natural disasters and security emergencies. Unfortunately, this critical agreement remains mired in the Philippine Supreme Court, where it faces challenges to its constitutionality.

With elections in both the Philippines and the United States in 2016, the future of the alliance must be institutionalized to ensure that it is not diminished by a change of leadership in either country. The EDCA and the South China Sea are important components of the
new era of relations, but they are not and should not be the defining feature of the alliance. Given the long history of U.S.-Philippine relations, the alliance must be based on more robust cooperation across the spectrum of political, security, economic, and sociocultural relations.

The Philippines lies in the world’s most economically vibrant region. The country’s economy has grown nearly 6 percent per year for the past three years, making it one of the brightest stars in Asia and boosting its gross domestic product (GDP) to $272 billion in 2014. The Philippines’ population stands at nearly 100 million, with 35 percent under 15 years of age.

But the Philippines’ economic ties with the United States lag behind their full potential. By volume of trade with the United States, the Philippines is roughly at the same level as tiny Ecuador and Costa Rica and behind the largest economies in Southeast Asia: Singapore, Malaysia, Thailand, Vietnam, and Indonesia. A number of factors hold back U.S. exports to the Philippines, including high tariffs and laws favoring domestic Philippine producers.

The Philippines attracted $6 billion in foreign direct investment (FDI) last year, up 65 percent over the previous year but still lower than the other large economies in Southeast Asia. U.S. investment in the Philippines is mainly focused on manufacturing, nonbank holding companies, and wholesale trade sectors.

Numerous policies and challenges limit the interest of U.S. investors. Among them are the restrictions in the constitution against investment in certain sectors. Foreign companies are concerned about the rule that limits the foreign share to 40 percent in many areas of the economy. The Philippines also has weak public institutions that are quite easily influenced by vested interests. Other challenges include overstretched roads, the high cost of electricity, the red tape involved in setting up a business, and corruption.

One initiative that could significantly boost the Philippines economy, including trade and investment ties with the United States, would be a decision to join the 12-nation Trans-Pacific Partnership (TPP) trade agreement once it is completed. Manila faces the risk of being left behind by its neighbors in the TPP—particularly Malaysia and Vietnam, which are in the current round of TPP negotiations—if it stays out of the trade grouping.

To be sure, the Philippines and the United States are at different stages of economic development. The United States needs to seek avenues to engage the Philippines in new forms of economic cooperation, including capacity building in the Philippines, that will benefit both countries. Government initiatives need to play a key role in creating an environment that promotes more robust investment and trade relations. In the end, however, it is up to American and Philippine businesses to push the economic relationship to a deeper level, despite the current challenges.
Thanks to their shared histories, Americans and Filipinos have over the decades established enduring ties at the grassroots level. According to a study by the Pew Research Center in 2014, 92 percent of Filipino respondents said they have a positive view of the United States, the highest percentage of all countries surveyed. However, a number of Filipinos who care about U.S.- Philippine relations have expressed concerns that the United States may have become complacent about the need to cultivate Philippine youth and the next generation of the country’s leaders. As the United States rebalances to the Asia Pacific, it is important that Washington does not take for granted people-to-people, cultural, and social ties between the two countries and that it acts to foster the existing goodwill between Americans and Filipinos.

Despite long-standing cultural and social ties between Americans and Filipinos and recent efforts to boost U.S. public diplomacy in the Philippines, the number of Philippine students studying in the United States remained at just over 3,000 as of 2014—a somewhat disappointing figure compared to neighboring states. Leading Philippine universities, meanwhile, maintain international linkages with a number of higher education institutions in the United States. These linkages should be institutionalized and expanded, preferably through scholarship programs, in order to serve as a channel to boost future faculty and student exchanges.

One of the more sensitive issues in U.S.-Philippine relations has been the treatment of Filipino World War II veterans. Past legislation passed by the U.S. Congress denied these veterans active military status, which would entitle them to full U.S. veterans’ benefits. In other cases, citizenship granted to some veterans was not extended to their families. U.S. officials believe that recent actions taken by the Obama administration have substantially addressed grievances on the veterans’ issue. However, many surviving veterans still report not being given adequate coverage or that their claims have been denied.

The United States recognizes that a prosperous, inclusive, and well-governed Philippines will be a stronger ally of the United States and more effective voice within the Association of Southeast Asian Nations (ASEAN). The United States Agency for International Development (USAID) has developed and led the implementation of the Partnership for Growth (PFG), an initiative running from 2012 to 2016 and jointly conducted by government agencies in both countries aimed at addressing problems that have prevented the Philippines from achieving its economic potential. These include weak governance, constrained public finance, inadequate infrastructure, and weak human resources.

USAID has lauded the cooperative spirit of its Philippine colleagues toward its action plan and the resolve of the Aquino government to address governance issues. However, U.S. officials have expressed uncertainty about whether this resolve and willingness to change will last beyond 2016, when a new government will take office. Therefore, the focus of USAID work has been on helping spread the benefits of the impressive economic growth in recent years to ordinary people.

1. The Philippines was a U.S. territory until 1946.
Key Political-Security Recommendations

Our recommendations for the Philippines and the United States are as follows:

• Strengthen the bilateral strategic dialogue to chart the future of the alliance. The last assessment of the U.S.-Philippine alliance was the 2003 Joint Defense Assessment, which fell far short of a robust examination of the relationship’s status and future and predated the U.S. rebalance, the EDCA, and the current round of South China Sea tensions. The two nations established an annual bilateral strategic dialogue in 2011 for senior officials, but did not have their first 2+2 ministerial dialogue until 2013. To address the future of the alliance and to help clarify its importance for both officials and regular citizens, Washington and Manila should strengthen the annual strategic dialogue, modeled on those held by the United States and Japan, and craft a long-term strategy paper on reinvigorating the alliance, like that issued by the U.S.-Japan Security Consultative Committee and signed off at the 2+2 ministerial in 2005.

• Cooperate on the development of a long-term South China Sea plan. Both the Philippines and the United States, like other interested parties around the region, have been reacting to incidents in the South China Sea in a semipermanent crisis management mode. But despite these efforts and commitments on multiyear modernization and security cooperation, they are lacking an overarching long-term strategy. The two governments should establish a high-level working group to draft a joint understanding of their interests in the South China Sea, what a long-term resolution would look like, and overall plans to get there. This strategy will have to recognize the intractability of the disputes over islands, which must be set aside, and focus on establishing an agreed-upon area of disputed waters and continental shelf among the various claimants with whom cooperation is possible.

• Consider clarifying the geographical scope of the mutual defense treaty. The United States should consider offering an explicit guarantee that it will respond under the framework of the U.S.-Philippine Mutual Defense Treaty to an attack on Philippine troops, ships, or planes in disputed waters or features in the South China Sea. This need not mimic exactly the guarantee given to Japan regarding the Senkaku/Diaoyu Islands, under which the United States has said it recognizes the disputed islands as falling within the scope of the treaty because they are under the effective administration of Japan. A clarification for the Philippines need only point out that disputed waters or features in the South China Sea fall within the scope of Article V of the U.S.-Philippine treaty, which commits the United States to respond to an attack on Philippine “armed forces, public vessels or aircraft in the Pacific.”² Such clarification of the U.S. security guarantee would provide an enormous boost to the relationship and help assuage doubts in the Philippines about whether the United States can be relied

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on in a real security crisis. This in turn will help depoliticize the debate over the
EDCA, easing the way for the Philippine Supreme Court to declare it constitutional.

• **Boost Australia-Philippines and Japan-Philippines security cooperation.** While the
renewed U.S.-Philippine security alliance will be critical for Manila in the years
ahead, diversifying its major security partners will bring significant benefits, in-
cluding deflecting fears that it is overly reliant on the United States or engaged in a
joint effort to contain China. It is also important to recognize that U.S. defense bud-
gets will be constrained for years to come, and Washington will need to push middle
powers in the Asia Pacific to help fill the gap. Australia, which already has a status of
agreement with the Philippines and takes part at a low level in the annual Balikatan
exercises, is a prime target for greater cooperation. Japan, which is normalizing its
defense strategy, is the Philippines only other strategic partner besides the United
States and recently signed a memorandum of understanding on defense cooperation
with the Philippines.

• **Enhance assistance for capacity building in the Philippine judiciary and police.** The
United States has for years provided assistance for capacity building and training
programs in the Philippine justice system and the police, particularly to the Philip-
pine National Police. But that assistance should be increased substantially, in coordi-
nation with other donors such as the European Union. The Philippine police are
severely lacking in investigative and forensic capabilities, as well as proper training
in the use of force and professionalism. The judiciary is highly politicized, under-
staffed, and faces severe inefficiencies. The result is a low level of trust among the
populace, severe backlogs of cases, and an acceptance of extrajudicial killings as an
alternative in places such as Davao.

Roughly 30 percent of courthouses in the country lack judges, and tens of thou-
sands of Filipinos remain behind bars awaiting trial long after the law says they
should be tried or released. Promising models that could be expanded include mobile
courts funded by the United States and other partners and a pilot program in Quezon
City to clear court backlogs by digitizing warrants and records and dismissing flimsy
cases that rest on poor police investigations and documentation.

**Key Trade and Investment Recommendations**

Our recommendations for the Philippines and the United States are as follows:

• **Work to make it possible for the Philippines to join the TPP once the current round of
talks is completed.** For the Philippines to participate in the TPP would require the
government to address a number of protectionist measures and restrictions, includ-
ing some in the constitution, against foreign imports and investment. Like some of its
neighbors in the TPP, the Philippines could look at the trade agreement as a necessary
source of external pressure to prompt domestic reform. In preparation for Manila
joining the TPP, the two countries could consider negotiating a bilateral investment treaty, which would constitute a core chapter of the trade agreement.

- **Launch a comprehensive study to determine which economic sectors in the Philippines would benefit most if the country joined the TPP.** Support of businesses and industry associations is critical to overcome political opposition to liberalization and allow the Philippines to join the TPP. But to build that support, the U.S. and Philippine governments need to be able to show businesspeople how the TPP could benefit their industries specifically, not just the Philippine economy broadly.

- **Work together closely on achieving important goals in the Asia-Pacific Economic Cooperation (APEC) forum,** which Manila is chairing this year. Some of the themes promoted by the Philippines include encouraging inclusive growth and increased integration of small and medium-sized businesses in the global supply chain. It is also pushing increased disaster resiliency and preparedness as well as further progress in cutting tariffs on environmental goods, and considering how to advance the study of the Free Trade Area of the Asia Pacific, which was proposed at the APEC summit in Beijing last year.

- **Bolster existing government-to-government discussions on investment and trade,** including through the Trade and Investment Framework Agreement. A small group of business representatives from both countries could be included in these talks to help focus discussions on the biggest barriers to deepened economic relations.

- **Establish an annual CEO-level business-to-business dialogue,** similar to those between Chinese and American business leaders, to promote increased investment and trade between the two countries. These dialogues could be used to promote more U.S. investment in the Philippines in such sectors as manufacturing and identify opportunities for more Philippine investment in the United States.

### Key People-to-People Recommendations

Our recommendations for the Philippines and the United States are as follows:

- **Ensure the PFG program is renewed beyond 2016 and allocated additional funding.** The United States has provided over $739 million to support projects to improve regulatory quality, strengthen the rule of law and anticorruption measures, improve fiscal performance, and promote human capacity development in the Philippines under the PFG. The next phase of the program should aim to deepen exchanges and cooperation between government agencies in the United States and the Philippines.

- **Launch a regular dialogue between leading Philippine private companies and relevant U.S. government agencies to find ways to leverage public-private partnerships in**

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This dialogue can serve as an institutionalized mechanism for U.S. officials to engage with Philippine business leaders and gauge their interest in playing a role in public-private partnerships in a number of areas that desperately need investment in the Philippines. The agenda of the dialogue should align closely with and add value to the scope of work of U.S. government agencies in the Philippines.

- **Expand the Cities Development Initiative (CDI) to more cities in the Philippines and forge sister-city partnerships between up-and-coming Philippine cities and cities in the United States.** Besides Cagayan de Oro, other cities under CDI currently do not have sister cities in the United States. City-level leaders and officials could benefit from exchanges and partnerships with other midsize U.S. cities that have had success in creating jobs. This will also allow up-and-coming Philippine leaders to gain more exposure to the United States.

- **Host the Global Entrepreneurship Summit (GES) in the Philippines in 2016, or beyond.** The United States should send more entrepreneurial ambassadors to the Philippines and ultimately design an initiative with a focus on incubating and supporting Philippine entrepreneurs and Muslim scientists from the Philippines. The United States should also consider establishing a regional operation of the Global Entrepreneurship Network in Manila.

- **Set up a research program on marine biodiversity and coral reefs in Philippines waters,** involving the U.S. National Oceanic and Atmospheric Administration and leading Philippine environmental scientists or research institutions. This joint research program will help both sides better understand the biodiversity in the waters surrounding the Philippines and what can be done to conserve the country's dwindling coral reefs. Scientists from both countries should also discuss the possibility of establishing marine peace parks in waters off islands controlled by the Philippines in the South China Sea.
Political and Security Relations

Presidents Barack Obama and Benigno Aquino have committed over the last five years to reinvigorating U.S.-Philippine relations. By building on progress made under their predecessors, the two administrations have managed to raise bilateral political and security cooperation to a robust level not seen in decades. The U.S.-Philippine relationship is experiencing a renaissance both for its own sake and as a critical part of the Obama administration’s larger “rebalance” to the Asia Pacific. And as part of that rebalance, the administration has committed to bringing the United States’ alliances in the region, including with the Philippines, into the twenty-first century by expanding their scope and refocusing on new security challenges.

One key to this new era of U.S.-Philippine security cooperation is the EDCA, which the two nations concluded in early 2014. Under this accord, the United States would be able to deploy larger numbers of U.S. troops, ships, and planes to the Philippines on a rotational basis, improve military infrastructure at Philippine bases to support those deployments, and place equipment in the Philippines to better respond to natural disasters and security emergencies. Unfortunately, this critical agreement, which is vital to Philippine hopes of standing against Chinese bullying in the South China Sea, remains mired in the Philippine Supreme Court, where it faces challenges to its constitutionality.

With elections in both the Philippines and the United States in 2016, the future of the alliance must be institutionalized to ensure that it is not diminished by a change of leadership in either country. The EDCA and the South China Sea are important components of the new era of relations, but they are not and should not be the only defining features of the alliance. Given the long history of U.S.-Philippine relations, the alliance must be based on more robust cooperation across the spectrum of political, security, economic, and sociocultural relations. Security concerns provide an acute impetus for leaders to put more energy into the relationship, but its sustainability will require a more comprehensive focus.

Recommendations

Our recommendations for the Philippines and the United States are as follows:

• *Strengthen the bilateral strategic dialogue to chart the future of the alliance.* The last assessment of the U.S.-Philippine alliance was the 2003 Joint Defense Assessment,
which fell far short of a robust examination of the relationship’s status and future and predated the U.S. rebalance, the EDCA, and the current round of South China Sea tensions. The two nations established an annual bilateral strategic dialogue in 2011 for senior officials, but did not have their first 2+2 ministerial dialogue until 2013. To address the future of the alliance and to help clarify its importance for both officials and regular citizens, Washington and Manila should strengthen the annual strategic dialogue, modeled on those held by the United States and Japan, and craft a long-term strategy paper on reinvigorating the alliance, like that issued by the U.S.-Japan Security Consultative Committee and signed off at the 2+2 ministerial in 2005.

• **Cooperate on the development of a long-term South China Sea plan.** Both the Philippines and the United States, like other interested parties around the region, have been reacting to incidents in the South China Sea in a semipermanent crisis management mode. But despite these efforts and commitments on multiyear modernization and security cooperation, they are lacking an overarching long-term strategy. The two governments should establish a high-level working group to draft a joint understanding of their interests in the South China Sea, what a long-term resolution would look like, and overall plans to get there. This strategy will have to recognize the intractability of the disputes over islands, which must be set aside, and focus on establishing an agreed-upon area of disputed waters and continental shelf among the various claimants with whom cooperation is possible.

• **Consider clarifying the geographical scope of the mutual defense treaty.** The United States should consider offering an explicit guarantee that it will respond under the framework of the U.S.-Philippine Mutual Defense Treaty to an attack on Philippine troops, ships, or planes in disputed waters or features in the South China Sea. This need not mimic exactly the guarantee given to Japan regarding the Senkaku/Diaoyu Islands, under which the United States has said it recognizes the disputed islands as falling within the scope of the treaty because they are under the effective administration of Japan.

   A clarification for the Philippines need only point out that disputed waters or features in the South China Sea fall within the scope of Article V of the U.S.-Philippine treaty, which commits the United States to respond to an attack on Philippine “armed forces, public vessels or aircraft in the Pacific.” Such clarification of the U.S. security guarantee would provide an enormous boost to the relationship and help assuage doubts in the Philippines about whether the United States can be relied on in a real security crisis. This in turn will help depoliticize the debate over the EDCA, easing the way for the Philippine Supreme Court to declare it constitutional.

• **Engage in joint freedom of navigation patrols, including with other partners.** The United States and the Philippines should jointly perform patrols in the South China Sea to assert the freedom of navigation in certain disputed waters. For instance, the two should jointly send ships in transit within 12 nautical miles of low-tide elevations

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1. “Mutual Defense Treaty,” Article V.

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that have been turned into artificial island by China, such as Mischief Reef and Subi Reef, and other claimants, such as the Vietnamese-occupied Discovery Great Reef. The Philippines should also perform such joint patrols with Japan, Australia, and other like-minded states to assert that the rule of law in the South China Sea is of concern to all nations and is not a bilateral U.S.-China issue.

- **Boost Australia-Philippines and Japan-Philippines security cooperation.** While the renewed U.S.-Philippine security alliance will be critical for Manila in the years ahead, diversifying its major security partners will bring significant benefits, including deflecting fears that it is overly reliant on the United States or engaged in a joint effort to contain China. It is also important to recognize that U.S. defense budgets will be constrained for years to come, and Washington will need to push middle powers in the Asia Pacific to help fill the gap. Australia, which already has a status of agreement with the Philippines and takes part at a low level in the annual Balikatan exercises, is a prime target for greater cooperation. Japan, which is normalizing its defense strategy, is the Philippines only other strategic partner besides the United States and recently signed a memorandum of understanding on defense cooperation with the Philippines.

- **Increase Foreign Military Financing (FMF) to the Philippines.** As part of its commitment to assist the Philippines’ military modernization effort, the United States should significantly increase the amount of assistance it provides under the Foreign Military Financing program. This program allows the United States to provide funding to partner nations on a grant or loan basis to procure defense equipment and training via the Foreign Military Sales program. It is of particular benefit to partner nations like the Philippines with acute military needs but severe budget constraints. But despite the U.S. rebalance, barely 1 percent of FMF goes to the Asia Pacific—the overwhelming majority is allocated to states in the Middle East, North Africa, and Europe.

- **Refocus counterterrorism assistance on interagency cooperation.** With the closure of the U.S. Joint Special Operations Task Force-Philippines in Zamboanga, the fight against extremist groups in the southern Philippines is entering a new phase in which the United States will continue to provide advisers and some training and intelligence gathering, but training, logistics, and operations will be even more Philippine-driven. It is critical that the U.S. State Department not only continue to provide funding through the Antiterrorism Assistance Program, but that it focus more of that assistance to building up Philippine capacity on interagency cooperation, which has been a particularly weak spot.

- **Advise the Philippines on development of relevant white papers.** The United States should offer assistance to the Philippines on developing a more comprehensive National Security Policy and Defense Policy Papers. The Philippines released its first National Security Policy in a decade in 2011. The document did a good job of identifying threats to national security in the 2011 to 2016 period but fell short on offering
strategies to confront them. The Department of National Defense released its first Defense Policy Paper since 1998 in 2010 and hopes to do another in 2015 or 2016. In an era of increasing external threats to national security, both of these documents must be strengthened and better institutionalized.

- **Cooperate on the negotiation of legally binding climate change accord.** Both Manila and Washington have made enormous strides lately toward grappling with the threat of climate change. The Obama administration passed groundbreaking limits on greenhouse gas emissions from power plants and has committed to reaching a binding international agreement at the UN Climate Summit in Paris in December 2015. The Philippines has reversed its long-standing opposition to emissions targets for developing nations, in recognition of its unique vulnerability to rising sea levels and extreme weather. The two should come together with like-minded states to sketch out a joint negotiating position on a climate accord and caucus at the Paris summit and beyond.

- **Enhance assistance for capacity building in the Philippine judiciary and police.** The United States has for years provided assistance for capacity building and training programs in the Philippine justice system and the police, particularly to the Philippine National Police. But that assistance should be increased substantially, in coordination with other donors such as the European Union. The Philippine police are severely lacking in investigative and forensic capabilities, as well as proper training in the use of force and professionalism. The judiciary is highly politicized, understaffed, and faces severe inefficiencies. The result is a low level of trust among the populace, severe backlogs of cases, and an acceptance of extrajudicial killings as an alternative in places such as Davao.

  Roughly 30 percent of courthouses in the country lack judges, and tens of thousands of Filipinos remain behind bars awaiting trial long after the law says they should be tried or released. Promising models that could be expanded include mobile courts funded by the United States and other partners and a pilot program in Quezon City to clear court backlogs by digitizing warrants and records and dismissing flimsy cases that rest on poor police investigations and documentation.

**History of the Alliance**

The relationship between the United States and the Philippines dates to the 1898 Treaty of Paris, under which Spain transferred the colony of the Philippines to U.S. control. Filipino troops fought beside U.S. forces in World War II and in every major military conflict into which the United States has entered since. That shared history, even if contested and at times rocky, has created an affinity between the Philippines and the United States unmatched by any other U.S. partner in Asia.

According to the annual Pew Global Attitudes Survey, Filipinos have a more positive view of the United States than anyone else in the world, including Americans. An astounding
and world-leading 90, 85, and 92 percent of Filipinos expressed a favorable opinion of the
United States in 2002, 2013, and 2014 respectively—the only years in which the Philippines
was included in the survey. This helps explain why the U.S.-Philippine relationship has
persevered with such consistency, despite the ups and downs of the last several decades,
and why the U.S. security commitment to the Philippines has remained “ironclad,” as
President Obama put it.³

Washington recognized the independence of the Republic of the Philippines in 1946,
and in 1951 the two independent states signed the Mutual Defense Treaty. The obligations
contained in that agreement, which forms the bedrock of contemporary U.S.-Philippine
security relations, closely mirror those the United States extended to other Asian allies
following World War II—particularly Japan. The heart of the treaty is Article IV, which
reads as follows:

Each Party recognizes that an armed attack in the Pacific Area on either of the
Parties would be dangerous to its own peace and safety and declares that it would act
to meet the common dangers in accordance with its constitutional processes.
Any such armed attack and all measures taken as a result thereof shall be imme-
diately reported to the Security Council of the United Nations. Such measures shall be
terminated when the Security Council has taken the measures necessary to restore
and maintain international peace and security.⁴

The United States maintained a sizable troop presence in the Philippines throughout most
of the latter half of the twentieth century, under the auspices of the Military Bases Agree-
ment of 1947. For much of that time, Clark Air Base in Angeles City, about 40 miles northwest
of Metro Manila, was one of the largest U.S. Air Force installations abroad. Nearby U.S. Naval
Base Subic Bay was the largest U.S. naval facility abroad, and it was briefly the largest air
force base after Clark was shuttered in 1991. But Subic Bay was also closed a year later.

The closure of the two bases and departure of the permanent U.S. troop presence from
the Philippines was caused by two forces: the 1991 eruption of nearby Mount Pinatubo,
which effectively destroyed Clark and caused heavy damage to Subic, and the failure of the
Philippine Senate to ratify an agreement to extend the U.S. presence beyond the expiration
of the Military Bases Agreement due to domestic political pressure.

Current U.S.-Philippine Relations
The Mutual Defense Treaty of 1951 remains the core of the U.S. security commitment to the
Philippines. But the current defense relationship has evolved beyond the old U.S. “boots on

http://www.pewglobal.org/database/indicator/1/survey/all/.
T20140429.
⁴. Mutual Defense Treaty, Article IV.
the "ground" paradigm in the years since the closure of Clark and Subic. In 1998, Manila and Washington signed a Visiting Forces Agreement temporarily regulating the rights and responsibilities of U.S. forces in the Philippines. That agreement allowed U.S. ships, planes, and troops to visit the Philippines for training purposes and other joint activities in greater numbers. It also paved the way for the next era of U.S.-Philippine security relations in a post–9/11 world.

In the wake of the attacks of September 11, 2001, the George W. Bush administration declared Southeast Asia the second front in the war on terror. Washington launched Operation Enduring Freedom–Philippines, also called Operation Freedom Eagle, to combat terrorism in the southern Philippines. In early 2002, U.S. Special Operations Command deployed 1,200 troops to the southern Philippine island of Basilan to advise and assist the Philippine army in operations against the terrorist Abu Sayyaf group.

By the end of 2002, U.S. operations in the Philippines, led by the Joint Special Operations Task Force–Philippines (JSOTF-P), settled into a smaller advising and assistance role. U.S. forces rotated through the Philippines at a strength of about 400 to 600 personnel, assisting the Philippine military in its fight against Abu Sayyaf, Jemaah Islamiyah—which killed over 200 in the 2002 bombings in Bali, Indonesia, and at its height operated cells across maritime Southeast Asia—and smaller terrorist groups. JSOTF-P did not directly engage in Philippine operations against the separatist Moro National Liberation Front (MNLF) and Moro Islamic Liberation Front (MILF), which the United States viewed as domestic separatists and not terrorists, except in cases in which members of the MNLF or MILF aided terrorist groups.

JSOTF-P finally shut down in February 2015—13 years after its mission began. Jemaah Islamiyah is no longer a transnational threat, having abandoned that mission as its ranks were greatly reduced and its operations restricted mainly to Indonesia and to some degree Malaysia. Abu Sayyaf has devolved from a terrorist group to a kidnapping and extortion ring, even if some of its members have made public statements of allegiance to the Islamic State in Iraq and Syria (ISIS). Some U.S. Special Forces will remain in the Philippines in smaller numbers to continue to assist and advise to ensure that the southern Philippines does not again become a haven for terrorists. But overall, both sides recognize that the post–9/11 mission has been a success, and the defense relationship is now shifting focus to other concerns.

The Bangsamoro and Peace in Mindanao

The major reason that large swathes of the southern Philippines lie beyond the effective governance of Manila and therefore are ideal havens for terrorism and criminal activity has been the decades-long insurgencies by the MNLF and its successor groups. The Moro communities in the southern Philippines (“Moro” is Spanish for Muslim) have long chafed at their inclusion in the predominantly Catholic Philippines. The MNLF was founded in 1969 with the goal of establishing an independent Muslim state in Mindanao. They eventually accepted autonomy within the Philippine state as an acceptable alternative after decades of unsuccessful violent struggle. The Autonomous Region in Muslim Mindanao (ARMM) was established in 1988 and the MNLF reached a final peace deal with Manila in 1996.8

The MILF split from the MNLF in 1978, rejecting autonomy in favor of outright independence. The government finally reached a ceasefire with the group in October 2012, ending nearly half a century of large-scale insurgency in the south that left over 120,000 dead and millions displaced.9 Other groups have splintered from the MILF, most prominently the Bangsamoro Islamic Freedom Fighters (BIFF), but they do not appear, at least to date, to represent more than a small fraction of the strength of the MNLF and MILF.

In March 2014, the Philippine government and the MILF signed the Comprehensive Agreement on the Bangsamoro, which would see a new autonomous region established to replace the ARMM.10 In order to implement that agreement, the government, after a substantial delay, drafted a Bangsamoro Basic Law (BBL), which was submitted to the Philippine Congress. The bill seemed set for relatively easy passage by lawmakers, despite opposition from certain circles within government and the general population, until January 25, 2015. That is when Philippine National Police commandos raided a BIFF base where a Jemaah Islamiyah member, Malaysian terrorist Zukifli bin Hir, aka Marwan, was hiding. The commandos killed Marwan, though a second terrorist, Abdul Basit Usman, escaped. When pulling out of the village, the commandos were engaged in a firefight by members of the BIFF, the MILF, and another group. The clash ultimately left 44 police dead and cast a pall over the BBL’s prospects.11

Following months of congressional hearings and investigations by the MILF, various Philippine government agencies, and an international team, the legislature finally took up the BBL again. After making a number of amendments to ensure the bill’s constitutionality and assuage some political concerns, a Philippine House of Representatives committee

9. Ibid.
studying the bill approved it on May 20, 2015, and it was expected to be quickly passed by the full chamber.\textsuperscript{12}

Unfortunately, a group of senators then dashed cold water over the hopes of passing the bill by the end of the legislative session on June 11. Senator Ferdinand Marcos Jr. has insisted the draft BBL is unconstitutional and said he would write his own version of the bill in July 2015, though he has offered no specifics.\textsuperscript{13} Fear is rising that this grandstanding will drag the legislative process out for several more months, making it impossible to include a referendum on the establishment of the Bangsamoro in the 2016 national elections, which could scuttle the enterprise.

Securing peace with the MILF is a major part of President Aquino’s legacy, and one that is now in danger. While it languishes in the Philippine Congress, the president has little political capital to spend on other priorities, such as the EDCA, which should be a major concern for U.S. leaders. The fate of the BBL is also a long-term concern for both governments. For its entire history as an independent nation, the Philippines’ top military concern has been internal security, whether battling the communist New People’s Army (which is still active), the succession of Moro insurgencies, or terrorist groups in the southern Philippines.

The result, in addition to decades of lost productivity and suffering in many areas of the country, has been an overwhelming focus on the army and internal security rather than external defense. The Aquino administration has now committed to modernizing the armed forces by investing heavily in the navy, air force, and coast guard in light of new external threats, especially from China in the South China Sea. The United States has committed to helping that modernization effort and is counting on the Philippines to be a productive security partner in the South China Sea. That is the short- and medium-term goal of EDCA. But the entire Philippine project of shifting to external defense is contingent on a reduction of violence in Mindanao. The failure of the peace process with the MILF and the resumption of large-scale hostilities could undermine the entire project.\textsuperscript{14}

The South China Sea

The Aquino government has identified Chinese coercion in the South China Sea as the greatest present threat to the Philippines’ national security. Since 2009, when Vietnam and Malaysia submitted a joint claim to an extended continental shelf to the UN Commission on the Limits of the Continental Shelf and China responded by submitting the now-infamous nine-dash line claim to the vast majority of the South China Sea as a \textit{note verbale}, tensions have steadily ramped up. In May 2012, China seized Scarborough Shoal from effective


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Philippine control and has maintained a presence there ever since, preventing Filipino fishermen from plying their trade there. In May 2014, Chinese Coast Guard vessels blocked Filipino marines stationed aboard the derelict BRP Sierra Madre at Second Thomas Shoal, relenting only after the Philippine military airlifted in supplies and a resupply ship ran the blockade with foreign journalists onboard to document the encounter.

In the face of China’s considerable military and paramilitary advantage in the South China Sea and its consistent unwillingness to negotiate with Southeast Asian claimants in good faith on a code of conduct, much less a resolution to the dispute, Manila in 2013 brought a case against China’s claims to a tribunal at the Permanent Court of Arbitration at The Hague. China has refused to accept or take part in the case, but under the compulsory dispute resolution mechanism of the UN Convention on the Law of the Sea (UNCLOS), the case is moving forward regardless and will be considered legally binding if and when the judges issue a ruling.15

In early July, the arbitral tribunal will hold hearings on whether or not it has jurisdiction in the case. This will be a critical moment in the case. The judges have said that the hearing will seek to address challenges raised by China in a position paper it released in late 2014.16 The court is treating that paper as an official plea regarding the tribunal’s jurisdiction and will seek to deal with the questions raised by it.17 If the court rules that it does have preliminary jurisdiction to hear the merits of the case, then it is almost certain that it will rule in the Philippines’ favor on at least one question—whether the nine-dash line constitutes a legal claim to maritime space in line with UNCLOS. If that happens, likely in the spring of 2016, then China will face the choice of redefining its claim according to international law or entirely thumbing its nose at the court. So far, it has been adamant that it will do the latter.

China’s response to increasing pressure from the Philippines, other claimant states, and outside parties such as Japan and the United States has been to strengthen its physical position in the Spratly Islands via a breakneck campaign of island building. From late 2013 to mid-2015, China massively expanded the size of seven features it claims in the Spratlys by dredging sand and coral from the seabed and dumping it on top of the surrounding reefs and rocks. The process is ecologically devastating, ratchets up military tensions in the region—especially in light of revelations that in addition to building airstrips, Beijing deployed at least two pieces of mobile artillery to the features18—and is in violation of international law.

The top priorities for the United States and its regional partners are seeing that the South China Sea disputes be resolved peacefully and according to international law. Much of current U.S. strategy is already geared toward ensuring those two conditions. The United States is engaged in substantial efforts to bolster the maritime domain awareness, patrol, and deterrence capabilities of Southeast Asian states, including the Philippines, all to prevent more blatant Chinese aggression. Washington is also putting considerable diplomatic effort into pushing all claimants, not just China, to bring their claims into accordance with international law. Washington and Manila are both cajoling others to support them, and the fear caused by China’s island building has gone a long way toward succeeding, with nations such as Australia that previously kept the disputes at arm’s length considering more direct involvement to pressure China to abide by international law and norms.

EDCA and the Next Phase of the Alliance

The Philippines, as much as any other partner in the Asia Pacific, is invested in its security relationship with the United States. The Aquino administration has committed to a new era of military modernization. The government in 2012 launched a 15-year Revised Armed Forces Modernization Program that aims to disburse nearly $5 billion on military modernization in its first five years, including big ticket purchases such as planned deals for new naval frigates, long-range patrol craft, and a now-stalled order of fighter jets from South Korea—the Philippines’ first in three decades. But so far, disbursement of funds has been slow and far short of expectations. The Philippines is also gaining considerable assistance from partner nations, including a high-profile, $160 million soft loan from Japan for the purchase of 10 coast guard patrol ships, the delivery of two former U.S. Coast Guard cutters, with a third likely on the way, and U.S. assistance in the establishment of a new Coastal Watch Center to boost maritime domain awareness.

But given the extremely poor state of the armed forces of the Philippines compared to regional counterparts, there is no way for Manila to invest enough in armed forces modernization, especially the navy, coast guard, and air force, quickly enough to meet its external defense needs without constraining productive economic growth. And as a developing nation plagued by widespread poverty, Manila must be primarily concerned with investing government revenues in education, health care, infrastructure, social services, and other public goods.

The realities of the Philippines’ low capacity to pursue military modernization are now butting up against the harsher realities of Chinese assertiveness in the South China Sea. The breakneck reclamation work that Beijing has engaged in on seven features in the Spratly Islands will soon allow China to project even more paramilitary, naval, and air capabilities in disputed waters. Philippine leaders recognize their situation and are therefore committed to forging a new era of U.S.-Philippine security cooperation as their best means of ensuring what Foreign Secretary Albert Del Rosario has termed a “minimum credible defense posture.”

This is where the EDCA comes in. Under the agreement, the United States would gain access to Philippine bases, which would also be used by Philippine forces and would allow substantially larger numbers of U.S. troops, ships, and planes to rotate through the Philippines. This would have a sizable impact on the frequency and quality of U.S.-Philippine training and other joint activities. It would also help boost the capacity for trilateral cooperation with other partners such as Australia and, potentially, Japan.

But most importantly, under the EDCA the United States would invest in substantial improvements to infrastructure at the bases to which it gained access in order to meet U.S. needs. Filipino officials have mentioned a number of bases under consideration for such upgrades, but the annex to the agreement that would lay out which facilities the United States would use has not been officially released and is still under negotiation, according to U.S. officials.

One obvious and highly effective choice would be Oyster Bay on Palawan on the south-eastern edge of the South China Sea. The Philippine government in 2013 earmarked about $7 million to upgrade the base to host naval frigates, and Philippine officials have said it remains a top priority due to its position directly across from the Spratlys. U.S.-funded upgrades to the base’s naval and air infrastructure and use of those facilities for U.S. naval and air patrols and intelligence gathering would have a substantial impact on the Philippines’ ability to monitor and react to developments in the South China Sea.

But it is important to view the EDCA as more than just a tool to bolster Philippine external defense shortcomings vis-à-vis China in the South China Sea with U.S. assistance. It is a framework for a new era of cooperation across the spectrum of security operations in the Asia Pacific. Its greatest value would be to assist the long-term development of capability for the Philippines. The upgrades that the United States would make to Philippine bases would have considerable long-term benefits for the Philippine military, as well as providing civilian uses. The same goes for the substantive training opportunities that would occur in the wake of EDCA.


EDCA could also bring substantive benefits beyond the immediate training and infrastructure boost. The Philippines’ poor intelligence-gathering capability and difficulty securing sensitive data are major hurdles to greater intelligence sharing by foreign partners, including the Five Eyes network of Australia, Canada, New Zealand, the United Kingdom, and the United States. U.S. assistance in improving Philippine military intelligence capabilities via EDCA could lead to an increased willingness of other partners to share intelligence.

The rapid U.S. response to Typhoon Haiyan, called Yolanda in the Philippines, in late 2013 shined a spotlight on the indispensable role American forces can play in humanitarian assistance and disaster relief (HADR) operations. With the United States expected to spread its rotational presence across the Philippines and boost infrastructure at eight different bases throughout the country, this capacity to rapidly respond to disasters as they happen should also be a major selling point of EDCA and the new era of security cooperation overall. The same goes for U.S. capacity to assist on maritime security and domain awareness, search and rescue, and counterpiracy and countertrafficking operations.

But these benefits of EDCA are contingent on its implementation sooner rather than later. The agreement has languished in the Philippine Supreme Court for over a year already, despite the serious capacity gaps it would fill for the Philippines. The major question before the court is whether the agreement qualifies as a treaty that must be ratified by the Philippine Congress, or whether it merely expands upon the Visiting Forces Agreement and is therefore the prerogative of the president. Most Filipino legal scholars are of the latter opinion.

U.S. officials are beginning to question Manila’s seriousness, and fears will only grow that a post-Aquino government might decide to cast the EDCA aside if the agreement is not implemented by the time he leaves office. Worse, while Manila has dithered, the most immediate reason for EDCA—Chinese coercion in the South China Sea—has grown even more pressing in light of the improved military and paramilitary capabilities its island building will soon give Beijing in the Spratlys.

It is time for the Philippine Supreme Court to take up the issue and make a decision, one way or another. It is also time for the Aquino administration to invest some political capital in campaigning for the EDCA among lawmakers and the public in order to dispel some of the controversy surrounding it and ease the way for the justices to take it up during the politically charged period heading into an election. With President Obama visiting Manila in November 2015 for the Asia-Pacific Economic Cooperation summit, there will not be a better opportunity to announce the EDCA’s final approval.
The Philippines lies in the world’s most economically vibrant region and astride the strategic South China Sea, the busiest shipping route in the Asia Pacific. The country’s economy has grown nearly 6 percent per year for the past three years, making it one of the brightest stars in Asia and boosting its GDP to $272 billion in 2014. The Philippines’ population stands at nearly 100 million, with 35 percent under 15 years of age.

But despite its seeming advantages, the Philippines' economic ties with the United States lag behind their full potential, both in trade and investment. Closer economic ties between the United States and Philippines are critical to a deeper partnership and would help solidify the U.S. rebalance toward Asia. Government initiatives need to play a key role in creating an environment that promotes more robust investment and trade relations. In the end, however, it is up to U.S. and Philippine businesses to push the economic relationship to a deeper level, despite the current challenges.

Recommendations

Our recommendations for the Philippines and the United States are as follows:

• **Work to make it possible for the Philippines to join the TPP once the current round of talks is completed.** For the Philippines to participate in the TPP would require the government to address a number of protectionist measures and restrictions against foreign imports and investment. Like some of its neighbors in the TPP, the Philippines could look at the trade agreement as a necessary source of external pressure to prompt domestic reform. In preparation for Manila joining the TPP, the two countries could consider negotiating a bilateral investment treaty, which would constitute a core chapter of the trade agreement.

• **Launch a comprehensive study to determine which economic sectors in the Philippines would benefit most if the country joined the TPP.** Support of businesses and industry associations is critical to overcome political opposition to liberalization and allow the Philippines to join the TPP. But to build that support, the U.S. and Philippine governments need to be able to show businesspeople how the TPP could benefit their industries specifically, not just the Philippine economy broadly.
• **Work together closely on achieving important goals in the APEC forum,** which Manila is chairing this year. Some of the themes promoted by the Philippines include encouraging inclusive growth and increased integration of small and medium-sized businesses in the global supply chain. It is also pushing increased disaster resiliency and preparedness as well as further progress in cutting tariffs on environmental goods, and considering how to advance the study of the Free Trade Area of the Asia Pacific, which was proposed at the APEC summit in Beijing last year.

• **Bolster existing government-to-government discussions on investment and trade,** including through the Trade and Investment Framework Agreement. A small group of business representatives from both countries could be included in these talks to help focus discussions on the biggest barriers to deepened economic relations.

• **Establish an annual CEO-level business-to-business dialogue,** similar to those between Chinese and American business leaders, to promote increased investment and trade between the two countries. These dialogues could be used to promote more U.S. investment in the Philippines in such sectors as manufacturing and identify opportunities for more Philippine investment in the United States.

## The Philippines Economy: Growth and Hurdles

As already noted, the Philippine economy has grown nearly 6 percent a year for the past three years, and its GDP was $272 billion in 2014. By comparison, Thailand grew 0.9 percent and Indonesia 5 percent last year.

The manufacturing sector grew over 10 percent in 2014, services continued to perform well, and agriculture beat expectations. As a net oil importer, the Philippines is expected to get sizable savings from the global oil price slide, which will lower transport and household costs and leave more cash in the pockets of consumers, who drive roughly two-thirds of the country’s economy. The Philippine Stock Exchange Index surged 23 percent last year, with foreign investors plowing $1.3 billion into Philippine stocks.¹

The Philippines ranked 95th out of 189 countries in the World Bank’s 2015 Ease of Doing Business survey, ahead of Indonesia at 114 but well behind Malaysia at 18, Thailand at 26, and Vietnam at 78. The Philippines’ rank is down nine places from 2014.²

Meanwhile, in Transparency International’s 2014 corruption index, the Philippines ranked 85th out of 175 countries.³ Under the Aquino administration, a number of senior officials have been prosecuted, including a chief justice, the national ombudsman, a number of generals, and members of Congress.

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As noted earlier, 35 percent of the Philippine population is under 15 years of age, giving the country a significant demographic dividend. The country’s working-age population—those between the ages of 15 and 64—has grown to 60 percent of the populace. The Philippines also has a large workforce of about 11 million working overseas, generating a return of $25.1 billion in 2013, nearly 10 percent of the country’s GDP. These overseas Filipino workers have been powering a recent boom in the real estate sector.

Another source driving the property surge is the estimated 1.1 million workers in the country’s flourishing business processing outsourcing (BPO) sector, which expects revenues of $18 billion this year and now makes up 6 percent of the country’s economy.

Multinationals that have set up BPO operations in the Philippines include JPMorgan-Chase and Royal Dutch Shell. The large, young, educated, English-speaking population is one key factor attracting BPO firms to the Philippines. Another is the relatively cheap rent for office space.

Philippine trade has grown steadily in recent years. Goods exports in 2014 reached $62.1 billion, up from $56.7 billion the previous year and $52.1 billion in 2012. The country’s imports totaled $65.4 billion in 2014, compared to $62.4 billion in 2013 and $62.1 billion a year earlier.

The Philippines’ most important exports are electronic products (42 percent), other manufactured goods (10 percent), and woodcrafts and furniture (6 percent). The country is
also the world’s largest producer of coconuts and pineapples. The Philippines’ top export partners are Japan (21 percent), the United States (15 percent), and China (12 percent).8

The Philippines major imports are electronic products (25 percent), mineral fuels (21 percent), and transport equipment (10 percent). China is the largest source of imports (13 percent) followed by the United States (11 percent) and Japan (8 percent).9

Infrastructure Challenges

Since President Beningo Aquino came to power in 2010, he has launched an anticorruption campaign, put more focus on transparency, and has stressed public spending to boost the economy and confront the widely held view that the Philippine economy is marred by bureaucratic inefficiency and graft. The government is planning to spend $13 billion on infrastructure projects in 2015, compared to less than $3 billion per year when Aquino took office. Another $18 billion is planned for 2016. Six large-scale projects valued at nearly $8 billion had already been approved by May of this year, one of which is a 400-mile rail line that will link Manila to Albay in the south.10

Despite increased infrastructure spending, investment is not able to keep up with the country’s demands. Manila and other cities suffer from major traffic congestion due to the growing economy, population, and vehicle numbers without corresponding investment in infrastructure. Cities in the Philippines in 2015 ranked fourth worst among Asian countries and ninth worst in the world in terms of commuting time, commuting dissatisfaction, traffic inefficiencies, and carbon dioxide emissions while commuting, according to Numbeo, which compares traffic data in 88 countries.11

Congestion at the Port of Manila, which handles two-thirds of the country’s shipments, is another drag on economic growth. From April to December 2014, gridlock at the port cost the Philippines some $1.6 billion in import volumes, according to an estimate by ASEAN Confidential, a research service owned by the Financial Times.12 Shipping and trucking firms have increased their fees or added supplementary charges to compensate for long queuing times and traffic gridlock.

The country also faces a critical power shortage. Aquino warned last year that the island of Luzon may generate only 8,000 megawatts of electricity this year, 1,000 megawatts

less than the island of 44 million needs. The Department of Energy estimates that the country will need nearly 30,000 megawatts by 2030 but will only double production to 26,000 over the next 15 years. The shortage, which has been building for years, regularly causes blackouts and is one reason why manufacturing investors have been reluctant to come to the Philippines. Aquino announced last year that he was asking the Philippine Congress for emergency powers to plug the gap in the nation’s electricity needs.13

The Manila airport, which held the title of world's worst airport for three years until last year,14 has only one primary runway for international flights and a smaller secondary runway for smaller planes, to handle about 500 flights a day. No plans have yet been developed to build a new airport.

The government’s challenges in rolling out projects, including much-vaunted public-private partnerships (PPPs), raise concerns about the longer-term impact of the infrastructure gap on the country’s economic growth. The Philippine Public Private Partnership Center reports on its website that only 10 projects have been awarded, 15 more are ready for roll-out, and another 27 are still in different stages of planning. Foreign institutional investors complain that they have difficulty snaring PPP contracts, saying that they appear to be reserved for local conglomerates controlled by a handful of elite families.15

The Philippines’ outlook for 2015 faces some challenges. Exports shrank in the first quarter because of weak demand in China and a strengthening peso. Should the United States raise interest rates this year, some of the sizeable foreign funds currently in stocks and bonds could be pulled out of the country. This could prompt the Philippines to increase interest rates, creating more economic headwinds. Portfolio inflows last year were $2.5 billion.16

Despite the country’s economic growth, roughly a quarter of Filipinos still live in poverty on family incomes of less than $5,000 a year. Many farmers lack land, despite the land reform program introduced in 1988. Unemployment remains around 7 percent and the Catholic country’s population is growing at 1.7 percent a year, considerably higher than in neighboring countries, creating competition for jobs.17

Foreign Investment

The Philippines attracted $6 billion in FDI last year, up 65 percent over the previous year but still lower than the other large economies in Southeast Asia. Neighboring Vietnam,

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which has a slightly smaller population than the Philippines, attracted FDI totaling $24 billion in 2014.\(^\text{18}\) The top foreign investors in the Philippines in 2013 in order of size of investment were the Netherlands, Japan, Singapore, the United States, and China.\(^\text{19}\)

Philippine companies are also exploring foreign investment abroad. Their top targets are the British Virgin Islands, China, the Cayman Islands, Hong Kong, and the United States, where they invested $181 million in 2013.\(^\text{20}\)

One factor holding back foreign investors is the provisions in the constitution that restrict the role of foreign firms in the economy. They are concerned about regulations that limit foreign ownership in companies to 40 percent. Aquino has sought to tweak some of the regulations; for example, last year he signed a law allowing 100 percent ownership in banks. In addition, foreign companies are hampered by the country’s over-stretched infrastructure, high electricity prices, and red tape in setting up businesses.\(^\text{21}\)

Factors attracting foreign investors to the Philippines include its skilled English-speaking workforce and its large domestic market. The resource-rich southern provinces in Mindanao could attract new investment if the current peace process takes hold on the island. The Philippines is a member of the 10-nation ASEAN, which is moving toward greater economic integration and as a bloc attracted more FDI than China in the past two years.

In 2013 and 2014, international credit rating agencies Fitch, Standard & Poor’s, and Moody’s upgraded the Philippines’ sovereign credit rating to investment grade, citing the country’s strong economic performance, continued fiscal and debt consolidation, and improved governance. Despite the country’s current high marks for its macroeconomic fundamentals, the Philippines faces concern among foreign companies about whether current economic policies will be continued after the 2016 presidential elections. Investors will be watching whether the new president will continue Aquino’s reforms and his focus on governance.

### Ties with the United States

In 2014 the Philippines goods exports to the U.S. market reached $10.2 billion, almost 10 percent higher than the previous years, while services exports were $3.8 billion in 2013 (the last year for which data is available). U.S. goods exports last year stood at $8.5 billion,

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\(^{20}\) Ibid.

Top 10 U.S. Imports from the Philippines

<table>
<thead>
<tr>
<th>Rank</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
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<tbody>
<tr>
<td>1</td>
<td>Semiconductors</td>
<td>Computer accessories</td>
<td>Computer accessories</td>
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<td>2</td>
<td>Computer accessories</td>
<td>Semiconductors</td>
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<td>3</td>
<td>Apparel, textiles, nonwool or cotton</td>
<td>Apparel, textiles, nonwool or cotton</td>
<td>Apparel, textiles, nonwool or cotton</td>
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<td>4</td>
<td>Food oils, oilseeds</td>
<td>Other parts and accessories of vehicles</td>
<td>Other parts and accessories of vehicles</td>
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<tr>
<td>5</td>
<td>Apparel, household goods - cotton</td>
<td>Apparel, household goods - cotton</td>
<td>Food oils, oilseeds</td>
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<td>6</td>
<td>Other parts and accessories of vehicles</td>
<td>Food oils, oilseeds</td>
<td>Apparel, household goods - cotton</td>
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<tr>
<td>7</td>
<td>Cell phones and other household goods, n.e.c.</td>
<td>Electric apparatus</td>
<td>Electric apparatus</td>
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<td>8</td>
<td>Electric apparatus</td>
<td>Fish and shellfish</td>
<td>Fish and shellfish</td>
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<tr>
<td>9</td>
<td>Fish and shellfish</td>
<td>Fruits, frozen juices</td>
<td>Fruits, frozen juices</td>
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<tr>
<td>10</td>
<td>Fruits, frozen juices</td>
<td>Cell phones and other household goods, n.e.c.</td>
<td>Televisions and video equipment</td>
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<tr>
<td>3</td>
<td>Soybeans</td>
<td>Civilian aircraft, engines, equipment, and parts</td>
<td>Dairy products and eggs</td>
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<tr>
<td>4</td>
<td>Civilian aircraft, engines, equipment, and parts</td>
<td>Soybeans</td>
<td>Animal feeds, n.e.c.</td>
</tr>
<tr>
<td>5</td>
<td>Computer accessories</td>
<td>Computer accessories</td>
<td>Soybeans</td>
</tr>
<tr>
<td>6</td>
<td>Dairy products and eggs</td>
<td>Dairy products and eggs</td>
<td>Meat, poultry, etc.</td>
</tr>
<tr>
<td>7</td>
<td>Meat, poultry, etc.</td>
<td>Meat, poultry, etc.</td>
<td>Computer accessories</td>
</tr>
<tr>
<td>8</td>
<td>Animal feeds, n.e.c.</td>
<td>Animal feeds, n.e.c.</td>
<td>Electric apparatus</td>
</tr>
<tr>
<td>9</td>
<td>Measuring, testing, control instruments</td>
<td>Electric apparatus</td>
<td>Measuring, testing, control instruments</td>
</tr>
<tr>
<td>10</td>
<td>Electric apparatus</td>
<td>Other foods</td>
<td>Other foods</td>
</tr>
</tbody>
</table>


making the Philippines the 33rd largest import market for U.S. products, while service exports reached $2.5 billion in 2013.22

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The Philippines’ economic ties with the United States lag behind their full potential. Although the United States is the Philippines’ third-largest trading partner, trade between the two countries is roughly at the level of U.S. trade with much smaller Ecuador and Costa Rica and behind the largest economies in Southeast Asia: Singapore, Malaysia, Thailand, Vietnam, and Indonesia.

A number of factors restrain U.S. exports to the Philippines. In agriculture, they are inhibited by high tariffs of 40 percent for rice and poultry, for example. In addition, rice imports are limited by quantity restrictions and price supports for rice farmers. Imported U.S. cars face tariffs of 30 percent, in contrast to vehicles from other ASEAN countries and Japan, which enjoy preferential tariffs under free trade agreements. The Philippines is not a member of the World Trade Organization’s (WTO) Agreement on Government Procurement, and the country’s laws favor Philippine companies in government procurement.

The total stock of U.S. FDI in the Philippines stood at $4.4 billion in 2013 (the last year for which data is available), up from $4.1 billion the previous year. U.S. investment in the Philippines is mainly focused on manufacturing, nonbank holding companies, and wholesale trade sectors.23

Numerous policies and challenges limit the interest of U.S. investors. Among them are the restrictions in the constitution against investment in certain sectors. Foreign companies are concerned about the rule that limits the foreign share to 40 percent in many areas of the economy. The Philippines also has weak public institutions that are quite easily influenced by vested interests. Other challenges include overstretched roads, the high cost of electricity, the red tape involved in setting up a business, the complex judicial system, and corruption.

Some foreign investors get around these infrastructure and red tape challenges by investing in industrial parks run by the Philippine Economic Zone Authority (PEZA), where companies such as Texas Instruments operate. The company, the world’s largest producer of mobile phone chips, several years ago invested $1 billion in its second plant in a PEZA in the Philippines.24

Benefits of Joining the Trans-Pacific Partnership

As a member of ASEAN, the Philippines is a participant in five free trade agreements that include an investment chapter: with China, India, Japan, South Korea, and Australia and New Zealand. These 6 partners and the 10 ASEAN member nations are now in the midst of negotiating the Regional Comprehensive Economic Partnership (RCEP) agreement. The RCEP will seek to harmonize the “noodle bowl” of differences between the various ASEAN free trade agreements and work to promote greater regional economic integration, eliminate tariff and nontariff barriers, and ensure consistency with the rules of the WTO.

23. Ibid.
A separate initiative that could significantly boost the Philippine economy, including trade and investment ties with the United States, would be a decision to join the 12-nation TPP trade agreement once it is completed. Manila faces the risk of being left behind by its neighbors in the TPP—particularly Malaysia and Vietnam, which are in the current round of TPP negotiations—if it stays out of the trade grouping. Fully half of the TPP countries are

### Philippine Import Growth under Different Scenarios

![Graph showing Philippine Import Growth under Different Scenarios]


### Philippine Imports by Sector under Different Scenarios

<table>
<thead>
<tr>
<th>Sector</th>
<th>2025 Levels</th>
<th>Difference from Baseline</th>
<th>Percent Difference from Baseline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Primary products</td>
<td>$6,488</td>
<td>$5,977</td>
<td>$6,752</td>
</tr>
<tr>
<td>Manufactures</td>
<td>$146,804</td>
<td>$180,451</td>
<td>$156,455</td>
</tr>
<tr>
<td>Electrical equip.</td>
<td>$80,241</td>
<td>$97,107</td>
<td>$85,561</td>
</tr>
<tr>
<td>Services</td>
<td>$9,810</td>
<td>$10,219</td>
<td>$10,655</td>
</tr>
<tr>
<td>Total</td>
<td>$163,102</td>
<td>$196,646</td>
<td>$173,862</td>
</tr>
</tbody>
</table>

**Source:** Asia-Pacific Trade, “Sectoral Results.”
also party to the RCEP negotiations, and there is considerable overlap on the issues being tackled in both agreements, including trade in services, investment, intellectual property, competition policy, and dispute settlement.

According to a leading economic simulation, the Philippines could get an economic boost by 2025 of $22.1 billion, nearly 7 percent, by joining a potential second tranche of countries in the TPP that would include Indonesia and Thailand, as well as the Philippines. Under this expanded TPP, the Philippines’ exports could increase by 20.6 percent, or $33.5 billion over the next 10 years.25 Manufacturing exports could increase by 22.9 percent over the next decade, while apparel and footwear exports could grow 55.4 percent, textiles 45.3 percent, and machinery 30.8 percent.26

The Philippines would also see significant economic benefits from a completed RCEP agreement, but they would be lower than under the expanded TPP. Under the RCEP, exports would increase 6.6 percent, or $11 billion, by 2025. Exports of manufactured goods would rise $10 billion, or 6.6 percent, over the next 10 years, and electronic equipment exports would increase by $5 billion, or 6.6 percent.27

Although Aquino told Obama during a visit to Manila in April 2014 that the Philippines was interested in joining the TPP down the road, neither the Philippine business community nor government officials have demonstrated much enthusiastic support for taking this step. Even business leaders who would stand to gain the most often ask foreign visitors why joining the TPP would be in the country’s economic interests. Some of this sentiment may be due to concerns about facing more competition from foreign firms in the fairly well protected Philippine market.

Another concern undoubtedly is that joining the TPP would require some significant economic changes, including in the country’s constitution, which could prove politically challenging. House Speaker Feliciano Belmonte tried earlier this year to garner support to make some of the necessary amendments to the economic provisions in the 1987 constitution, including the stipulation that limits foreign ownership to 40 percent in public utilities, land, and media companies. But in mid-June, Belmonte abandoned his efforts to change the nation’s charter because he was not able to get the votes needed to support the final reading of the bill.28

27. Ibid.
Philippine Exports under Different Scenarios

Philippine Exports by Sector under Different Scenarios

<table>
<thead>
<tr>
<th>Sector</th>
<th>2025 Levels</th>
<th>Difference from Baseline</th>
<th>Percent Difference from Baseline</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Baseline</td>
<td>TPP-16</td>
<td>RCEP</td>
</tr>
<tr>
<td>Primary products</td>
<td>$12,161</td>
<td>$13,013</td>
<td>$12,176</td>
</tr>
<tr>
<td>Manufactures</td>
<td>$141,255</td>
<td>$159,938</td>
<td>$149,004</td>
</tr>
<tr>
<td>Electrical equip.</td>
<td>$42,376</td>
<td>$47,323</td>
<td>$43,910</td>
</tr>
<tr>
<td>Services</td>
<td>$21,127</td>
<td>$24,322</td>
<td>$23,910</td>
</tr>
<tr>
<td>Total</td>
<td>$174,543</td>
<td>$208,521</td>
<td>$185,502</td>
</tr>
</tbody>
</table>

One economic bill important for future TPP membership approved by the Congress earlier this year was the Fair Competition Act, aimed at curbing monopolies and unfair business practices.\(^{29}\)

Over the past few years, the Philippines has taken steps to address some intellectual property rights (IPR) concerns, which will help make it easier for Manila to join the TPP down the road. Washington last year removed the Philippines from the Special 301 Watch List, which identifies countries that do not take adequate steps to protect IPR, in response to the Philippine government’s efforts to improve the country’s IPR laws and enforcement. Manila had amended the Philippines Intellectual Property Code and passed legislation to address cable signal piracy and infringement related to money laundering.\(^{30}\)

To be sure, the Philippines and the United States are at different stages of economic development. The United States needs to seek avenues to engage the Philippines in new forms of economic cooperation that will benefit both countries. The U.S. government should explore opportunities for capacity building in the Philippines to move the country toward its goal of achieving a developed economy.

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Furthering People-to-People Ties

Thanks to their shared histories, Americans and Filipinos have over the decades established enduring ties at the grassroots level. According to a study by the Pew Research Center in 2014, 92 percent of Filipino respondents said they have a positive view of the United States, the highest percentage of all countries surveyed. However, a number of Filipinos who care about U.S.-Philippine relations wish to see the United States engage more vigorously with Philippine youth and the next generation of the country’s leaders. As the United States rebalances to the Asia Pacific, it is important that Washington does not take for granted people-to-people, cultural, and social ties between the two countries and acts to foster the existing goodwill between Americans and Filipinos.

By the same token, in recent years the U.S. government has invested significant resources to step up its diplomatic efforts in the Philippines and to help sustain and build on the momentum of recent impressive economic growth there. Washington recognizes that a prosperous, inclusive, and well-governed Philippines will be a stronger ally of the United States and a more effective voice within ASEAN. However, as resources will likely become scarcer in the coming years, Washington and Manila will need to reconfigure how to better leverage the potential of the private sector in both countries in dealing with a host of nontraditional security threats facing the Philippines. They will want to advance initiatives that will help spread the benefits of economic growth more widely to the majority of Filipinos.

Recommendations

Our recommendations for the Philippines and the United States are as follows:

- **Ensure the PFG program is renewed beyond 2016 and allocated additional funding.** The United States has provided over $739 million to support projects to improve regulatory quality, strengthen the rule of law and anticorruption measures, improve fiscal performance, and promote human capacity development in the Philippines under the PFG. The next phase of the program should aim to deepen exchanges and cooperation between government agencies in the United States and the Philippines.

- **Launch a regular dialogue between leading Philippine private companies and relevant U.S. government agencies to find ways to leverage public-private partnerships in**

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1. USAID Philippines, “Partnership for Growth.”
the Philippines. This dialogue can serve as an institutionalized mechanism for U.S. officials to engage with Philippine business leaders and gauge their interest in playing a role in public-private partnerships in a number of areas that desperately need investment in the Philippines. The agenda of the dialogue should align closely with and add value to the scope of work of U.S. government agencies in the Philippines.

- **Expand the CDI to more cities in the Philippines and forge sister-city partnerships between up-and-coming Philippine cities and cities in the United States.** Besides Cagayan de Oro, other cities under CDI currently do not have sister cities in the United States. City-level leaders and officials could benefit from exchanges and partnerships with other midsize U.S. cities that have had success in creating jobs. This will also allow up-and-coming Philippine leaders to gain more exposure to the United States.

- **Host the GES in the Philippines in 2016, or beyond.** The United States should send more entrepreneurial ambassadors to the Philippines and ultimately design an initiative with a focus on incubating and supporting Philippine entrepreneurs and Muslim scientists from the Philippines. The United States should also consider establishing a regional operation of the Global Entrepreneurship Network in Manila.

- **Set up a research program on marine biodiversity and coral reefs in Philippines waters, involving the U.S. National Oceanic and Atmospheric Administration and leading Philippine environmental scientists or research institutions.** This joint research program will help both sides better understand the biodiversity in the waters surrounding the Philippines and what can be done to conserve the country’s dwindling coral reefs. Scientists from both countries should also discuss the possibility of establishing marine peace parks in waters off islands controlled by the Philippines in the South China Sea.

- **Extend the USAID-led Higher Education and Productivity Project beyond 2016 and expand its scope to more locations throughout the country.** In addition to reforming the curriculum and building linkages between the private sector and academia, USAID and the Philippine Business for Education forum should explore ways to actively promote the teaching and studying of science and technology in the Philippines.

- **Increase funding for the Fulbright program in the Philippines.** This will allow greater numbers of two-way exchanges between U.S. and Philippine students and scholars every year. The level of funding for the Fulbright program in the Philippines has hit a plateau in the past decade.

- **Sustain dialogue with Philippine government agencies on the potential of the Philippines’ membership in the TPP.** USAID has discussed with Philippine government agencies what it means for the Philippines to join the TPP in coming years. This dialogue should be sustained as the next government comes into office in 2016.
EDUCATION, CULTURE, AND PEOPLE-TO-PEOPLE EXCHANGES

The Fulbright program in the Philippines, which was founded in 1948, has been a pioneer in forging ties between thousands of students and scholars from both the Philippines and the United States. Its scope has recently been expanded to support postgraduate research on regional issues by Philippine scholars at partnering higher education institutions in the United States. There are over 30 Fulbright fellows in both countries each year.

There are between 30 and 35 visitors from the Philippines who come to the United States every year as part of the International Visitor Leadership Program led by the Department of State. The program takes visitors to meet with U.S. organizations and individuals that conduct work in their areas of interest and allows visitors to meet and exchange views with U.S. government officials in Washington.

In addition, the State Department–backed Kennedy-Lugar Youth Exchange and Study program, which has been active in the Philippines since 2004, gives full scholarships to Philippine high school students, particularly Muslims, to live with a host family and study in the United States for a year. Over 360 young Filipinos have come to the United States under the Kennedy-Lugar exchange program. Yet this number lags behind the numbers of Muslim youth in neighboring Indonesia and Malaysia who have participated in the program.

The Peace Corps has also been a robust element in people-to-people exchanges between the two countries. Over 8,600 Peace Corps volunteers have served since 1961 in the Philippines, where they have worked with local communities on projects related to education, youth development, and the environment.

The Peace Corps’ environmental program in the Philippines has focused on coastal resource management by raising awareness among youth and residents in coastal communities about the importance of protecting marine habitats and fisheries management and how marine protection can be carried out at the grassroots level through community-based initiatives. Environmental volunteers work with local government units. Previous U.S. participants in this program have helped create or restore coastal and marine habitats and developed coastal resource management plans and conservation policies.

A number of U.S. graduate students at institutions that have partnered with the Peace Corps have chosen to conduct their research for a master’s degree on marine environmental issues in the Philippines, thereby raising public awareness and contributing to the body of research regarding the Philippines’ marine environment. The environmental component of the Peace Corps program has been particularly valuable because of the Philippines’ dependence on coastal and marine resources. A nation of over 7,000 islands, the Philippines

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has one of the longest coastlines in the world, with 25 of its major cities lying on the coast. It is estimated that about 60 percent of the population lives in coastal areas and that over 1 million Filipinos earn a living directly from fisheries. Coastal and marine sites are also popular tourist destinations in the Philippines.4

Furthermore, environmental experts agree that Philippine waters are home to some of the world’s most diverse ecosystems, with an abundance of species, extensive coral reefs, and dense mangrove forests. It is estimated that coral reefs alone contribute over $1 billion, both directly and indirectly, to the Philippine economy annually.5

Yet there is wide recognition that the Philippine marine environment has been in crisis. A study conducted by the Japan International Cooperation Agency in collaboration with Philippine and international universities, which surveyed over 10,400 square miles of coral reefs in Philippine waters, found that only 5 percent were still in excellent condition.6 This is due to overfishing, ongoing population pressures, and the widespread use of destructive fishing techniques such as dynamite fishing. The total fish catch is also believed to have stagnated, if not decreased, over the past few decades, forcing Filipino fishermen to travel farther offshore to catch fish.

In response, the Philippine government has launched a project called the Integrated Population and Coastal Resource Management to try to address these growing environmental and food security threats. The main objectives of this program are improving reproductive health outcomes for coastal communities, strengthening local and community-based management of marine and coastal resources, and boosting public awareness about the linkages between reproductive health in coastal areas and food security and coastal resource sustainability.7

The Philippine government now operates this program in 18 coastal municipalities and 105 barangays, the lowest local governance unit in the Philippines. Communities chosen for this program meet the criteria of possessing high fishery and biodiversity values and are home to large populations. Areas under this program that the Department of Environment and Natural Resources has classified as “extremely high priority” include the Calamianes region, Palawan, Eastern Visayas, and Mindanao.8

The Peace Corps has also played a role in helping improve youth education and human capacity and building civil society in Mindanao in the past few decades, although Peace Corps volunteers currently do not go to Mindanao due to security concerns. With support

5. Ibid.
8. Ibid.
from USAID, Peace Corps volunteers have provided skills training to teachers and youth leaders from Mindanao at other Peace Corps sites in the Philippines.  

Volunteers have also served as role models for children through the Peace Corps' youth leadership training camps, which target children from Mindanao. These camps aim to teach Mindanao youth how to recognize and assess the needs of their communities and develop microprojects to deal with those needs accordingly. The Peace Corps has partnered with the Department of Education and Department of Social Welfare Development in these efforts.

Ultimately, the Mindanao component of the Peace Corps program in the Philippines helped promote building peace in the region through improving literacy and life skills among young people and by creating opportunities for communities in conflict-affected areas in the southern Philippines.

Yet despite long-standing cultural and social ties between Americans and Filipinos, the number of Filipino students studying in the United States remains at just over 3,000 as of 2014. U.S. diplomats express disappointment with this small figure but point out that the relatively decent quality of the Philippine higher education system in major urban areas means that Philippine students are generally less interested in studying abroad than are their counterparts in neighboring countries.

On the other hand, leading Philippine universities such as Ateneo de Manila and the University of the Philippines do maintain international linkages with a number of higher education institutions in the United States. But most of the existing university links between the two countries have depended on the goodwill and support of Filipino-Americans, a model that may not be sustainable in the long run. These linkages should be institutionalized and expanded, preferably through scholarship programs, in order to serve as a channel to boost future faculty and student exchanges.

The U.S. embassy in Manila regularly holds programs to engage Philippine youth, media, and civil society groups. U.S. officials say that the Philippine public often shows keen interest in attending events hosted by the embassy. In particular, recent events under the Young Southeast Asian Leaders Initiative—a program launched by President Obama in 2013 aimed at strengthening leadership development and networking in Southeast Asia for rising leaders from 18 to 35 years old—have resonated well with young Filipinos.

U.S. embassy officials note a strong interest in entrepreneurship among Philippine youth and the public. Many attribute this to the entrepreneurial nature of Philippine
culture, as well as self-started efforts among many ordinary Filipinos to reduce the poverty that remains widespread in many parts of the country.

A study by the Asian Development Bank estimates that micro, small, and medium-sized enterprises (MSMEs) account for over 90 percent of all business endeavors in the Philippines and employ over 60 percent of the labor force. Yet the business and regulatory environment in the Philippines in many ways remains unconducive to start-ups and enterprise development.

Recognizing the importance of entrepreneurship for poverty reduction and inclusive economic growth for the Philippines, the government of President Aquino in 2014 signed into law what is known as the “Go Negosyo Act,” which seeks to promote and strengthen MSMEs in localities across the country. The Go Negosyo Act plans to improve the ease of doing business and access to services for MSMEs within their own provinces, cities, and municipalities; allow technology transfer, management training, and marketing assistance to small businesses; create a nationwide registry database under the Department of Trade and Industry that can be used by all business enterprises in the Philippines; and create a start-up fund for MSMEs in priority economic sectors.

The Department of Trade and Industry has allocated over $2 million this year to set up Go Negosyo centers across the Philippines, which are tasked with helping entrepreneurs launch and register their businesses. The government’s goal is to have 1,200 centers over the next five to seven years. The government intends to make Go Negosyo a multiagency and multisector project, involving—besides the Department of Trade and Industry—the Department of Science and Technology, the University of the Philippines, the Cooperative Development Authority, and the Technical Education and Skills Development Authority, among other agencies and institutions.

The Aquino government’s efforts to promote entrepreneurship are in line with Obama’s push to elevate entrepreneurship to the forefront of U.S. engagement with the world and the global agenda since 2009. The United States hosted the inaugural GES in Washington 2010 and has since cohosted the annual summit with the governments of Turkey, the United Arab Emirates, Malaysia, Morocco, and Kenya. The GES has become a prominent annual gathering of entrepreneurs, business leaders, mentors, and senior government officials.

In addition, the U.S. government has invested in more than 1,000 initiatives to promote entrepreneurship worldwide, committed about $3.2 billion to support MSMEs around the world, and mobilized $80 million in private capital to help finance start-ups in the developing world. As part of this effort, the United States plans to establish Global

Entrepreneurship Network operations in different parts of the world that aim to raise $1 billion in private investments for entrepreneurs worldwide over the next three years.\textsuperscript{15}

The Philippines is well positioned to play a major supporting role in U.S. efforts to foster entrepreneurship in the Asia Pacific. The Philippines has an entrepreneurial culture, a young population that is highly attuned to social media (the Philippines was nicknamed “the world’s social media capital” in 2010), a services-oriented economy, a largely English-speaking workforce, and a large consumer base. If the Philippines continues to grow at current levels and future governments continue to embrace economic and institutional reforms, the country is poised to become one of the world’s top 20 largest economies by 2050, according to a 2012 report by HSBC.\textsuperscript{16}

The United States could help add momentum to efforts and trends that have been underway in the Philippines by helping integrate the mechanisms of the Go Negosyo project with those of the GES initiative. By holding a future GES in the Philippines, Washington and Manila could bring together emerging Philippine entrepreneurs and business and thought leaders with those from the United States and other countries.

The United States launched the Presidential Ambassadors for Global Entrepreneurship initiative in 2014 to send the country’s top entrepreneurs abroad to help empower the next generation of global entrepreneurs. Through this initiative, Washington can begin to send some of the top entrepreneurial ambassadors to the Philippines in the coming years to network with and support rising Philippine business leaders. This can culminate in a signature Philippines component in the overall initiative, as has been the case with Mexico, Cuba, the Middle East, and Africa. In a separate effort spearheaded by USAID, the U.S. government has set aside $95 million in credit guarantees to partner with Philippine financial institutions to encourage them to increase lending to small and medium-sized enterprises.\textsuperscript{17}

Likewise, the United States should extend the scope of its Global Innovation through Science and Technology initiative, which set out to support business ideas by scientists from the Muslim world, to Muslim scientists and Muslim youth start-ups in the Philippines. Washington could also consider establishing a regional arm of the Global Entrepreneurship Network in a major Philippine city.

Public Diplomacy and a Nonmilitary U.S. Role in Mindanao

The United States has in recent years stepped up public diplomacy in the southern Philippines through greater engagement with Muslim youth in Mindanao and the Sulu


archipelago, holding interfaith dialogues and promoting the rule of law as a channel to bring about change. For instance, half of the 14 American Corners in the Philippines, where large volumes of books and materials about U.S. history and culture are on display for public access, are located in Mindanao.

Since 2012 the embassy has helped establish legal aid clinics at law schools in Mindanao and Palawan through the Legal Assistance Program in Mindanao, a partnership between the embassy and local nongovernmental organization Mindanao Youth Corps Volunteers. As part of this program, students from at least 10 participating law schools across Mindanao provide pro bono legal services to members of their communities. These clinics aim to instill awareness among youth in Mindanao about their legal rights and responsibilities and help improve access to justice for marginalized Muslim communities in Mindanao in particular and Filipino Muslims in general. In addition to offering free legal services, these clinics have held workshops and seminars to raise local awareness on women's rights, human rights, challenges of peace building, and the importance of the rule of law.

Since 2002, USAID and the Philippine House of Representatives have jointly run an internship program that allows university students and recent graduates who live primarily within the Autonomous Region in Muslim Mindanao to intern in the offices of Philippine lawmakers in Manila. The internship program is designed to help youth in conflict-affected areas gain an understanding of democratic values and institutions, governance issues, and the process of legislating. It is estimated that over 300 young people from conflict areas in Mindanao have been chosen to participate in this program.

Since April 2015, the embassy has begun placing a small group of students from the University of Mindanao—one of the participating universities in its legal assistance program—in month-long internships with grassroots organizations that champion human rights, gender equality, and community empowerment. In early 2015, the State Department brought a group of legal professionals and law students from institutions based in Mindanao to the United States, where they met with U.S. government officials and nongovernment actors involved in civic legal aid and conflict resolution as part of the annual International Visitor Leadership Program.

The embassy has also brought former combatants from Cotabato and Sulu to Manila, where they attend sessions designed to help them sort out self-identity issues and provide them with job skills. According to U.S. officials, participants in this program tend to carry out microbusiness projects when they return to their native provinces. Taken together, all

of these efforts have helped build an important nonmilitary role for the United States in Mindanao.

In conducting outreach activities in Mindanao, the embassy works through a broad range of partners in civil society at the local level. However, U.S. diplomats have reported that the varying quality and level of development of civil society organizations across Mindanao have sometimes made it challenging to expand U.S. engagement efforts in the area.

Grievances of Filipino World War II Veterans

One of the more sensitive issues in U.S.-Philippine relations has been the treatment of Filipino World War II veterans. Roughly 250,000 Philippine soldiers and guerilla fighters fought alongside the United States during the war and were promised citizenship and veterans’ benefits by the U.S. government. But past legislation by the U.S. Congress has denied these veterans active military status, which would entitle them to full U.S. veterans’ benefits. And in many cases, citizenship granted to some veterans was not extended to their families.

In 2009, the Obama administration established a $198 million Filipino Veterans Equity Compensation Fund, which provided for one-time payments to eligible veterans living in both the United States and the Philippines. There are an estimated 6,000 surviving Filipino World War II veterans.\(^{21}\)

U.S. officials believe that recent actions taken by the Obama administration have substantially addressed veterans’ grievances. However, many surviving veterans still report not being given adequate coverage or that their claims have been denied. According to U.S. officials, the hardest part of the process involves proving the claims of veterans and their families.

Filipino guerilla fighters who fought as part of informal units during World War II may also have had difficulty proving their claims, as their service was not recorded on any lists certified by U.S. government agencies. The question that arises in these cases is whether these “informal” veterans—and their families—can use secondary evidence of any kind to prove their eligibility status.

U.S. Investment in a Prosperous, Inclusive, and Well-Governed Philippines

The United States recognizes that a prosperous, inclusive, and well-governed Philippines will be a stronger ally of the United States and more effective voice within ASEAN. One of USAID’s signature projects in the Philippines as part of the U.S. rebalance to the Asia Pacific

has been the PFG initiative, which runs from 2012 to 2016 and is jointly conducted by government agencies in both countries. The PFG aims to identify and address problems that have prevented the Philippines from achieving its economic potential. An analysis conducted by USAID identified four growth constraints facing the Philippines: weak governance, constrained public finance, inadequate infrastructure, and weak human resources.

The Philippines is one of just four countries selected for the PFG, a program that has the backing of President Obama. Based on the four constraints, an action plan was formulated to improve regulatory quality, strengthen the rule of law and anticorruption measures, improve fiscal performance, and promote human capacity development in the Philippines. The United States has provided over $739 million to support the program, and USAID has launched 22 projects under the PFG.\(^{22}\)

As part of the “whole-of-government” approach under the PFG, the U.S. Treasury Department has established a limited presence in the Philippines as well as the Departments of Agriculture, Labor, and Justice. On the Philippine side, there are 11 government agencies involved, including the Departments of Finance, Trade and Industry, Justice, Budget and Management, and Education.\(^{23}\) USAID officials have lauded the cooperative spirit of their Philippine colleagues on this project and the resolve of the Aquino government to address governance issues.

The portfolio of the PFG’s work in the Philippines ranges from promoting trade, investment, and private sector growth to strengthening health and education systems in areas outside of Metro Manila.

For example, the PFG has supported efforts to improve the Philippines’ legal environment by, among other things, strengthening anticorruption institutions and lending support to the Office of the Ombudsman and Supreme Court in prosecuting large-scale corruption cases and promoting the importance of contract and intellectual property rights enforcement. Other Philippine government institutions that have benefited from the legal component of the PFG include the Commission on Audit, the Civil Service Commission, the Securities and Exchange Commission, and the newly created Governance Commission for Government-Owned and Controlled Corporations. The Philippines has consistently moved up the ranks on Transparency International’s Corruption Perceptions Index for the past three years. Last year, it ranked 85th out of 175 countries on the index, compared to 105th in 2012 and 94th in 2013.\(^{24}\)

U.S. officials have expressed uncertainty, however, about whether this resolve and willingness to change will last beyond 2016, when a new government will take office in the

\(^{22}\) USAID Philippines, “Partnership for Growth.”
\(^{23}\) Ibid.
Therefore the focus of USAID’s work has been on helping spread the benefits of the impressive economic growth in recent years to ordinary people. Examples of PFG projects that aim to promote inclusive growth include supporting community-led development in poor rural areas and helping reduce poverty in Samar and Eastern Samar in the central Philippines through infrastructure development.

Toward this end, USAID currently operates the CDI, a project that aims to help develop second-tier Philippine cities into engines of growth and centers of employment. The problem with the high economic growth of recent years is that it has been centered mostly in and around Metro Manila, while one-fifth of the Philippine population still lives in poverty. Three cities targeted under the CDI are Batangas City on Luzon, Cagayan de Oro on Mindanao, and Iloilo City in the Western Visayas region. Zamboanga City signed a memorandum of understanding with USAID in November 2014 and is expected to join the CDI soon.

For each of these target cities, USAID conducted an analysis of the city’s priority sectors and projects that may help accelerate growth. The agency has worked with local governments to foster an open and competitive business climate, boost human capital, and strengthen health services and climate resilience for cities chosen as part of the CDI. As these second-tier cities prosper, it is hoped that the economic benefits will trickle down to farmers and poor communities in surrounding rural areas.

In an effort to build a well-equipped Philippine workforce, USAID has partnered with Philippine Business for Education, a forum led by representatives of prominent Philippine companies, to establish an initiative called the Higher Education and Productivity (HEP) Project. Through HEP, a three-year program that runs from 2013 to 2016, universities and industry work to reform the curriculum and bridge the divide between the quality and technical abilities of graduates and market demands. Dealing with this mismatch could go a long way in addressing the country’s unemployment rate, which hit 27 percent at the end of 2014 and was most pervasive among youth between 18 and 24 years old.

In the long run, it is in the interests of both the United States and the Philippines to see the Philippine economy become more integrated into the global supply chain, through the proposed TPP and other trade agreements. A significant amount of USAID work under the PFG aims to prepare the Philippines for membership in the TPP, if and when it is concluded.

The USAID mission in the Philippines has explained to various Philippine government agencies the potential benefits of and required policy adjustments for TPP membership. These dialogues should be expanded if the TPP is ratified this year, as is widely expected.

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Another important U.S. effort to help the Philippines fight poverty is the Philippine Compact Program under the Millennium Challenge Corporation (MCC), which was signed in 2010 in the presence of President Aquino and former secretary of state Hillary Clinton. The Philippines was declared eligible for compact funding in March 2008, after two years of working with the MCC to improve anticorruption efforts and revenue administration from 2006 to 2008. Philippine government institutions that have benefited from these efforts include the Office of the Ombudsman, the Department of Finance, the Bureau of Internal Revenue, and the Bureau of Customs.\(^{28}\)

The MCC has allocated a total of $434 million to the Philippines’ Millennium Challenge Account. About half of this amount, $214 million, goes toward developing infrastructure—one of the biggest challenges to growth and investment in the Philippines—through an initiative known as the Secondary National Road Development Project. Another $120 million is dedicated to the implementation of a “comprehensive and integrated delivery of social services” across the country, thereby contributing to the improvement of living conditions in rural areas.\(^{29}\)

### Harnessing the Potential of the Private Sector in the Philippines

The Obama administration has invested significant resources in its public diplomacy efforts and initiatives to help build a well-governed, prosperous, and inclusive society in the Philippines as part of the U.S. rebalance to Asia. Another area where more U.S. investment would be useful is in helping the Philippines more effectively deal with a number of health and nontraditional security risks facing the country.

USAID officials acknowledged that some of the most poignant health and environmental issues for the Philippines include the endurance of tuberculosis, poor maternal health and child mortality, and water insecurity. For instance, it is estimated that over one-fifth of the Philippine population does not have access to basic sanitation and that inadequate sanitation costs the Philippines over $1.4 billion in economic losses annually.

Against this backdrop, USAID has in recent years tapped into the public-private partnership model as a way to achieve some of its goals in the Philippines. One such example is the Philippine Sanitation Alliance (PSA), an initiative that USAID and the U.S. Navy launched in 2007 with Philippine and U.S. private companies and business associations. The mission of PSA is to provide low-cost sanitation treatment for the poor and turn waste into energy in rural farming communities. Projects under PSA have been implemented in Lipa City south of Manila, San Fernando City, and the island of

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\(^{29}\) Ibid.

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Samar. However, replicating models such as the PSA across the Philippines and in different sectors can be challenging partly because the 1987 Philippine constitution imposes restrictions on foreign ownership and participation in the Philippine economy, deterring away many potential U.S. businesses that would be interested in public-private partnerships.

In the future, the Philippine private sector, particularly larger Philippine enterprises, should and can play a bigger role in cooperating with U.S. and international aid organizations in advancing public-private partnerships in the health care and infrastructure development sectors. By engaging in regular dialogue with Philippine companies, U.S. government agencies can also strengthen support within the private sector for relaxing currently restrictive economic provisions on foreign investors.

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