

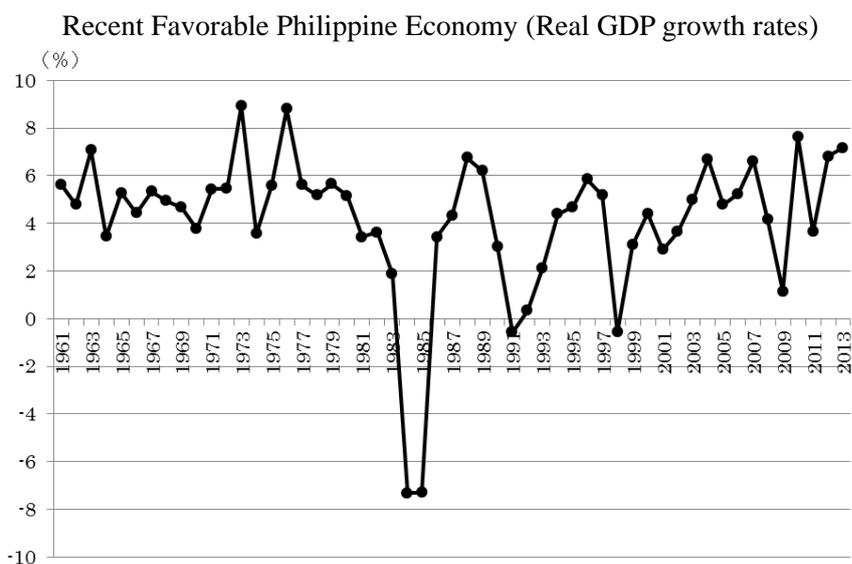
▶ Chapter 6

## Philippines: The Challenge of Sustaining High Growth — Formulation of effective medium to long-term plan is essential

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### Key Points

- Recent Philippine economy has been showing strong growth driven by household consumption, government expenditures and investments.
- Sustaining high growth is the largest issue in the Philippines. It is recommended not only to rely on consumption, but also to create a favorable environment where domestic consumption and exports accompany increase in investment.
- Revival of manufacturing sector is the key to sustaining high growth. Generation of employment can also be expected. To this end, developing human resources, addressing inadequate infrastructure and strengthening institutions are considered necessary conditions.
- It is recommended that the Philippines formulate an effective medium to long-term plan with the support of private sector. The plan must be swiftly implemented, and be effective hopefully even after the change in administration.



Source: World Development Indicators, World Bank

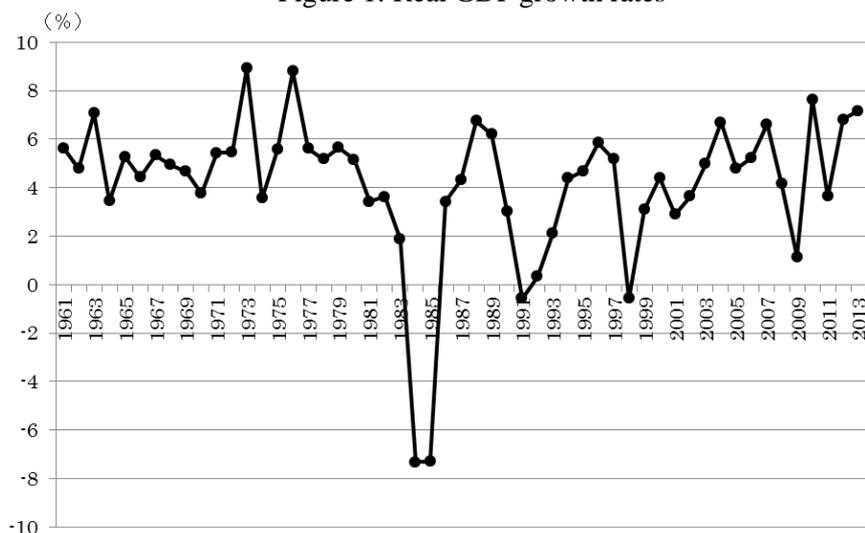
## 1. Characteristics of the Philippine economy

### 1.1 Sluggish Economic Growth

Recent Philippine economy has been showing strong growth. The real GDP growth rate in 2012 was 6.6%, and was 7.2% for the year 2013 (Figure 1). In October 2013, US rating agency Moody's Investors Service upgraded the credit rating of the country to 'investment grade' which follows similar moves by the other two credit rating agencies whose upgrade took place in the first half of 2013.<sup>1</sup> The Philippines had been known as the "sick man of Asia" in the 1980s and until early 1990s due to the slow growth, but this was now a matter of the past.

However, as a result of the sluggish growth in the past, per capita income of the Philippines is far below that of Malaysia and Thailand, and was even surpassed by Indonesia. Rather than being caused by economic factors noted in the discussion of "middle-income trap" (see the Introduction), this was mainly due to non-economic factors such as the poor business environment and unstable political situation. By contrast, the recent robust economic growth is favorable outcome. Nonetheless, sustaining high growth is the greatest issue for the Philippines. At the same time, it is also important to transform country's economic structure to which the benefit of economic gains could be felt by the majority. This is indeed the "inclusive growth" upheld by the Philippine government.

Figure 1: Real GDP growth rates



Source: World Development Indicators, World Bank.

<sup>1</sup> Fitch Ratings upgraded credit rating of the Philippines to 'investment grade' in March 2013, followed by Standard and Poor's (S&P) in May.

## 1.2 Economic and Social Imbalances

Historically, the Philippines has taken the path of imbalanced development. Even in years when the economy is experiencing strong growth, economic and social imbalance persisted. Let us briefly note below the state of inequality and disparity in the areas of: 1) economic structure, 2) regional development, 3) income structure, and 4) the labor market.

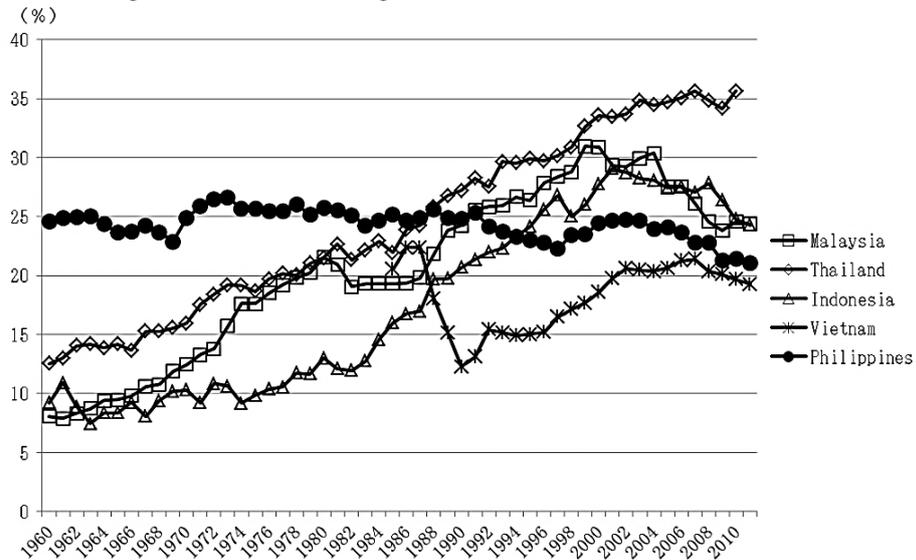
### Economic Structure

The Philippine economy is mostly driven by the consumption which makes up over 70% of the economy. On the other hand, investment level is low. After the Plaza Accords in 1985, Japan increased its direct investments in South East Asian countries such as Malaysia and Thailand. However, due to unstable political situation in the Philippines, the inflow of investment into the country remained at a low level. And to this day, the country has been a laggard in attracting foreign direct investments.

Looking at the industry breakdown, the share of services sector is nearly half of the GDP while that of manufacturing is approximately 20%. Although the figure is not greatly different from that of the peers in South East Asia, it has been stagnant, or rather slightly declining, since the beginning of the 1980s (Figure 2). The other countries had their manufacturing sector expanded which eventually led to economic development, whereas the same case did not occur in the Philippines. The stagnation in manufacturing could be linked to low external demand such that the share of export of goods and services to GDP has been trending downward to 30%.

Among manufacturing sector, foods (including beverages) have a share of nearly half of the total. Over the past 30 years, the share of machine industry has risen while materials industries and the consumer goods have slightly declined. Machine industry is mostly comprised of electronics which is known for major export goods in the Philippines. Nonetheless, the sector is still engaged in low value added process and therefore the contribution to the economy is still low.

Figure 2: Manufacturing share (as % of GDP)



Source: World Development Indicators, World Bank.

### Regional Development

Disparity among regional development in the Philippines is large. For instance, per capita GDP of Metro Manila is approximately \$6,650, which is between Thailand and Malaysia (both in the national level). However, per capita GDP of the Philippines in the national level is only one third that of Metro Manila. Furthermore, the Autonomous Region of Muslim Mindanao (ARMM) which known for the poorest region, per capita GDP is approximately one tenth that of Metro Manila. It seems that per capita income level decreases and the poverty ratio rises as it moves towards southern region.

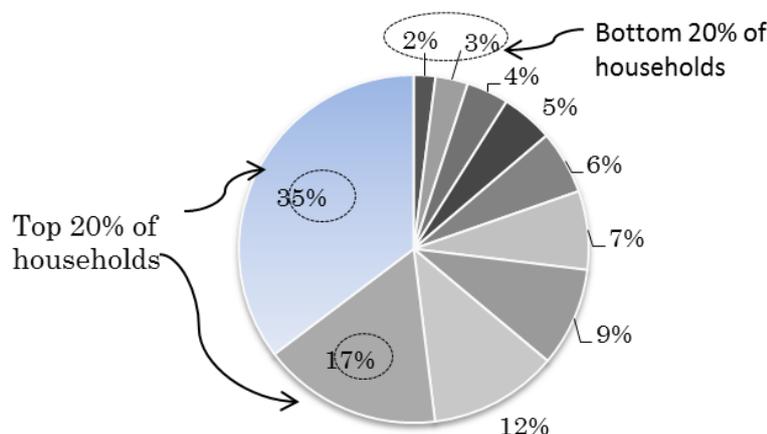
In terms of economic activities nearly 40% of GDP is concentrated in Metro Manila. If the neighboring regions are included, the share rises to approximately 60%. This concentration towards the metropolitan capital and surrounding regions has not changed for a long time. Looking at the industries, nearly half of the entire services sector of the country is concentrated again in Metro Manila. With regards to the manufacturing sector, nearly 40% of the sector is concentrated in Calabarzon (region IV-A),<sup>2</sup> which is located to the south of Metro Manila. The share rises to almost 70% if neighboring regions such as Metro Manila and Central Luzon (region III) is added to Calabarzon.

<sup>2</sup> The region has many large economic zones in which foreign companies including Japanese are located.

## Income Structure

The Philippines is characterized not only by regional disparity but also by large income inequality. Figure 3 represents percentage distribution of total family income by income decile. It shows that the top 20% households receive almost half of the total income. It has been estimated that these top 20% households approximately correspond to the middle and the upper income class. The remaining 80% are considered to be in the low income class.<sup>3</sup> Based on the poverty lines defined by the Philippine statistical authority, poverty incidence among families is estimated at 22.3% in 2009.<sup>4</sup> Furthermore, World Development Indicators by the World Bank shows that the poverty headcount ratio at \$2 a day (PPP) in the Philippines is approximately 40%.

Figure 3: Income Distribution (2009)



Source: 2009 Family Income and Expenditure Survey, NSO.

## Labor Market

The labor market in the Philippines is also distinctive. One characteristic is the presence of large number of overseas workers, and the other is the high unemployment as well as underemployment. Number of deployed overseas workers exceeds 1.5 million every year (1.8 million in 2013), and for the stock estimate, approximately 4.2 million are considered abroad as a temporary status.<sup>5</sup> Remittances from overseas Filipinos exceed \$20 billion every year and totaled \$22.9 billion in 2013. The inflow of remittances is more than large enough to compensate for the trade deficit. In other words, it greatly contributes to the current account surplus of the country.

<sup>3</sup> Figure 3 is the annual income distribution. If assets are taken into considerations, it is believed that the inequality would even be more pronounced.

<sup>4</sup> Poverty incidence among population is estimated at 27.9% (National Statistical Coordination Board).

<sup>5</sup> If emigrants (permanent residents) and irregular overseas Filipinos are included, it is estimated that there are over 10 million overseas Filipinos. The number is nearly 10% of the total population.

In spite of this large number of overseas workers, there are many unemployed and underemployed in the Philippines. The unemployment rate in 2013 is 7.1% which corresponds to nearly 2.9 million persons. The youth (aged 15-24) comprises almost half of the unemployed. In addition, when seen by educational attainment, those who completed tertiary education (university graduate or higher) comprised about 20% of the unemployed. On the other hand, underemployment rate is around 20%, which is another distinctive feature in the Philippine labor market.

As briefly seen above, the country is facing economic and social imbalances. The sluggish economic growth was certainly one of the causes for these imbalances to persist. It seemed, contrarily, that these imbalances might have induced sluggish economic growth as well.

### 1.3 Effects of Politics

The political instability in the Philippines was another factor behind the sluggish economic growth. The administration of former president Ferdinand Marcos, which was known as an authoritarian regime, fell down in 1986 and the democracy had been restored since then. However, even after democratization, several coup attempts against the new administration of Corazon Aquino<sup>6</sup> occurred. Political situations as well as public security were unstable. While Malaysia and Thailand were receiving direct investments from Japan and elsewhere in the mid-1980s, and experiencing strong economic growth, the Philippines was not in a position to attract investments due to the political instability.

In addition, Philippine administration is limited to six years. Based on the constitution, the president is not allowed to seek his/her second-term. When there is a change in administration, Department secretaries and other high government officials are mostly replaced. Continuity and consistency of policies, therefore, are not fully guaranteed. This political system may have been creating negative impact on business environment.<sup>7</sup>

## 2. Medium to Long-term Issues

There are two main issues the Philippines currently face. One is sustaining high growth. The other is incorporating the poor and low income classes into respectable economic activities and transforming the economy inclusive.

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<sup>6</sup> She is the mother of the current President Benigno Aquino III.

<sup>7</sup> Even when the Secretary is replaced within the same administration, the policy prioritization may change and projects already in progress may be altered.

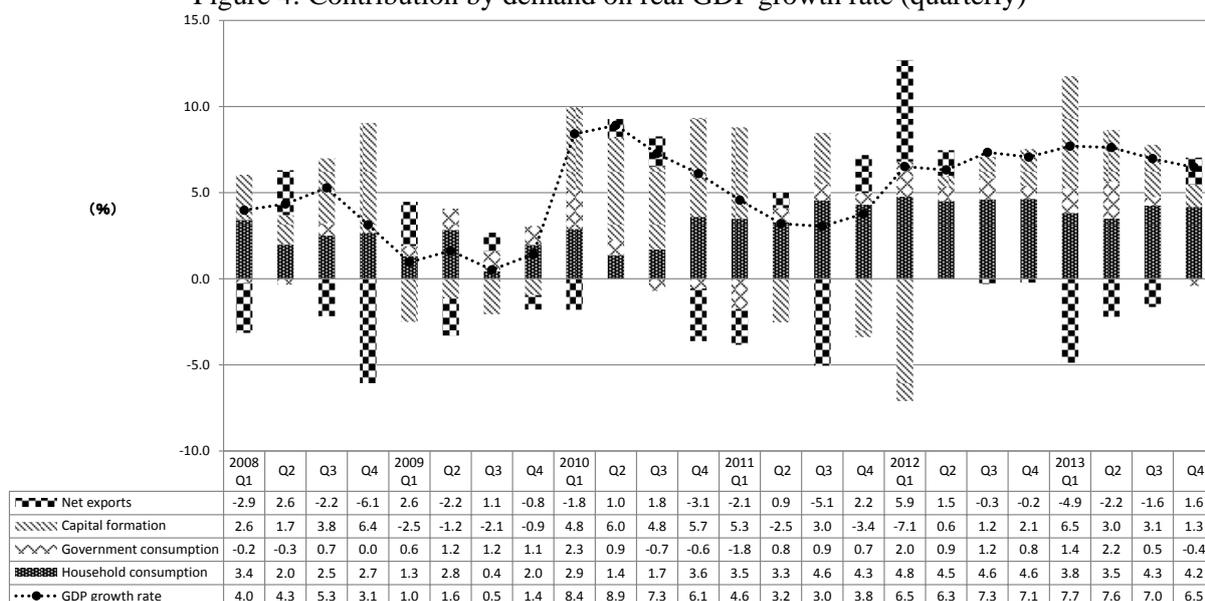
## 2.1 Sustaining High Growth

Unfortunately, Philippines has never sustained annual growth rate of 6-7% consecutively for multiple years (Figure 1). Consequently, the greatest issue for the country is how to sustain current high growth. This overlaps the discussion of avoiding the “middle-income trap.”

As has been said, strong consumption demand is driving the country’s high economic growth (Figure 4). However, consumption is partly dependent on remittances from abroad which are easily affected by the international situation. Another factor, such as investment in construction led by public works, is also positively affecting the recent economy. But there is a possibility of public expenditures being suppressed subject to the fiscal situation. Philippine’s economic growth is thus dependent on unpredictable international situation and uncertain fiscal position. Foundation for sustainable high growth is therefore considered weak.

Sustaining high growth may depend on whether a virtuous cycle of consumption/exports and investments is created. Given the strong consumption demand, the growth rate will definitely be higher if there would be a continuous increase in investments. Looking at the past, it was a common scene that the increase in investments leads to increase in imports and partial decrease in net exports (exports minus imports) which eventually had a negative impact on the economy in terms of domestic value added. This signifies that capital goods, raw materials, and a majority of components are largely import-dependent. If the production base in the country expands and increase in investments leads to increase in exports, and further induce investments, such virtuous cycle would allegedly sustain high growth. The same is considered to be true for the cycle of increase in both consumption and investments.

Figure 4: Contribution by demand on real GDP growth rate (quarterly)



Note: Excludes statistical error.

Source: National Accounts of the Philippines, NSCB.

It is the manufacturing sector which will create virtuous cycle of exports and investments. The share of manufacturing in the Philippines is stagnant at around 20% and the industry share of employed persons is only 8%. Revival of the sector supported by foreign direct investments is thus inevitable for achieving inclusive high growth. To this end, the country is urged to improve business environment. It is also strongly hoped that an effective industry development strategy be crafted and swiftly implemented.

Nevertheless, one must not forget that the driving force of Philippine economy is services. Services sector also generates large proportion of employment. Increasing efficiency and productivity of the sector is one another issue. For instance, business process outsourcing (BPO), which already has certain competitiveness, shall preferably move up the ladder to higher value function in order to attract more investments and to further expand as well.

Lastly, it must be mentioned that the Philippines has an abundant human capital. With proper development of human resources, it is possible to supply promising labor force to the labor market with appropriate wage rates. In this sense, the Philippines has an enormous potential. In order to sustain high growth while taking advantage of such abundant labor force, an effective medium to long-term “growth strategy” is again considered inevitable.

## 2.2 Transforming the Economy Inclusive

The other issue the Philippines face is incorporating the poor and low income classes into respectable economic activities, that is to say, transforming the economy inclusive. As seen in the previous section, there are many people and regions that are not benefitting from economic gains. Large income inequalities and regional disparities still persist. Inadequate infrastructure, insufficient education and health services, and weak industrial base in the regional cities are considered impediments for the economy to be inclusive. Transforming the economy into which most people can find decent work and earn stable income is necessary for sustaining high growth. “Development strategy” is the key in this sense.

As briefly mentioned in the previous section, there is no room for argument that the Philippines must prepare medium to long-term “growth strategy,” but at the same time, the country is still in need for “development strategy” as well. The role of government required in each strategy may greatly differ. Moreover, there shall be a fiscal burden to certain extent. The balancing act of the government is hence being tested.

### 3. The Efforts of the Aquino Administration

#### 3.1 Philippine Development Plan 2011-2016

In the Philippines, when a new administration takes office, a development plan is formulated in which economic and social objectives are indicated. For more than past ten years, each newly installed administration has been citing similar objectives such as: sustaining growth, reducing poverty, and generating employment. If one could be critical, this means that the neither administration had fully accomplished his/her goal.

Be that as it may, let us briefly examine the perceived role of the industry and services sectors in current administration's growth strategy. Figure 5 is the list of priority industries illustrated in the Development Plan. As can be seen, some industries already have certain international competitiveness but some are seemingly chosen for the purpose of generating employment rather than taking much into consideration of their economic impact as potential driving force to sustain high economic growth. One interesting feature is that "logistics" and "infrastructure" are seemingly treated here as industries equivalent to "electronics". Admitting their economic impact is large once they are fully addressed; they are both truly "infrastructure" in nature on which development of manufacturing and services as well as agribusiness industries stand. Moreover, process of developing infrastructure is different from other industries. Thus, they are much more expected to be classified into the "business environment."

Figure 5: Key Areas of Investments

1. Tourism
2. Business Process Outsourcing
3. Electronics
4. Mining
5. Housing
6. Agribusiness / Forest-based Industries
7. Logistics
8. Shipbuilding
9. Infrastructure
10. Other High-potential Industries:
Homestyle products (furniture and furnishing, holiday décor, houseware and ceramics, woodcraft, giftware, shellcraft, basketwork)
Wearables (jewelry, fashion accessories)
Garments
Construction and related materials
Motor vehicle parts and components

Source: Philippine Development Plan 2011-2016, NEDA.

Generating employment is one of the focuses of the given industries. Necessary skills are broad ranged from low to high levels<sup>8</sup>. For instance, industries requiring low to mid-level skills are: construction, agribusiness, mining, tourism (including hotels and restaurants), and MSMEs (micro, small and medium enterprises). Meanwhile, industries considered to be requiring relatively high-skills are: business process outsourcing (BPO), fashion garments, jewelry, medical/health care services, automotive/parts and electronics. It is noted in the Development Plan that enhancing productivity and efficiency as well as maximization of the “total value chain” are the focus of the said high-skilled industries. However, some industries are seemingly prioritized only for the purpose of utilizing local educated and talented labor force.

One must admit that the Development Plan is simply a plan. Actual industry development strategy differs by the industry given its structure and international environment. Thus, detailed and doable measures for such strategy which complements the Plan must be carefully defined. In this regard, the current move to formulate Manufacturing Industry Roadmap and the Comprehensive National Industrial Strategy led by the private sector is a positive start.

### 3.2 Industry Roadmap

In the Development Plan discussed above, formulation of a Comprehensive National Industrial Strategy is proposed. It is the consolidation of sectoral roadmaps of which manufacturing sector will have its own Manufacturing Industry Roadmap. Major objective of the roadmap is “to revive the manufacturing industry and support the growth of the services sector”<sup>9</sup> by enhancing competitiveness of Philippine industries.

According to the Department of Trade and Industries (DTI)/Board of Investments (BOI), the government in 2012 called on the private sector to come up with their respective roadmap for the short, medium, and long term growth of their industries. Thus, the crafting of industry roadmap is led by the private sector. On the other hand, the role of government is considered as an enabler and facilitator, coordinating with interested industry associations and partner agencies.<sup>10</sup> As of November 2013, about 21 industry associations seemingly submitted roadmaps to the BOI.<sup>11</sup>

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<sup>8</sup> Skill classification cited here follows Medium-Term Philippine Development Plan 2004-2010.

<sup>9</sup> From the BOI website (<http://www.boi.gov.ph/index.php/en/tid-updates>).

<sup>10</sup> Same as note 9.

<sup>11</sup> As of November 2013, the following industry groups have submitted roadmaps to the BOI: 1) Automobile components, 2) biodiesel, 3) cement, 4) ceramic tiles, 5) chemicals, 6) copper and copper products, 7) electric vehicles, 8) furniture, 9) information technology and business process management (IT-BPM), 10) iron/steel, 11) mass housing, 12) metal forging, 13) two-wheel vehicles, 14) two-wheel vehicle components, 15) automobiles, 16) paper and paper products, 17) petrochemical 18) plastic, 19) rubber products, 20) tool and die, and 21) electronics. Moreover, the industries that are currently preparing or revising roadmaps are: shipbuilding, medical tourism, mineral processing, bamboo products, creative industries, and aerospace. (From the Board of Investments website <http://www.boi.gov.ph>)

As has been said, the move to formulate Industry Roadmap and Comprehensive National Industrial Strategy led by private sector is a positive start. However, implementing them is another matter. It seems that “multi-stakeholder technical working group”, which is composed of both government and private representatives, would be organized for each sector. The group will be responsible “in drawing up the sectoral plans of action and seeing to it that the goals and targets of the roadmaps are achieved within the identified timelines.”<sup>12</sup> One may say that convening working group meetings and identifying major policy reform issues in this manner are the first necessary step toward industry development though the move is already a big challenge for both the private and public sectors.

Nonetheless, further challenges remain. The first is effectiveness. Historically, Philippines was not much successful in implementation phase. Coordination between concerned government agencies to swiftly implement the reform is thus required. In this sense, it would be no exaggeration to say that the said move is valuable attempt for experiencing not only public-private partnership but public-public coordination as well.

The Second is consistency. The country formulates Investment Priorities Plan (IPP) every year. In order to promote investment, IPP identifies priority areas which are entitled to incentives. It is therefore commendable to have consistency between annual IPP, Industry Roadmaps and Comprehensive National Industrial Strategy.

The third is continuity. The term of Aquino administration terminates in June 2016. There is no guarantee at this moment that the new administration maintains Industry Roadmaps and upcoming Comprehensive National Industrial Strategy formulated by the previous administration.

### 3.3 Education Sector Reform and Infrastructure Development

Among the achievements of the Aquino administration, there are two issues which must be briefly mentioned. One is education sector reform, and the other is infrastructure development.

#### Basic Education Sector Reform

The Aquino Administration decided to reform the Philippine basic education sector by adding three more years to the ten-year system. The new system is called “K to 12” which adds one year of compulsory Kindergarten and two more years to the high school<sup>13</sup>. The aim is to

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<sup>12</sup> Same as note 9.

<sup>13</sup> The new system therefore covers at least one year of kindergarten, six years of elementary education and six years of secondary education, broken down into four years of junior high school and two years of senior high school.

enhance the quality of education and to make the educational level of Filipino students at par with their peers in other countries. The new system is being implemented since 2012

Additional two years in four-year high school such as Grade 11 and 12 will be introduced in 2016. Hence, the first graduates of six-year high school will come out in 2018. Although it is difficult to predict the effect of this new system at the current moment, enhancing secondary education will definitely be of great advantages for the development of human resources and expected to have a positive effect on the Philippine economy. Nevertheless, the focus for the time being is the refinement and updating of the old curriculum as well as allocating sufficient budget to support the increase in number of teachers and classrooms.

One should also note that there still are many children in the Philippines who do not properly finish elementary education. Chronic shortages in textbooks and classrooms are not fully resolved. Without seriously addressing these long-due issues, the education gap between the children may further widen and the effect of the new basic education system may become limited.

#### Infrastructure Development

For the Aquino Administration, infrastructure development is the major issue of concern. Philippine Development Plan 2011-2016 admits that “the country’s inadequate infrastructure has been identified as a critical constraint to economic growth.”<sup>14</sup> President Aquino, from the beginning of his term, showed a strong will towards addressing the problem. However, the progress has been very slow especially the Public-Private Partnership (PPP) projects. Behind this lies the fact that the infrastructure development plan has been formulated without extensive studies. Moreover, insufficient ability and experience to implement the projects by the concerned government offices is causing the delay.

In 2010, the administration launched the plan of nearly 80 projects for PPP.<sup>15</sup> As of November 2013, only 18 projects have completed their feasibility studies among which 4 are being awarded.

The Aquino Administration has entered its latter half, and given the huge delay in infrastructure development which is seriously criticized, the government has conducted a major review of the plan. According to the first draft in May 2013, 69 “strategic” projects totaling 551.5 billion pesos are listed anew. The list includes not only the ordinary public

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<sup>14</sup> Philippine Development Plan 2011-2016, p122.

<sup>15</sup> Total of 740 billion pesos. This corresponds to approximately 60% of the governments’ 2010 annual budget (Business World September 18, 2010). The planned projects were later narrowed down, and as of November 2013, 47 PPP projects are being listed including those which have been successfully awarded. (<http://ppp.gov.ph/>)

projects but those of PPP and international donor assisted projects. They are in line with the Philippine Development Plan 2011-2016 and are feasible to implement within the administration.

#### 4. Conclusion

As discussed, there are two medium to long-term issues for the Philippines. The first is to sustain high growth, and the second is to transform the economy inclusive. This is exactly what the Aquino Administration repeatedly upholding as an “inclusive growth.” It is also stated in the Philippine Development Plan 2011-2016. In order to address the issues, it is recommended that the Philippines formulate growth strategy along with development strategy. The growth strategy, in particular, seemingly overlaps the discussions for avoiding the “middle-income trap.” The main focus is to enhance productivity and competitiveness as well as to increase value added of domestic industries given the deepening of regional integration. To this end, development of infrastructure and human resources in addition to strengthening of institutions are regarded necessary. To sustain high growth, it is much expected that the economic structure turn into that of a virtuous cycle where an increase in consumption and exports accompany increase in investments. Increase in investments is expected to generate employment so that the growth would be inclusive.

There are several points to be noted. First, highly effective and feasible Development Plan must be formulated with a medium to long-term perspective. Second, the Plan must be truly implemented, and third, the implementation must be prompt and swift. These points are hopefully achieved once the strong will and commitment of the administration are given. Moreover, enhancement of public-private cooperation as well as public-public coordination is believed to be the requisite condition.

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