

ILO Asia-Pacific Working Paper Series

ASEAN Community 2015: Managing integration for better jobs and shared prosperity in the Philippines

Josef T. Yap
January 2015



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Regional Office for Asia and the Pacific

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Preface

By 2015, the ASEAN Economic Community (AEC), envisioned as a single common market and production base, will become a reality. This will lead to the freer flow of goods, services, investment capital and skilled labour in the region. Tariff and non-tariff barriers will be reduced, which will have implications for intraregional trade and investment. New opportunities for growth and prosperity are likely to emerge, but the challenge is to ensure that growth is inclusive and prosperity is shared.

Ultimately, the success of ASEAN regional integration will depend on how it affects the labour market and therefore how it improves the quality of life of women and men in the region. To prepare for the impact and find the opportunities to seize, the International Labour Organization initiated with the Asian Development Bank a joint study to examine the impact of the AEC on labour. Findings from the series of studies that were initiated are collected in the 2014 publication *ASEAN Community 2015: Managing integration for better jobs and shared prosperity*. That report highlights the challenges and opportunities that will accompany the AEC, including managing labour migration, boosting productivity and wages and improving job quality. The report offers policy recommendations for creating better jobs and ensuring that the benefits of the AEC are equitably shared among different countries and sectors.

The background papers to the joint publication are available as part of the ILO Asia–Pacific Working Paper Series, which is intended to enhance the body of knowledge, stimulate discussion and encourage knowledge sharing and further research for the promotion of decent work in Asia and the Pacific. This paper by Josef T. Yap offers a prognosis on the possible impact of the ASEAN Economic Community on the Philippine economy and its employment structure in terms of the potential growth for quality jobs.

The ILO is devoted to advancing opportunities for women and men to obtain decent and productive work. It aims to promote rights at work, encourage decent employment opportunities, enhance social protection and strengthen dialogue in handling work-related issues. As countries in the Asia and the Pacific region continue to recover from the global economic crisis, the ILO's Decent Work Agenda and the Global Jobs Pact provide critical policy frameworks to strengthen the foundations for a more inclusive and sustainable future.

Yoshiteru Uramoto
Assistant Director-General and
Regional Director for Asia and the Pacific

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Abstract

The economic record of the Philippines since the Second World War has been patchy, making it one of the laggards in South-East Asia. The major reason for the Philippines trailing many of its neighbours in South-East Asia is its inability to participate extensively in regional production networks. Its manufacturing sector, therefore, has declined and employment in manufacturing has also stagnated. The inability to provide medium-skill, high-productivity jobs has much to do with the country's relatively high poverty incidence. The establishment of the ASEAN Economic Community (AEC) in 2015 has the potential to attract more foreign direct investment to the Philippines. This will be an opportunity to revive the manufacturing sector, but only if there is bias towards small and medium-sized enterprise development, which will help overcome the sector's low employment elasticity. Additionally, the AEC will provide added leverage to policy-makers to counter the vested interests of the oligarchy. The AEC will create more regional public goods, especially in terms of physical infrastructure. This is required to increase connectivity in the region, which is necessary to generate more investment. The Philippines stands to benefit immensely, given the existing poor quality of its overall infrastructure. However, policy-makers must be aware of the potential drawbacks, in particular greater involvement in regional production networks or global value chains. These include limited value-added by domestic firms, possible transfer pricing because global value chains are mostly run by multinational companies, and a race to the bottom in terms of working conditions and environmental standards. Policy-makers must be prepared to intervene to minimize the adjustment costs that will result from deeper regional economic integration. Measures include social safety nets and assisting workers in obtaining more appropriate skills.

About the author

Josef T. Yap is a former President of the Philippine Institute for Development Studies.

The responsibility for opinions expressed in articles, studies and other contributions rests solely with the authors, and publication does not constitute an endorsement by the International Labour Office of the opinions expressed in them, or of any products, processes or geographical designations mentioned.

Acronyms

AEC	ASEAN Economic Community
AFTA	ASEAN Free Trade Area
ASEAN	Association of Southeast Asian Nations
CGE	computable general equilibrium
ERIA	Economic Research Institute for ASEAN and East Asia
FDI	foreign direct investment
GDP	gross domestic product
MVA	manufacturing value added
SME	small and medium-sized enterprises
TRP	Tariff Reform Program

1. Introduction

During the post-Second World War period, economic development in the Philippines became enigmatic. Despite favourable conditions (initially), relatively abundant natural resources, a largely democratic form of government and a decent stock of human capital, the economic record of the Philippines has paled in comparison with its neighbours in East Asia. For example, the country's gross domestic product (GDP) per capita in 2012 was lower than that of the Republic of Korea, Indonesia, Malaysia, Singapore and Thailand, among other countries (table 1). Some experts refer to this stagnation as the "Philippine development puzzle".

Table 1. GDP per capita, 1960–2012 (in constant 2005 US\$)

	1960	1980	1984	2011	2012
Hong Kong (China)	2 968	10 325	12 696	32 636	32 742
Indonesia	201	556	646	1 651	1 732
Korea, Rep. of	1 154	4 270	5 498	21 226	21 562
Malaysia	813	2 318	2 713	6 512	6 765
Philippines	692	1 109	1 005	1 430	1 501
Singapore	2 251	9 645	11 951	34 379	33 989
Thailand	321	882	1 018	3 158	3 353

Note: 1960 data are in constant 2000 prices and were accessed on 15 Aug. 2012

Source: World Bank's World Development Indicators, <http://data.worldbank.org/indicator> [accessed 7 Oct. 2013].

The spotty economic development record is reflected in the employment structure of the Philippines. The unemployment rate is higher than those same five countries (Republic of Korea, Indonesia, Malaysia, Singapore and Thailand) as well (table 2). The majority of employment is in low-paying, low-skill jobs that are concentrated in the services and agriculture sectors. Informality is also high; 75 per cent of workers do not have written contracts, social insurance or access to benefits when laid off from work (World Bank, 2013). Not surprisingly, the incidence of poverty is also relatively high (Table 3).

Table 2. Unemployment rate in selected East Asian countries, 1990–2012

	1990	1995	2000	2005	2012
China	2.5	2.9	3.1	4.2	4.1
Indonesia	2.4	7.2	6.1	11.2	6.1
Korea, Rep. of	2.4	2.0	4.4 ¹	3.7	3.3
Malaysia	5.1	3.1	3.0	3.5	3.1
Philippines	8.1	8.4	11.2	7.8 ²	7.0
Singapore	1.8	1.8	2.7	3.1	2.1
Thailand	3.8	1.7	3.6	1.9	0.7
Viet Nam	12.3	5.8	6.4	5.3	4.5

Notes: ¹Estimates based on the 2000 Population Census results. ²Definitions were revised, thus the data are not strictly comparable.

Source: World Bank, World Economic Outlook and ILO LABORSTA, <http://laborsta.ilo.org/> [accessed 6 Oct. 2013].

Table 3. Poverty and inequality in East Asia

	Population in poverty (%) ¹	Proportion of population living on less than \$1.25 (PPP) a day ²	Gini coefficient ³
China	4.2 (2008)	11.8 (2009)	0.425 (2005)
Indonesia	12.0 (2012)	16.2 (2011)	0.381 (2011)
Malaysia	1.7 (2012)	0.0 (2009)	0.462 (2009)
Philippines	26.5 (2009)	18.4 (2009)	0.430 (2009)
Thailand	13.2 (2011)	0.4 (2010)	0.394 (2010)
Viet Nam	20.7 (2010)	16.8 (2008)	0.356 (2008)

Sources: ¹World Bank, <http://data.worldbank.org/indicator> [accessed 6 Oct. 2013]; ²ADB, <https://sdbs.adb.org/sdbs/index.jsp> [accessed 6 Oct. 2013]; ³ ADB, www.adb.org/sites/default/files/pub/2013/ki2013.pdf [accessed 6 Oct. 2013].

The reasons for this development puzzle have been discussed in many studies (Balisacan and Hill, 2003; Yap and Majuca, 2013; World Bank, 2013). This paper can add little to the existing analysis. Instead, an overview of the key points of that puzzle is presented here. The value added is a prognosis on the possible impact of the ASEAN Economic Community (AEC) on the Philippine economy and its employment structure.

The AEC is part of the process for deepening regional economic integration in East Asia. Regional economic integration in general has potential benefits and costs (box 1), and the AEC is not an exception. This paper explores the policy interventions to mitigate the costs and maximize the benefits, especially to address the Philippine development puzzle. First, though, the paper considers the historical and institutional contexts that have bearing on the policy measures.

Box 1					
Regional integration – Process, benefits and drawbacks*					
Regional economic integration is both a process and a state of affairs. The former implies a dynamic sequence of events, the outcome of which cannot be captured fully by static models. Economic integration also can be viewed as a means of developing deep and stable relations of labour division among national economies. However, the more accepted definition is that economic integration is recognition, by a group of countries, that partnerships among themselves – whether weak or strong – will lead to a higher level of welfare than a unilateral pursuit of such a goal.					
Regional economic integration generally proceeds in a hierarchical fashion. The most basic form is a free trade area, of which the ASEAN Free Trade Area is an example. This is followed by a customs union, a common market, an economic union – of which the European Union is the only example – and full political union. The various levels differ on five criteria: (i) reduction or removal of tariffs and quotas; (ii) existence of common external tariffs; (iii) degree of factor mobility; (iv) harmonization of economic policies; and (v) total unification of economic policies. The different levels of regional economic integration, based on their characteristics, can be summarized in the following table.					
Policy action	Type of integration				
	Reduction or removal of tariffs and quotas	Common external tariffs	Factor mobility	Harmonization of economic policies	Total unification of economic policies
Preferential tariff agreement	Yes (reduction)	No	No	No	No
Free trade area	Yes (removal)	No	No	No	No
Partial customs union	No	Yes	No	No	No
Customs union	Yes	Yes	No	No	No
Common market	Yes	Yes	Yes	No	No
Economic union	Yes	Yes	Yes	Yes	No
Total economic union	Yes	Yes	Yes	Yes	Yes

Theoretically, there are many benefits that can be enjoyed by countries that increase their level of regional and global economic integration. The main benefit arises from economic efficiency gains resulting from trade liberalization. A member country will allocate resources to sectors in which it has a comparative advantage in relation to the other members, and trade is created. Consumers will have a wider selection of products that are suitable to their preferences, because firms of participating countries face greater competition in the markets, they are forced to sell their product at a lower price and with better quality.

Economic integration is also beneficial to producers (firms) of participating countries. One of the benefits provided by economic integration is broader access to markets of other member countries. This may stimulate firms to expand their production, specialize and take advantage of economies of scale. Competition with other firms will promote technological improvement and raise the quality of workers. Firms with the most modern technology will have first-mover advantages to dominate markets. To improve efficiency of its operations, firms need trained workers with a particular level of specialization, which can be more readily obtained in a larger labour market.

Other than the traditional economic benefit of greater economic efficiency, countries enter into regional trade agreements for many development-related reasons. Such arrangements offer the chance to create larger regional markets that are more attractive to foreign investors; to sequence liberalization by opening up in stages; to lock in unilateral reforms; and to pursue structural change jointly with other members. Regional trade arrangements also provide political benefits. Economic interdependence creates incentives for political cooperation and reduces the potential for violent confrontation. Together, the Member States have the economic clout to enhance trade with other countries or trading blocs.

Regional trade arrangements also carry potential drawbacks, one of which is that trade may be diverted away from more efficient non-members to less efficient members. If a preferential agreement diverts more trade than it creates, it will yield smaller efficiency gains than would multilateral liberalization. Trade also may be diverted if members of a free trade area impose rules of origin, because they may cause imports to be redirected through the member country that has the lowest external tariff. The literature on the benefits and costs of regional trade agreements do not offer conclusive guidance on whether trade creation will outweigh trade diversion or on what such agreements will contribute to welfare.

In the higher forms of integration – common market, economic union and total economic union – in which the factors of production (capital and labour) are allowed to move freely among the member countries, there is certainly impact. Free capital movement is generally easier to achieve because many countries tend to liberalize both their capital accounts and financial system towards freer international capital flows while retaining immigration policies to protect indigenous workers. The consequences of free labour mobility are ambiguous. On one hand, it may adversely affect human development because workers in a member country will face stiffer competition from other member countries' workers. This may result in a decline in wages. On the other hand, as an incentive to find a better job or keep their existing job, workers must improve their skills and raise the quality of their work. Human resource development then becomes a must for countries involved in economic integration to secure better welfare conditions for their own citizens. Removing barriers to factor mobility will benefit firms by increasing the effective labour pool.

*Text largely based on Jovanovic, 1998 and Pangestu and Gooptu, 2003.

1.1 The emergence of extractive institutions

Indonesia, the Philippines and Thailand have each undergone a phase of agricultural commercialization, mainly in the nineteenth century. The Philippine experience, however, has differed from the other two countries in one important aspect. Agricultural commercialization strengthened the bureaucratic-aristocratic elites in Indonesia and Thailand. But the same process gave rise to a new class of landowners in the Philippines, the economic base of which was firmly outside the State (De Dios and Hutchcroft, 2003). As Acemoglu and Robinson (2013) perceive it, the three countries had similar opportunities at a critical juncture in their history. However, institutional drift in the Philippines led the process of agricultural commercialization into a consolidation of power by extractive institutions.

This group of relatively autonomous landowners formed the primary social base of the first Philippine republic, which then evolved into the present-day oligarchs. Their power base was strengthened during the American occupation of the country as part of the usual “divide and conquer” policy of colonizers.

Consequently, what evolved in the Philippines was a semi-feudal economy dominated by elite factions. Instead of encouraging competitive behaviour, a culture of rent-seeking or extraction was engendered. This is the context in which the absence of a “culture of competition” can be explained. It was deemed that more money could be made by redistributing wealth through the political process than by actually creating wealth (De Dios and Hutchcroft, 2003).

Over the years, there has been greater overlap between political and business oligarchs. The political and economic elite have used the state institutions as instruments of wealth. Many reform programmes, including genuine land reform, were sacrificed at the altar of particularistic interests (De Dios and Hutchcroft 2003, p. 48).¹ In the context of the import-substitution period, controls were far less a tool of state industrial planning than an object of oligarchic plunder. During the martial law period, the Government took steps to limit the power and influence of oligarchs but ended up creating a new breed of elites, described as cronies of President Marcos. This is reminiscent of what Acemoglu and Robinson (2013) refer to as the “iron rule of oligarchy”, a historical pattern discerned by the German sociologist Robert Michels (1962). In a nutshell, the iron rule states that an oligarchy can be overthrown but only to be replaced by a new and more abusive oligarchy.

Apart from the emergence of the oligarchs, the quality of political and social institutions was also adversely affected by the colonial experience. Formal institutions were undermined by a parallel network of informal, personal and kin-based institutions (De Dios and Hutchcroft, 2003). As a result, formal institutions have not been given their proper regard, and, instead, what became dominant almost by default were primordial institutions, such as the clan or family, or religious and ethnic affiliations, with their agenda superimposed upon the formal political process (De Dios, 2008).

Weak institutions and an oligarchy are two sides of the same coin. A gridlock has evolved wherein stronger institutions are required to loosen the grip of the oligarchs. Yet, to strengthen institutions, the influence of oligarchs has to be reduced. Admittedly, previous reforms yielded favourable outcomes in terms of less monopolistic power, more diversified economic activities and a healthier policy debate. However, unless there are major political and social reforms, significant economic transformation will not be possible.

1.2 Framework for analysis

That brief historical background provides a framework for understanding the progress of economic reforms in the Philippines, or lack thereof. The role of the oligarchs in fomenting extractive institutions is underscored. A growth diagnostics framework was used in this paper’s analysis to determine the required reforms. Both frameworks were handy for evaluating the impact of the ASEAN Economic Community on the quality of institutions and the pace of economic reform within the Philippines.

¹ This is a description of the situation in the Philippines in the mid-1950s but is applicable to present day. A footnote in De Dios and Hutchcroft (2003) describes the system more aptly: “This influence endures in the midst of continuing change in the oligarchy’s composition, as new families appear out of nowhere and some of the old families fall by the wayside. Unlike an aristocracy, an oligarchy has little stability in its composition; there is a constant stream of new entrants as new wealth is created. As a system of government, oligarchy is rule ‘for the benefit of the men of means’, not rule for the ‘common interest’.”

For this paper's analysis, the growth diagnostics approach originally proposed in Hausman, Rodrik and Velasco (2005) was applied to the employment generation framework presented by Boyer (2006) to explore labour market outcomes. Generally, three groups of factors limit employment generation: lack of demand (Keynesian), excessive cost or lack of profitability (classical) and lack of productive capacity (Marxian). A modified version of the framework is presented in figure 1.

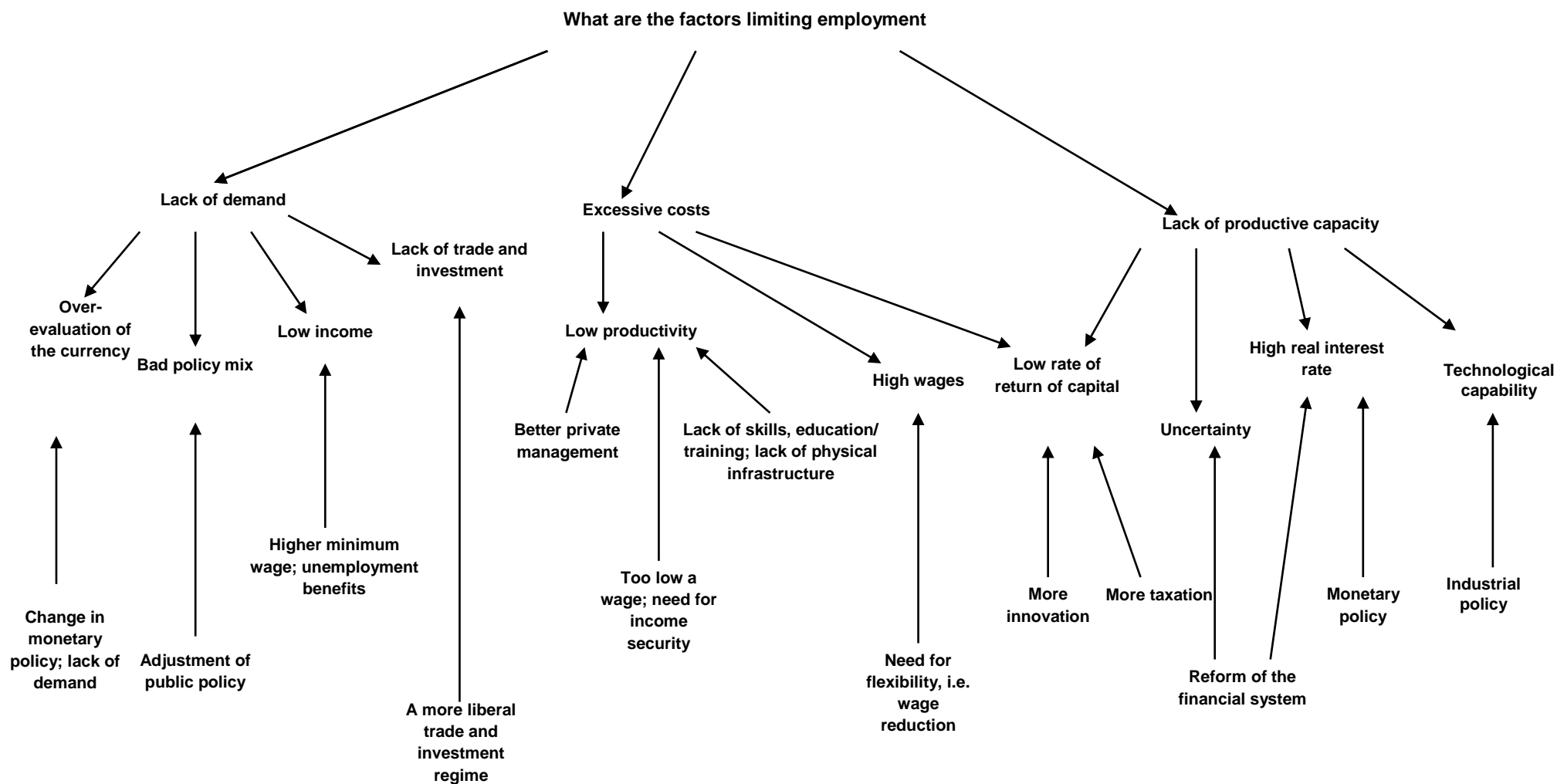
Section 2 of this paper describes the extent of economic reform in the Philippines. This includes a discussion of recent macroeconomic performance, the main features of the labour market and analysis of the binding constraints to employment growth.

Section 3 deals with the extent of the country's global and regional economic integration and the role of ASEAN, noting that regional production networks have been the anchor of regional economic integration in East Asia. The Philippines fell behind the other middle-income countries of South-East Asia largely because of its inability to latch on to these regional production networks as extensively as the other countries did. Section 3 also describes how the lack of economic transformation adversely affected the inclusivity of economic growth. Historically, the manufacturing sector has provided medium-skill, high-paying jobs, which benefited workers with little education. Hence, the stagnation of the manufacturing sector in the Philippines contributed directly to the country's relatively higher poverty incidence.

Section 4 tackles the possible impact of the ASEAN Economic Community. Regional economic integration provides both opportunities and challenges. The Philippines stands to benefit because foreign direct investment (FDI) will be attracted to a larger contiguous market. However, policy-makers must be aware of the possible drawbacks of FDI, particularly in the context of participation in global value chains and regional production networks.

Section 5 consolidates the discussion of sections 3 and 4 by presenting policy interventions that can accelerate the development of the manufacturing sector and make economic growth more inclusive. The section explores products that are labour-intensive and within the comparative advantage of Philippine firms.

Figure 1. A growth diagnostics approach to employment creation



Source: Boyer, 2006, with some modifications.

2. The Philippine economy

2.1 Attempts at economic reform

Like many other developing countries, the Philippines adopted the “openness model” of development. This reform package began modestly in the early 1970s and was interrupted by the debt crisis in 1983–85. The reform programme, however, accelerated in the late 1980s and has been the government mantra ever since. The general thrust of the reforms was closer global economic integration, underpinned by liberalization, deregulation and privatization. Similar to reform programmes in other developing countries, attention was given to macroeconomic stability and exchange rate movements; appropriate sequencing of liberalization of the trade, financial and capital-account regimes, supported by prudential regulation and financial sector reform; strengthening of domestic institutional capacity; and attracting FDI (UNCTAD, 2004).

In the area of trade liberalization, the following reforms were pursued from the 1980s till present day. The first Tariff Reform Program (TRP I), initiated in 1981, reduced tariffs, from a range of 70–100 per cent to a range of 0–50 per cent. This was followed by TRP II in 1991, which reduced tariffs further to the 3–30 per cent range and converted quantitative restrictions to tariffs. TRP III, launched in 1995, introduced further changes towards a 5 per cent uniform tariff.

The Philippines signed a series of multilateral free trade treaties, such as GATT–WTO 1995; bilateral/regional free trade agreements, such as AFTA–CEPT 1993,² China–ASEAN 2004, ASEAN–Korea 2006, ASEAN–Japan 2008, Philippine–Japan Economic Partnership Agreement 2007; and trade facilitation initiatives, such as the Revised Kyoto Convention 2009 and the National Single Window 2010. These agreements provided domestic firms access to markets abroad and leverage to policy-makers that allowed them to pursue economic reforms more aggressively.

In the area of investment, the Philippine Government has pursued several investment liberalization and facilitation initiatives since the late 1980s. In 1987, the Omnibus Investment Code simplified and consolidated past investment laws. In 1991, the Foreign Investment Act permitted foreign equity participation up to 100 per cent, except in areas on the negative list (Lists A, B, C). List C – restriction in areas where an adequate number of establishments already serves the economy’s needs – was abolished in 1996, so the remaining restrictions are those in List A (restrictions imposed by the Constitution and specific laws) and List B (restriction for reasons of defence, risk to health and morals, and protection of small and medium-sized enterprises (SMEs)). Several other liberalization laws were also passed, including the Foreign Bank Liberalization Act in 1994, the 2000 Retail Trade Liberalization Act, which allows 100 per cent foreign investment in a retail business, subject to minimum equity of \$7.5 million,³ and the 1995 Special Economic Zone Act. These measures were intended to attract more foreign direct investment.

2.2 Low investment rate and its causes

Despite these reforms, the investment rate in the Philippines remains one of the lowest in the region (table 4). FDI inflows into the Philippines pale in comparison with what its neighbours attract. Data on FDI stock between 1990 and 2012 show that the Philippines even lags behind Viet Nam, which lived

² GATT–WTO = General Agreement on Tariffs and Trade and World Trade Organization; AFTA–CEPT = ASEAN Free Trade Area and Common Effective Preferential Tariff.

³ All \$ currencies are US\$.

with a trade embargo for a long while and has a lower per capita income (table 5). Political and economic instability were the main reasons the country did not benefit greatly from Japanese investments that were made throughout the region following the sharp appreciation of the yen, which resulted from the Plaza Accord in 1985 and the Louvre Accord of 1987. The economy contracted sharply in 1984–85, owing to a balance of payments crisis. Meanwhile, the Marcos regime fell in 1986, which was followed by several attempted putsches, the major ones occurring in August 1987 and December 1989.

Table 4. Gross domestic investment, 1994–2010 (% of GDP)

Year	Indonesia	Korea, Rep. of	Malaysia	Philippines	Thailand
1994	31.1	37.0	41.2	24.1	40.3
1995	31.9	37.7	43.6	22.5	42.1
1996	30.7	38.9	41.5	24.0	41.8
1997	31.8	36.0	43.0	24.8	33.7
1998	16.8	25.0	26.7	20.3	20.4
1999	11.4	28.9	22.4	18.8	20.5
2000	22.2	30.6	26.9	21.2	22.8
2001	22.5	29.2	24.4	19.0	24.1
2002	21.4	29.2	24.8	17.7	23.8
2003	25.6	29.9	22.8	16.8	25.0
2004	24.1	29.9	23.0	16.8	26.8
2005	25.1	29.7	20.0	14.6	31.4
2006	25.4	29.6	20.5	14.5	28.3
2007	24.9	29.4	21.6	15.4	26.4
2008	27.8	31.2	19.3	15.3	28.9
2009	31.0	25.9	14.5	14.6	21.8
2010	30.7	29.4	20.0	15.0	25.5

Source: UN Economic and Social Survey of Asia and the Pacific, 2011.

Table 5. FDI inward stock in ASEAN and China, 1990–2012

	FDI inward stock (\$ million)			
	1990	2000	2010	2012
Indonesia	8 732	25 060	154 158	205 656
Malaysia	10 318	52 747	101 510	132 400
Philippines	4 528	18 156	26 319	31 027
Singapore	30 468	110 570	461 417	682 396
Thailand	8 242	29 915	137 191	159 125
Viet Nam	1 650	20 596	65 348	72 530
China	20 691	193 348	587 817	832 882

Source: UNCTAD, FDI/TNC database, www.unctad.org/fdistatistics [accessed 6 Oct. 2013].

Over time, the poor physical infrastructure discouraged both foreign and domestic investment. The Philippines ranks quite low – 113 of 142 countries – in terms of quality of overall infrastructure (table 6). Such a status is largely due to fiscal constraints that have prevented the Government from providing its share of infrastructure spending. The fiscal position has been, more often than not, in a fragile state since 1980, largely as a result of the international debt crisis that erupted in 1982 and led to a huge external debt overhang. Not only did the Government borrow heavily between 1976 and 1980, it eventually assumed responsibility over many debts extended to the private sector. This was facilitated by President Corazon Aquino’s Proclamation 50, which mandated the Government to honour all Philippine debt and thus legitimized the assumption of debt, including private loans. This policy dovetailed with Presidential Decree 1177, which appropriated debt servicing automatically into the national budget.

Table 6. The state of Philippine infrastructure

Weak revenue collection also has contributed to the country's fiscal bind. The Philippines has one of

Country	Quality of port infrastructure		Quality of air transport infrastructure		Quality of railroad infrastructure		Quality of roads		Quality of overall infrastructure	
	(How would you assess port facilities in your country? 1 = extremely underdeveloped; 7 = well developed and efficient by international standards)* 2008–09 weighted average		(How would you assess air transport in your country? 1 = extremely underdeveloped; 7 = well developed and efficient by international standards)* 2008–09 weighted average		(How would you assess the railroad system in your country? 1 = extremely underdeveloped; 7 = well developed and efficient by international standards)* 2008–09 weighted average		(How would you assess the roads in your country? 1 = extremely underdeveloped; 7 = well developed and efficient by international standards)* 2008–09 weighted average		(How would you assess general infrastructure (e.g. Transport, telephone & energy) in your country? 1 = extremely underdeveloped; 7 = well developed and efficient by international standards)* 2008–09 weighted average	
	Score	Rank (142 countries)	Score	Rank (142 countries)	Score	Rank (123 countries)	Score	Rank (142 countries)	Score	Rank (142 countries)
Australia	5.1	40	5.9	29	4.3	28	5.1	34	5.2	37
Brunei										
Darussalam	4.4	60	4.9	62	2.2	85	5.2	33	5.0	44
Cambodia	4.0	76	4.3	84	1.8	96	4.0	66	4.1	76
China	4.5	56	4.6	72	4.6	21	4.4	54	4.2	69
Hong Kong (China)	6.6	3	6.6	2	6.5	3	6.2	9	6.5	4
Indonesia	3.6	103	4.4	80	3.1	52	3.5	83	3.9	82
Japan	5.2	33	5.2	50	6.5	2	5.8	16	6.0	13
Korea, Rep. of	5.5	25	5.9	28	5.7	8	5.8	17	5.9	18
Malaysia	5.7	15	6.0	20	5.0	18	5.7	18	5.7	23
New Zealand	5.5	24	6.2	12	3.3	47	4.7	45	4.7	50
Philippines	3.0	123	3.6	115	1.7	101	3.1	100	3.4	113
Singapore	6.8	1	6.9	1	5.7	7	6.5	2	6.6	2
Taiwan (China)	5.2	35	5.2	51	5.4	12	5.6	25	5.6	25
Thailand	4.7	47	5.7	32	2.6	63	5.0	37	4.7	47
Viet Nam	3.4	111	4.1	95	2.5	71	2.6	123	3.1	123

Note: Values are on a 1–7 scale unless otherwise annotated with an asterisk (*).

Source: World Economic Forum, www3.weforum.org/docs/WEF_GCR_Report_2011-12.pdf [accessed 3 Sep. 2012].

the lowest tax efforts in South-East Asia (table 7). Meanwhile, government-owned and controlled corporations have exacerbated the country's fiscal position; many of them suffer from poor cost recovery due to inadequate tariff adjustments, political interference in tariff setting, government intervention in pricing policies, liabilities that they had contracted through the years, poor revenue generation performance and overstuffed structures with grossly overpaid staff.

Table 7. Tax effort in selected South-East Asian countries, 1990–2011

	1990	1995	2000	2005	2009	2010	2011
Indonesia	17.8	16.0	8.3	12.5	11.1	11.6	11.8
Malaysia	17.8	18.7	13.2	14.8	14.9	13.8	15.3
Philippines	14.1	16.3	12.8	12.4	12.2	12.1	12.3
Singapore	14.6	15.9	15.1	11.5	13.0	13.2	-
Thailand	16.0	16.4	12.9	15.3	13.8	14.5	16.0
Viet Nam	11.5	19.1	18.0	22.8	22.5	24.3	23.1

Source: ADB, 2012b.

Despite these problems, the Philippines consolidated its fiscal balance in the early 1990s, partly because of proceeds from the privatization of government assets and improvements in the tax effort. The result was a surplus of less than 1 per cent of GDP in 1994–97 but still a stark contrast from years of fiscal deficit in the 1980s up to the early 1990s. However, although the Philippines did not suffer as much as other South-East Asian countries in the financial crisis that began in 1997, the fiscal gains achieved in the 1990s were squandered. Deficits persistently grew, from 1.9 per cent of GDP in 1998 to 4 per cent in 2000, reaching a peak of 5.2 per cent in 2002 (table 8). The level subsequently fell from 2005 to 2008, mostly as a result of reforms aimed at increasing revenues.⁴ The improvement was short-lived; the promising tax effort declined, and expenditures had to be raised to offset the adverse impacts of the 2008 global financial and economic crises.

The struggle with the fiscal deficit has contributed to a domestic savings rate that is quite modest in comparison with other South-East Asian countries. This is not even a case of a lower-income country having to allocate a proportionately larger share of its GDP for consumption. A comparison with the savings rates of selected East and South-East Asian countries, when their levels of GDP per capita were similar to that of the Philippines, shows that the Philippine domestic savings rate has been historically one of the lowest (ADB, 2007). This is one major reason why other countries were able to achieve higher rates of investment.

There are other important factors as well. Bocchi (2008) cites institutional factors when he explains why investment in the Philippines did not respond to higher economic growth in 2005–07. One of those factors was the dominance of corporate conglomerates in strategic sectors, such as agriculture, maritime and air transport, power, cement and banking. These corporate conglomerates had no incentive to invest and expand their operations because their primary source of profitability was a captured market. In turn, the resulting higher costs in those sectors discouraged investment in other sectors that have strong backward and forward links with them, particularly manufacturing. Hence, the oligarchic structure of the economy is an important consideration when analysing the low investment rate.

⁴ In 2005, the Attrition Act (Republic Act No. 9335) was implemented. It provides for a system of rewards and sanctions to encourage revenue and customs officials and employees to exceed their revenue targets, creates a rewards and incentives fund, draws specific measures for employees who fail to meet the revenue targets and creates the Revenue Performance Evaluation Board. In 2006, reform of the value-added tax (VAT) was enacted. It substantially expanded the scope of the VAT and gave powers to the president to increase the VAT rate, based on specific criteria. The reformed VAT also institutes mitigating measures, such as a reduction in the excise tax on certain petroleum products, and increases corporate income tax from 32 per cent to 35 per cent, subsequently reduced to 30 per cent in 2009.

Table 8. Philippine government deficit, 1996–2011 (PHP million)

	Surplus/(deficit)	GDP	Surplus/(deficit) as % of GDP
1996	6 256	2 171 922	0.3
1997	1 564	2 421 306	0.1
1998	-49 983	2 665 060	-1.9
1999	-111 658	3 136 169	-3.6
2000	-134 212	3 354 727	-4.0
2001	-147 023	3 673 687	-4.0
2002	-210 741	4 022 694	-5.2
2003	-199 868	4 316 402	-4.6
2004	-187 057	4 871 555	-3.8
2005	-146 778	5 444 038	-2.7
2006	-64 791	6 032 624	-1.1
2007	-12 441	6 648 245	-0.2
2008	-66 117	7 423 213	-0.9
2009	-298 532	7 678 917	-3.9
2010	-314 458	9 003 480	-3.5
2011	-197 754	9 734 783	-2.0

Note: PHP = Philippine pesos.

Source: Bureau of Treasury of Philippines, monthly and yearly statistics; National Government Fiscal Position (CY2000–11); National Statistical Coordination Board of Philippines; National Accounts of the Philippines.

2.3 Limited economic transformation

The low investment rate contributed to the widening gap between the Philippines and its neighbours with a comparative level of development. This is evident not only from GDP per capita figures (table 1) but also in the lack of transformation of the economy. One of the most striking features of the Philippine economy is the stagnation in the share of manufacturing value added (MVA) to GDP over the past three decades (table 9). The MVA–GDP ratio even declined between 1980 and 2010 while it rose significantly in Indonesia, Malaysia and Thailand. Further analysis of the stagnant manufacturing sector emerges in Section 3 in the context of regional production networks.

Table 9. Share of manufacturing in GDP in selected Asian countries, 1980–2011 (%)

	1980	1990	2000	2006	2011
China	43.9	36.5	40.4	32.9	32.2
Indonesia	13.5	23.0	27.7	27.5	24.3
Malaysia	21.6	22.7	29.9	28.8	24.6
Philippines	27.7	26.8	24.5	23.6	21.1
Thailand	21.5	24.9	33.6	35.0	29.9
Viet Nam	16.1	12.3	18.6	21.2	19.4

Source: UN Statistics Division, <http://unstats.un.org/unsd/dnList.asp> [accessed 6 Oct. 2013].

The fall in the MVA–GDP ratio also occurred at the time the share of manufactured exports to total exports increased sharply. The data show that the share of manufactured exports increased from 61 per

cent in 1993 to 96 per cent in 2005, before stabilizing at 93 per cent in 2009 (table 10). The share of medium- and high-technology exports also increased dramatically between 1993 and 2005, from 39 per cent to 81 per cent. However, this trend was not reflected in the domestic manufacturing sector, where the share of production of medium- to high-technology products only increased from 30 to 38.9 per cent in the same period. This eventually rose to 45.3 per cent in 2009.⁵ The dichotomy between the export sector and the domestic manufacturing sector is a symptom of the narrow base of the industry sector. This dichotomy and lack of economic transformation becomes more inexplicable, given the economic reforms implemented during this period, and only serves to add to the development puzzle surrounding the Philippines.

Table 10. Indicators of industrial performance in selected Asian countries, 1993, 2005 and 2009

Economy	Share of manufactured exports in total merchandise exports (%)			Share of medium- and high-tech value added in total manufacturing (%)			Share of medium- and high-tech exports in manufactured exports (%)		
	1993	2005	2009	1993	2005	2009	1993	2005	2009
China	90.2	95.0	96.3	37.2	41.6	40.7	28.5	57.7	59.8
Hong Kong (China)	98.4	96.4	93.2	32.3	30.2	28.8	43.6	65.4	70.4
India	85.5	87.8	88.2	41.8	39.1	34.1	16.7	22.6	28.9
Indonesia	66.7	64.4	61.9	25.0	33.0	32.7	14.9	33.2	30.6
Japan	98.6	98.2	96.7	52.5	53.9	54.6	84.6	82.3	78.7
Korea, Rep. of	98.4	97.7	96.8	46.7	54.3	55.1	54.8	75.3	75.8
Malaysia	85.0	86.4	85.1	51.6	47.4	46.1	62.9	72.3	64.5
Philippines	61.3	95.6	93.0	30.7	38.9	45.3	39.4	81.5	79.6
Singapore	96.0	97.5	96.7	67.0	77.0	75.0	70.5	72.8	69.3
Thailand	91.3	88.3	83.7	21.4	42.0	46.2	38.1	61.9	59.6

Source: UNIDO, 2011.

Lack of economic transformation also resulted in an imbalance in terms of production and employment. For example, in 2012 the agriculture sector accounted for only 10 per cent of output but 32 per cent of employment. This indicates the inability of both the market and the Government to allocate resources to the more productive sectors of the economy; and it can be argued that this is a result of the lack of a coherent industrial policy (the structure of the labour market is discussed further on).

The more glaring imbalance is in terms of productivity, as measured by real value added per worker (table 11). This imbalance reflects the dualistic nature of the Philippine economy. Although there has been some convergence over time, it has been slow in coming. In 2011, industry still had 6.2 times the level of productivity in agriculture and 2.1 times the level of services. Relatively high unemployment

⁵ The performance of the Philippines in this aspect is actually better than that of some of the countries included in table 10. For example the share of medium- and high-technology value added in total manufacturing declined between 1993 and 2009 in Malaysia and India. The increase was lower in China, Indonesia and the Republic of Korea. It was only Thailand that experienced better performance, as explained in Section 3 in the context of participation in regional production networks and global value chains.

and underemployment and the imbalance in productivity have contributed to the disappointing poverty record of the Philippines.

Table 11. Real value added per worker,* 1995–2011 (in 2000 constant prices)

	Agriculture (PHP)	Ratio			
		Industry to agriculture	Industry to services	Manufacturing to agriculture	Manufacturing to services
1995	39 872	6.5	1.8	n.a.	n.a.
2000	49 122	5.6	1.9	6.5	2.2
2005	51 318	5.7	1.9	6.7	2.2
2009	55 110	5.9	2.0	7.1	2.4
2011	55 420	6.2	2.1	7.8	2.5

Notes: *Defined as value added divided by total employment in the sector. Each entry is a three-year average of the year indicated, the previous year and the succeeding year, using 2000 prices. PHP = Philippine pesos; n.a.=not available.
Source: Bureau of Labor and Employment Statistics.

2.4 Recent macroeconomic performance

The economy posted high growth rates by historical standards from 2012 to the first three quarters of 2013 (table 12). This has raised hopes that a government agenda anchored on transparency and good governance will push the economy into a virtuous cycle of development. Apart from the overall GDP growth rate of 7.4 per cent in the first three quarters of 2013, a very encouraging sign is the 9.8 per cent increase in value added in the manufacturing sector. However, fixed investment as a ratio of GDP was less than 20 per cent during this period.

In the first nine months of 2013, inflation averaged a mere 2.8 per cent, which was lower than the average in 2012. This allowed the Bangko Sentral ng Pilipinas to maintain interest rates at a relatively low level. As a result, expenditure – particularly private consumption – grew at a fast clip over the past two and a half years. Low inflation was partially driven by the appreciation of the peso in relation to the US dollar.

The recent peso appreciation and accumulation of foreign exchange reserves now concern policy-makers. These phenomena are primarily an offshoot of the quantitative easing implemented by the US Federal Reserve Bank in response to the 2008 financial crisis. Remittances from overseas, which averaged 9 per cent of GDP in the past three years, have contributed to the appreciation of the peso, but over an extended period. A strong peso has affected the competitiveness of exports and has reduced the value of foreign remittances. It also has made imports cheaper, thereby hurting competing local products. The surge in foreign exchange reserves partly reflects the low investment rate.

The peso began to depreciate along with other currencies in East Asia when the monetary policy component of “Abenomics”⁶ was announced in April 2013. This involved quantitative easing on the part of the Bank of Japan, which led to a strengthening of the US dollar. Hints of “tapering” of US monetary policy in the last week of May also contributed to the depreciation of currencies. There was some reversal when the US Federal Reserve Bank announced that tapering was not imminent.

⁶ “Abenomics” refers to the economic policies advocated by Shinzō Abe since his December 2012 re-election as Prime Minister of Japan.

Despite the robust GDP growth, the unemployment and underemployment rates in the Philippines remain stubbornly high. The jobless growth and persistence of low productivity employment indicate that inclusive economic growth remains elusive. This has been a characteristic of the labour market for the past decade or so, as the next section details.

Table 12. Selected macroeconomic indicators, Philippines, annual growth rates and share to GDP, at constant 2000 prices, in per cent unless otherwise stated

	2007	2008	2009	2010	2011	2012	1 st -3rd quarter 2013
Gross national income	6.2	5.0	6.1	8.2	3.2	6.5	7.3
Gross domestic product	6.6	4.2	1.1	7.6	3.9	6.8	7.4
<i>Agriculture, fishery & forestry (share to GDP)</i>	4.7 12.9	3.2 12.8	-0.7 12.5	-0.2 11.6	2.7 11.5	2.8 11.1	1.1 10.1
Agriculture & forestry <i>(share to GDP)</i>	5.0 12.8	3.2 12.7	-0.7 12.5	0.0 11.6	4.5 9.3	3.6 9.0	0.6 8.2
Fishing <i>(share to GDP)</i>	-24.5 0.1	2.1 0.1	-2.0 0.1	-31.3 0.0	-4.1 2.2	-0.4 2.1	3.3 1.9
<i>Industry sector (share to GDP)</i>	5.8 32.2	4.8 32.4	-1.9 31.5	11.6 32.6	2.3 32.1	6.8 32.0	9.8 32.5
Mining & quarrying <i>(share to GDP)</i>	18.6 1.0	-1.4 1.0	16.1 1.1	11.4 1.2	7.0 1.2	2.2 1.1	-2.0 1.2
Manufacturing <i>(share to GDP)</i>	3.6 22.8	4.3 22.8	-4.8 21.5	11.2 22.2	4.7 22.4	5.4 22.1	9.8 22.3
Construction <i>(share to GDP)</i>	14.6 5.0	7.0 5.1	6.8 5.4	14.3 5.7	-7.3 5.1	15.7 5.4	16.3 5.6
Electricity, gas & water <i>(share to GDP)</i>	5.5 3.5	6.8 3.6	-0.8 3.5	9.9 3.6	0.6 3.5	5.1 3.4	4.4 3.5
<i>Service sector (share to GDP)</i>	7.6 54.9	4.0 54.8	3.4 56.0	7.2 55.8	5.1 56.4	7.6 56.9	7.3 57.4
Transportation, storage & communication <i>(share to GDP)</i>	8.4 8.1	3.9 8.1	-0.1 8.0	1.0 7.5	4.3 7.5	8.1 7.6	5.3 7.6
Trade and repair of motor vehicles, motorcycles, personal <i>(share to GDP)</i>	8.6 16.9	1.4 16.5	1.4 16.5	8.4 16.6	3.3 16.6	7.5 16.7	6.0 16.2
Financial intermediation <i>(share to GDP)</i>	10.2 6.3	1.8 6.2	5.5 6.4	10.1 6.6	5.2 6.7	8.2 6.8	13.3 7.3
Real estate, renting & business activities <i>(share to GDP)</i>	7.9 9.6	9.0 10.0	4.1 10.3	7.5 10.3	9.3 10.9	7.5 10.9	9.3 11.3
Public administration & defence: Compulsory social security <i>(share to GDP)</i>	1.4 4.4	2.0 4.3	6.1 4.5	5.8 4.5	0.3 4.3	6.1 4.4	5.1 4.5
Other services <i>(share to GDP)</i>	6.1 9.5	6.0 9.7	6.5 10.2	8.4 10.2	6.6 10.5	7.7 10.5	5.7 10.5
<i>Household final consumption expenditure (share to GDP)</i>	4.6 71.6	3.7 71.2	2.3 72.1	3.3 69.2	6.3 70.8	6.6 70.4	5.6 67.8
<i>Government consumption (share to GDP)</i>	6.9 9.8	0.3 9.4	10.9 10.4	3.4 10.0	1.0 9.7	12.2 10.3	12.3 11.6
<i>Capital formation (share to GDP)</i>	-0.5 15.9	23.4 18.8	-8.7 17.0	31.6 20.8	8.1 21.6	-3.2 18.5	24.4 19.6
Exports (nominal \$)	6.0	-2.9	-21.9	33.7	-6.9	7.6	0.09
Imports (nominal \$)	7.2	2.0	-24.1	26.9	9.5	1.9	0.03
Inflation (2006=100) (average)	2.9	8.3	4.1	3.9	4.6	3.2	2.8
91-day treasury bill rate (average)	3.41	5.39	4.19	3.73	1.37	1.58	--
Nominal exchange rate (PHP/\$ average)	46.15	44.47	47.64	45.11	43.31	42.23	42.06

Sources: National Accounts of the Philippines, National Statistical Coordination Board; Bangko Sentral ng Pilipinas; NSO.

2.5 Employment structure

Low investment and lack of economic transformation have important implications for employment. As noted earlier, the Philippines has one of the highest unemployment rates in East Asia (table 2). The situation was not mitigated by the relatively high growth rates in 2012 or the first half of 2013.

Because of the lack of economic transformation, the service sector absorbed surplus workers from agriculture while the share of manufacturing employment has been stagnant (table 13). The weak manufacturing sector has affected the type of service jobs available, meaning those mostly in low-productivity sectors. The lack of employment opportunities in the country and widespread underemployment are the reasons for the increasing number of Filipinos working abroad. Felipe and Lanzona (2006) pointed out that the goal in the 2004–10 Medium-Term Philippine Development Plan of generating 1.5 million jobs a year, or a total of 10 million jobs, would not be enough to solve the unemployment problem at that time. Rather, the World Bank (2013) estimated that 14.6 million “good” jobs need to be created between 2013 and 2016; the World Bank defines good jobs as those that raise real wages and bring people out of poverty.

Table 13. Philippine employment structure, by industry, 1990–2012 ('000s)

	1990	1995	2000	2005	2012
All industries	22 532	25 698	27 453	32 313	37 600
Agriculture	10 158 (45.1)	11 323 (44.1)	10 181 (37.1)	11 628 (36.0)	12 093 (32.2)
Industry	3 386 (15.0)	4 088 (15.9)	4 454 (16.2)	5 024 (15.5)	5 743 (15.3)
Manufacturing	2 188 (9.7)	2 571 (10.0)	2 745 (10.0)	3 077 (9.5)	3 112 (8.3)
Services	8 946 (39.7)	10 365 (40.3)	12 811 (46.7)	15 660 (48.5)	19 764 (52.6)
Industry not elsewhere classified	15	21	6	–	–

Notes: 1. Details may not add up to totals due to rounding off, in which case, averages were computed, based on rounded figures. 2. Data are averages of the four survey rounds (January, April, July, October). 3. Figures in parentheses are the share to total employment.
Source: NSO.

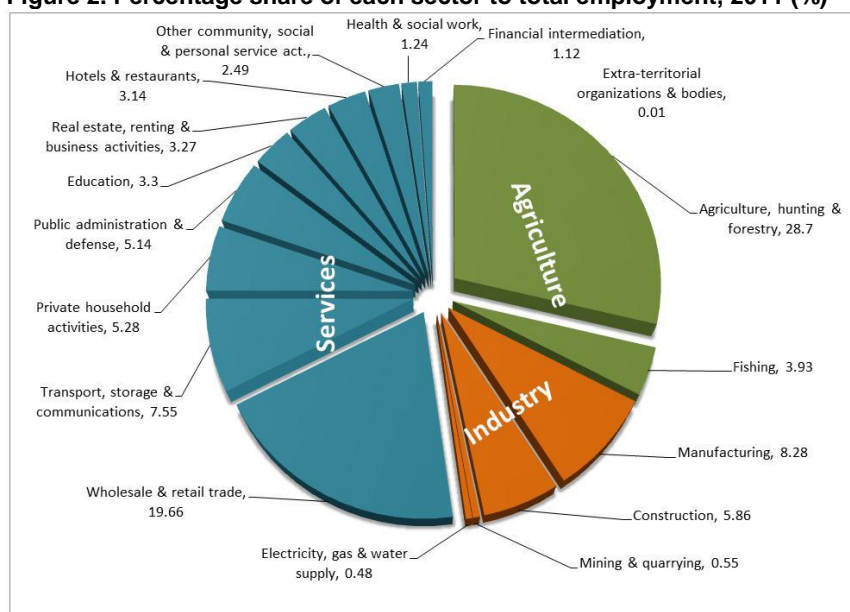
The following points describe the Philippine labour market. The description is largely based on the 2013 *Philippine Development Report* of the World Bank, which highlights employment, an International Labour Organization report (2012) on work conditions in the Philippines and a study by Reyes et al. (2013).

- Approximately 64 per cent of employment is in the agriculture and fisheries sector and the informal service sector, which is defined as the wholesale and retail trade, private household activities, transportation, communication and storage (figure 2). Most of the jobs in these sectors are low wage and low skill in nature.
- Not surprisingly, the workers classified as poor are mostly found in these sectors (Figure 3). This is the crux of the problem: the inability of the economy to generate high-productivity, high-paying jobs that require medium and high skills that would count as “good” jobs.
- The unemployment rate is highest in the upper quintiles (figure 4). This is complemented by relatively high unemployment rates among those with a higher level of education (figure 5). This suggests a possible mismatch between the job requirements and existing skills or a higher reservation wage, largely because of opportunities to work abroad (World Bank, 2013).
- Unemployment is highest among the group aged 15–35 years (table 14). Youth, or the 15–24 age group, account for about 50 per cent of total unemployment. This is not an unusual outcome because “previous experience” is a requirement for many jobs. In addition, the growth in labour force participation in the Philippines is faster than employment growth, and the gap has remained

large (World Bank, 2013). New entrants to the labour force would therefore have a disproportionate share in the ranks of the unemployed.

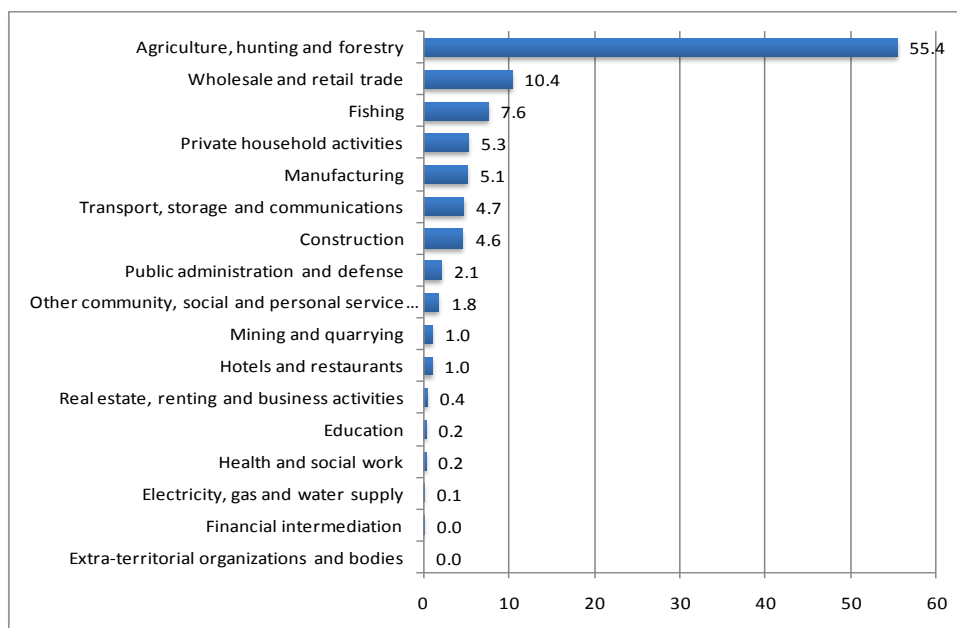
- What is more alarming is the rate of underemployment, which has remained high, at approximately 20 per cent (table 15). This reflects the lack of good jobs. In contrast to the unemployment rate, underemployment is highest in the poorest quintile (figure 6) and is higher among those with a lower level of educational attainment (figure 7). This is the reason why these jobs are characterized by low wages.
- Related to the high underemployment rate is the relatively large share of vulnerable employment, which consists of self-employed and unpaid family workers (table 16). However, the share of this group has declined, from 50.3 per cent in 1995 to 41.7 per cent in 2010.
- Table 16 also shows that the working poverty rate – the share of those employed who are living below the poverty line – has been stable and is not much different from the official poverty rate in the Philippines. This is related to the inability of the economy to generate high-productivity, high-paying jobs. As a result, the average real daily basic pay declined between 2001 and 2008 (Table 16), with a modest increase in 2009 and 2010. The manufacturing wage index followed a similar pattern.
- The Philippines is one of many developing countries that have experienced declining employment elasticity (Kapsos, 2006; World Bank, 2013 for more recent estimates). This can partly explain why unemployment remains high in the Philippines despite high GDP growth rates. The World Bank estimates show the manufacturing sector to have the lowest employment elasticity (see the next section for possible reasons).

Figure 2. Percentage share of each sector to total employment, 2011 (%)



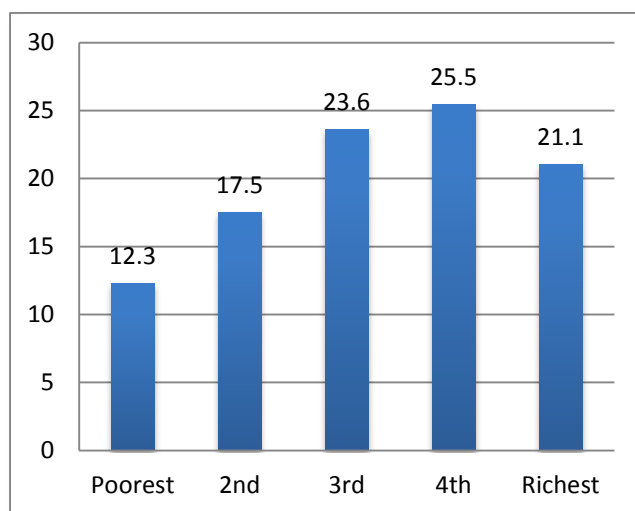
Source: NSO, July 2011.

Figure 3. Distribution of poor workers, by sectors, 2010



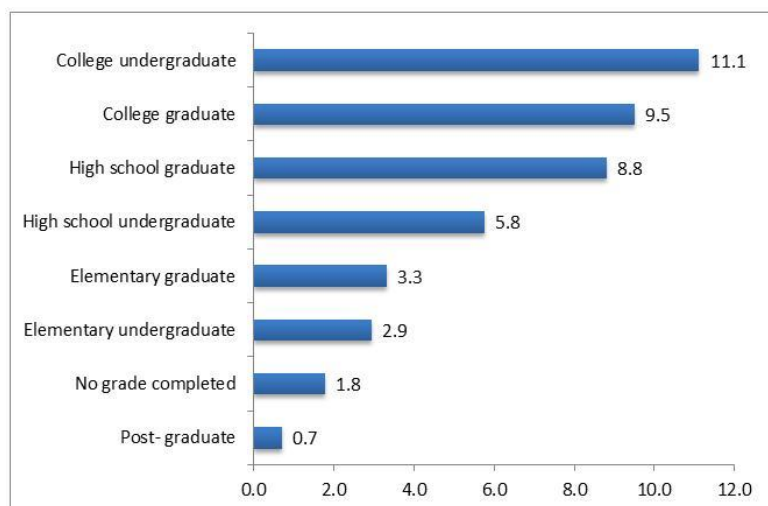
Source: Merged files of FIES, 2009 and NSO, January 2010.

Figure 4. Unemployment rate (aged 25 and older), by income quintile, 2010 (%)



Source: Merged files of FIES, 2009 and NSO, January 2010.

Figure 5. Unemployment rate, by highest educational attainment, 2011 (%)



Source: NSO, July 2011.

Table 14. Philippine unemployment structure, by age group, 1990–2012 ('000s)

Age group	1990	1995	2000	2005 ¹	2012
All age groups	1 992	2 342	3 459	2 859	2 826
15–24 years	947	1 086	1 766	1 459	1 412
25–34 years	495	578	776	847	820
35–44 years	213	268	398	266	286
45–54 years	152	179	263	181	190
55–64 years	104	134	161	87	96
65 years and older	82	99	95	19	21
Age not reported	–	–	–	–	*

Notes: 1. Details may not add up to totals due to rounding off, in which case, averages were computed, based on rounded figures.

2. Data are averages of the four survey rounds (January, April, July, and October). 3. Definitions were revised and the data are not strictly comparable.*Fewer than 500.

Sources: NSO; ILO LABORSTAT, <http://laborsta.ilo.org/> [accessed 24 Oct. 2013].

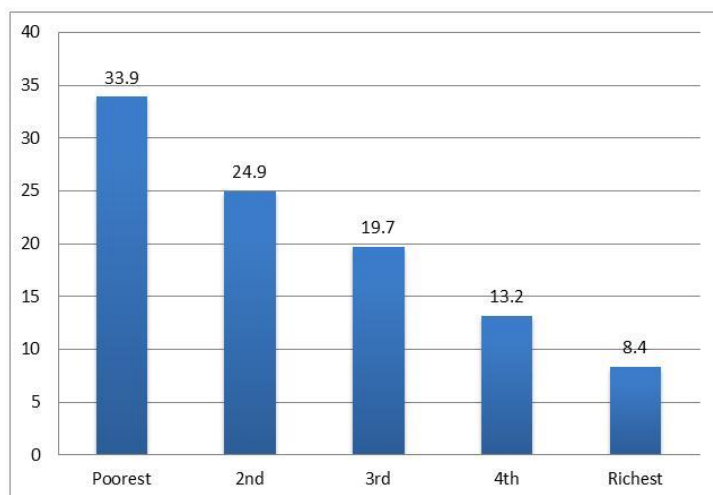
Table 15. Underemployment structure, by major industry sector, 1996–2012 ('000s)

Sector	1996	2000	2005	2012
All industries	5 719 (25.4)	5 955 (23.2)	6 785 (21.0)	7 514 (20.0)
Agriculture	2 971 (29.2)	2 666 (23.5)		
Industry	941 (27.8)	990 (24.2)	3 107 (26.7)	3 239 (26.8)
Manufacturing	534 (24.4)	549 (21.4)	585 (19.0)	–
Services	1 806 (20.2)	2 299 (22.2)	2 581 (16.5)	3 081 (15.6)

Notes: 1. Details may not add up to totals due to rounding off, in which case, averages were computed based on rounded figures. 2. Data are averages of the four survey rounds (January, April, July and October). 3. Population projection benchmark for 1998–2005 was based on the results of the 1995 Census of Population. Onwards, the benchmark was based on the results of the 2000 Census of Population. 4. Data in parentheses is ratio to total employment.

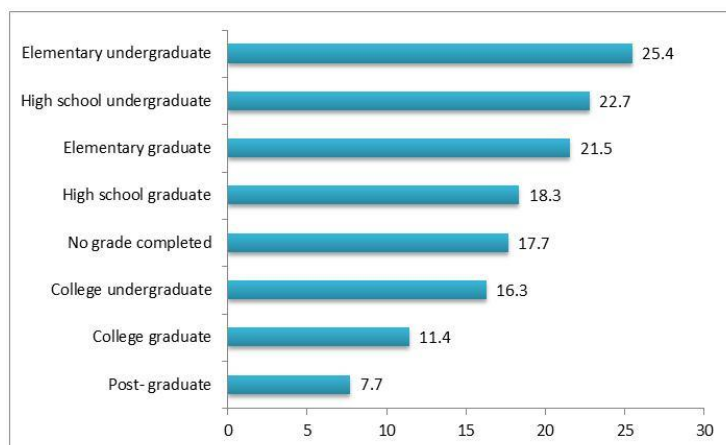
Source: NSO.

Figure 6. Underemployment rate (aged 25 and older), by income quintile, 2010 (%)



Source: Merged files of FIES, 2009 and NSO, January 2010.

Figure 7. Underemployment rate by highest educational attainment, 2011 (%)



Source: NSO, July 2011.

Table 16. Decent work indicators for the Philippines, 1995–2010

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Proportion of self-employed & unpaid family workers in total employment (%) ¹	50.3	49.8	46.9	46.5	45.6	44.5	45.2	45.7	44.6	42.8	44.8	44.5	43.6	43.5	42.6	41.7
Working poverty rate (nationally defined poverty line) ² (%)			27.7			28.1			25.1			28.2				
Average real daily basic pay ³ , at 2000 PHP							208.14	205.81	202.21	194.10	189.04	189.92	188.05	179.95	181.71	184.55
Manufacturing wage index (2000=100)							93.6	92.0	92.3	87.7	84.0	85.0	86.5	82.6	82.9	82.7
Wage share in GDP ⁴ (%)	25.3	26.0	27.2	28.3	27.1	26.2	25.2	24.5	24.5	27.6	27.7	27.8	27.8	27.8	28.6	

Notes: ¹The MDG indicator on employment "proportion of own-account workers and contributing family workers in total employment" was changed to "proportion of self-employed and unpaid family workers" in order to use national terminology. The computation conforms to the international standards. ²MDG indicator on employment. Statistics on working poor were based on poverty threshold estimates using the old 2003 methodology for estimating poverty before the 2011 refined methodology. ³Labor Force Survey began collecting data on basic pay in January 2001 survey round. The inquiry is on basic pay per day in cash or in kind (imputed value) of employees from their primary jobs and not their total earnings. Not all employees were able to report their basic pay from their primary jobs as they were paid on commission basis and as such posed difficulty in determining their pay on a per day basis. This group of workers accounted for about 7 per cent of total employment and 12 per cent of wage and salary employment in 2010. The proportions were 2 per cent and 5 per cent, respectively in 2001. ⁴Defined as total compensation of employees as a percentage share of GDP. Estimates of GDP and compensation of employees based on Philippines SNA prior to 2011 revision/rebasing.

Source: ILO, 2012, Tables 2 and 3.

2.6 Explaining the Philippine employment structure

To summarize, the Philippines has one of the highest unemployment rates in South-East Asia. Although underemployment appears to be declining, it is still very high, at approximately one fifth of the employed workforce. The number of new entrants has outpaced net job creation, resulting in increasing unemployment rates. This trend has continued in recent years, despite consistent and sometimes high economic growth. Unemployment among young workers (aged 15–35 years) underpins the overall unemployment rate.

The service sector has absorbed surplus workers from agriculture, while the share of industry has been stagnant and actually declined in recent years. Because of the stagnant manufacturing sector, the more sophisticated elements of the service sector do not have the dominance they should have. Hence, the majority of jobs in the service sector are low skill and low wage. Consequently, wages have been declining in real terms. The lack of employment opportunities in the country and the low level of compensation, as previously note, push more and more Filipinos to work abroad.

What are the important constraints to employment and wage growth? Boyer's framework (2006) is useful for dissecting this problem.

Is it lack of demand?

There are several factors that contribute to the lack of domestic demand to perk up employment. One is the slow decline in the high poverty incidence and deteriorating income inequality. Another is the lack of success in merchandise trade. Labor-intensive garment exports have been replaced by more capital-intensive electronics exports, which have little value added in the domestic economy. Moreover, resource-based primary exports continue to decline. Finally, the sector composition of employment generation has not yielded higher average labour income. The service sector is absorbing the surplus

from the agriculture sector while the industry's employment share is not increasing. Although the service sector includes modern sectors, such as IT firms and banking, it also covers retail trade and personal services, which generally are low-wage activities.

Is it excessive costs or lack of profitability?

Felipe and Sipin (2005) provide estimates of the labour share of output, unit labour costs and real wage for the Philippines from 1980 to 2002. During this period, the labour share of output lost 10 percentage points, from 75 per cent to 65 per cent. There is a variance in the value of labour share, based on data from ILO (2012), as shown in table 16 and the figures of Felipe and Sipin. This variance is because the latter study includes the category "mixed income". Overall, however, both sets of data indicate that the situation of the labour sector has not improved much in the past 30 years.

Moreover, Felipe and Sipin show that the real wage rate fell sharply between 1980 and 1994 but increased by an average of 1.49 per cent per annum from 1994 to 2002. Despite the recovery, the real average wage in 2002 is only about three-quarters of what it was in 1980. Data in table 16 illustrate a declining trend for real wages in more recent years.

The profit rate, on the other hand, was stable, and the mark-up rate rose during that same period. The latter increased by more than 50 per cent, from 0.35 per cent in 1980 to 0.58 per cent in 1996. This has been attributed to the increasing concentration of ownership (Felipe and Lanzona, 2006). However, because of the rise in concentration, the substantial opening of the country to foreign trade since the 1980s has done little to improve competition. The analysis presented here implies that the high cost of doing business in the Philippines is not because of high labour costs but is attributable to other factors, such as the high cost of power, poor infrastructure and lack of competition in certain sectors.

Both labour and capital productivity declined in the same period (Felipe and Sipin, 2005). This phenomenon cannot be attributed to lack of education and skills because the Philippines has one of the highest enrolment rates at all levels, approximating levels in industrialized countries. The record on the quality of education outcomes, though, is mixed.

Is it lack of productive capacity?

As noted, the investment rate in the Philippines is one of the lowest in South-East Asia and not due to lack of profitability, considering the profit rate has been stable. Analysts have pointed to the poor quality of physical infrastructure in the country and the unstable policy environment. To increase employment, many experts have recommended an increase in investment by a sufficiently large amount to push the Philippines out of the low-equilibrium trap.

The discussion of the unemployment and underemployment story is not complete without looking at the labour supply. Other countries in the region have successfully reduced their population growth, but it is still a relatively high 1.96 per cent for the Philippines (as of the 2010 census). There is no indication that there will be a substantial decline in the near future, given the lukewarm implementation of the population programme. This is clearly indicated by the strenuous opposition to the Reproductive Health Law. Apart from the continuing high growth of the working-age population, the labour force participation rate of women is also rising.

Meanwhile, issues of lower employment elasticity and rising income inequality are highly intertwined. A 2012 Asian Development Bank (ADB) report succinctly presents the major economic reasons underlying the rising inequality in Asia, which the following summarizes.⁷

“Technological progress, globalization, and market-oriented reform have been the key drivers of developing Asia’s rapid growth in the last two decades – but they also had huge distributional consequences. Together, they have favoured skilled rather than unskilled labour, capital rather than labour, and urban and coastal areas rather than rural and inland regions. These changes can explain many of the movements in inequality in many regional countries.

“Technological change can impact on the distribution of income among different factors of production. If it favours skilled labour (more educated or more experienced) over unskilled labour by increasing its relative productivity, we could expect the skill premium – the ratio of skilled to unskilled wages – to go up, which would most likely increase income inequality. Technological change could also affect the distribution of income between labour and capital. If it is biased in favour of capital, it could increase inequality since capital incomes, in general, are less equally distributed and accrue to the rich more than to the poor.

“In a similar fashion, globalization can affect income distribution. Trade integration, for example, could change relative demand for and hence relative wages of skilled and unskilled workers. It could also affect income distribution between capital and labour because capital and skills often work together due to their complementarity. Financial integration could broaden access to finance by the poor – but could also increase the risk of financial crises and hurt the poor more than the rich. Globalization can magnify the distributional impact of technological progress.

“A large literature has emerged in recent years attempting to understand the impacts of trade integration, financial integration, and technological change on income distribution, though it has yet to provide a clear-cut answer. One complication is that there are several, closely linked, confounding factors.

“Market-oriented reform is an important driver of growth, but can also have significant distributional consequences. Trade policy reform is often part of the driving forces of globalization. Labor market reforms can change the bargaining position of labour vis-à-vis capital owners, impacting on wage rates and income distribution between labour and capital. Economic transition from a command to a market economy can improve efficiency and make returns to assets more closely reflective of resource scarcity, which can affect income distribution among different productive assets in a significant way.

“Technological change, globalization, and market-oriented reform – the main drivers of Asia’s rapid economic growth – are the basic driving forces behind the rising inequality in Asia. Working together, these have significantly impacted on inequality through a number of channels, in particular:

“**Increasing skill premiums and returns to human capital.** The emergence of vast new economic opportunities, unleashed by trade and financial integration, technological progress, and market-oriented reform, has increased returns to human capital and the skill premium, with individuals having higher educational attainment and skill endowment able to benefit more from the new opportunities. Our analysis shows that, in many countries, as high as 25–35

⁷ The discussion is taken from ADB (2012), pp. 62 and 74.

percent of the total income inequality can be explained by personal differences in human capital and skill endowments.

“Falling labour income shares. As in many countries in other parts of the world, technological progress appears to have favoured capital over labour. The abundance of labour relative to capital, which depresses wage rates, is also a contributing factor to the declining labour income share in developing Asia. Since capital is less equally distributed, this has contributed to rising inequality.

“Increasing spatial inequality. Some regions, especially urban and coastal areas, are better able to respond to the new opportunities because of their advantages in infrastructure and market access, as well as agglomeration economies from a self-perpetuating process of increasing concentration. The process of urbanization reinforces the inequality effects of agglomeration. Our analysis shows that in many Asian countries, about 30–50 per cent of income inequality is accounted for by spatial inequality due to uneven growth.”

The factors that affect income inequality through employment – technological progress, globalization and market-oriented reform – cut across the three constraints to employment generation. Because many of these factors are “irreversible”, the challenge for policy-makers is determining how to harness the positive effects of these forces and channel them to higher employment. This is important because the AEC will become an integral component of globalization and market-oriented reform.

Greater regional economic integration in East Asia actually provided an opportunity for the Philippines to expand its manufacturing sector and generate more good jobs. Unfortunately, as explained in the next section, the Philippines missed the boat. The AEC affords another opportunity for the Philippines to move up the value chain and, at the same time, deepen links with the manufacturing sector.

3. Regional economic integration in ASEAN and inclusive growth

Global and regional economic integration have benefited the ASEAN Member States. ASEAN, of course, has been an integral part of the economic dynamism of East Asia in the past 40 years. This phenomenon has been well documented (see World Bank, 1993, for example).

The impact on ASEAN countries is reflected primarily in the surge in exports of goods and services (table 17). That surge was accompanied by an increase in intraregional trade, from 17 per cent in 1990 to 24 per cent in 2012. As a result, economic growth has been impressive and growth rates in some Member States –Singapore, Malaysia, Thailand and Viet Nam – have been among the fastest in the world (Plummer and Chia, 2009). The main driving force has been ASEAN’s outward-orientation, which allowed it to take advantage of opportunities afforded by the rise in globalization.

Meanwhile, the structure of trade indicates how ASEAN countries have benefited from structural transformation. Table 10 shows that it is not only the Philippines where the share of medium- and high-technology manufactured exports has risen. Plummer and Chia (2009) provide data on how the product mix in ASEAN trade has changed significantly, from a bias towards natural resource-intensive goods to a far greater dependence on electronics and other relatively sophisticated manufacturing. The change

in ASEAN countries' top-ten exports and imports also indicates this structural transformation, with exports of thermionic, cold and photo-cathode valves and tubes (SITC 776) experiencing the largest jump between 1990 and 2006.

Table 17. Export of goods and services, selected Asian countries (\$ million)

	1995	2000	2005	2011	2012
Japan	441 538	479 323	595 697	821 312	798 937
Korea, Rep. of	125 058	172 268	284 419	555 214	547 870
Indonesia	45 418	62 124	85 660	203 497	190 032
Taiwan (China)	111 405	151 458	198 168	306 817	300 533
Philippines	17 447	38 078	41 255	48 305	51 995
Malaysia	73 865	98 229	141 595	228 059	227 334
Thailand	56 444	69 152	110 360	219 994	228 141
China	148 780	249 203	761 953	1 898 380	2 048 900
Hong Kong (China)	173 753	201 855	289 325	428 732	442 775
Viet Nam	5 449	14 483	32 447	96 906	114 573

Source: ADB, 2013.

3.1 Regional production networks

Arguably, regional integration was largely driven by regional production networks (Fujita, Kuroiwa and Kumagai, 2011). Trade and investment flows that intensified over the years were compelled mostly by the international production system that emerged. Regional production networks are a subset of global value chains, which Yeats (1998, p. 1) defined as “the internationalization of a manufacturing process in which several countries participate in different stages of the manufacture of a specific good. The process is of considerable economic importance since it allows stages of production to be located where they can be undertaken most efficiently and at the lowest cost.” Furthermore, “if production sharing is increasing in relative importance this implies that countries are becoming more interdependent on each other”.

Intraregional trade and regional production networks flourished in the late 1980s when Japanese firms began to locate and set up factories in neighbouring Asian countries because of the cost advantages. The appreciation of the Japanese yen and the rise in real wages made manufacturing in Japan costly and uncompetitive. This made it profitable for labour-intensive firms to relocate initially in the newly industrialized economies and the more developed ASEAN countries and later to China and Viet Nam. Athukorala (2010) offered three factors to explain the subsequent development of production networks: (i) advanced technology allowed industries to break down the long production chain into a shorter one; (ii) communication technology and the development in transportation systems reduced costs while improving the speed and efficiency in coordinating the fragmented production processes; and (iii) deregulation in trade and investment policies reduced the cost of cross-border business activities.

Trade data affirm the role of regional production networks. For example, Thorbecke (2011) provides the value of imported intermediate goods of selected East Asian countries and regions (table 18).

Intermediate goods consist of mainly parts and components that are the lifeblood of regional production networks. Imports of intermediate goods surged between 1990 and 2010.

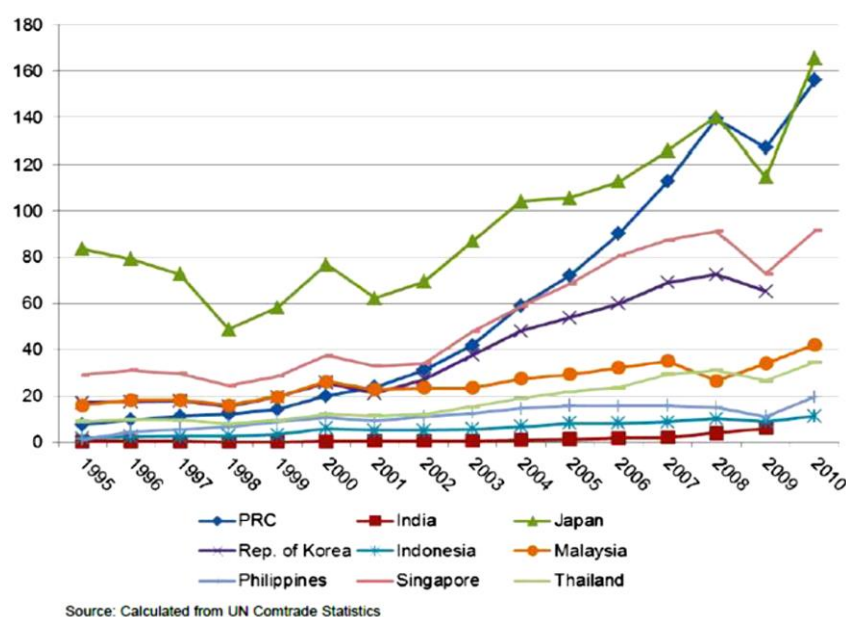
Table 18. Value of intermediate goods imports of selected East Asian countries and regions (\$ billion)

Region	1990	1995	2000	2005	2008	2009	2010
Japan	5.2	13.6	22.0	34.3	45.0	37.1	47.9
China	5.6	19.2	23.9	85.2	118.6	115.7	161.9
ASEAN-4	15.8	47.5	54.6	67.9	82.7	69.6	95.9
Korea, Rep. of + Taiwan (China)	13.2	31.8	41.7	59.2	74.0	64.2	86.1

Note: ASEAN-4 refers to Singapore, Thailand, Malaysia and the Philippines.
Source: Thorbecke, 2011.

The biggest transformation was experienced by China, which imported only \$5.6 billion worth of intermediate goods in 1990. By 2010, China was importing \$161.9 billion worth of intermediate goods. Cheewatrakoolpong, Sabhasri and Bunditwattanawong (2013) offer more detailed trade data (Figure 8), which show that exports of intermediate goods have been increasing for the major economies in East Asia.

Figure 8. Export of machinery and parts from selected East Asian countries (\$ billion)



Source: Figure 1 of Cheewatrakoolpong, Sabhasri and Bunditwattanawong, 2013, calculated from UN Comtrade Statistics.

3.2 Regional production networks and the manufacturing sector

The primary beneficiary of the expansion of regional production networks has been the domestic manufacturing sector. With a modest start in the electronics and clothing industries, multinational production networks have gradually evolved and spread into many industries, such as sports footwear, automobiles, televisions and radio receivers, sewing machines, office equipment, power and machine

tools, cameras and watches, and printing and publishing (Athukorala, 2010). Historically, economic transformation has been driven by the manufacturing sector. Hence, the surge of FDI flows in the region and the establishment of regional production networks have accelerated the development of the recipient economies.

The economic transformation can be observed from the increase in the share of value added from the manufacturing sector to total GDP for Indonesia, Malaysia and Thailand between 1990 and 2011 (table 9). If 1980 is used as a base year for comparison, the transformation becomes more remarkable for Indonesia.

The data clearly reveal the enigma that the Philippines represents in terms of benefiting from these regional production networks. Between 1993 and 2009, the Philippines experienced the largest increase in terms of the share of manufactured exports to total exports. In 2009, the share of medium- to high-technology exports in total manufacturing exports was greatest among the countries listed in table 10, which includes Japan and the Republic of Korea. Nevertheless, the manufacturing sector in the Philippines has stagnated, based on its share to total GDP. This reflects a dichotomy between the export sector and the domestic manufacturing sector. Moreover, the Philippines lags behind the major countries of East Asia in terms of total exports (table 17).

The enigma seems to deepen when recent estimates on the extent of participation in global value chains are considered. Data from the United Nations Conference on Trade and Development (UNCTAD, 2013) demonstrate that the Philippines has one of the highest global value chain participation rates in South-East Asia (table 19). This is consistent with data in a Yamashita and Kohpaiboon study (2011), which found that the share of Philippine trade of parts and components to its total trade – whether in exports or imports – was higher than the average of the six ASEAN countries with the highest per capita incomes.

Table 19. Export structure of selected Asian countries

	Global value chain participation rate (%), 2010	Domestic value added embodied in gross exports (%), 2000	Domestic value added embodied in gross exports (%), 2009
China	59	81.2	67.4
Hong Kong (China)	72	67.4	71.5
India	36	87.2	78.1
Indonesia	44	80.6	85.6
Malaysia	68	57.0	62.1
Republic of Korea	63	67.0	59.3
Philippines	56	54.1	61.6
Singapore	82	49.3	50.1
Thailand	52	65.2	65.5
Viet Nam	48	70.4	63.3

Notes: Global value chain participation rate indicates the share of a country's exports that is part of a multistage process by adding to the foreign value added used in a country's own exports and also the value added supplied to other countries' exports. Domestic value added is the part of exports created in-country, i.e. the part of exports that contributes to GDP.

Sources: Global value chain participation rate was obtained from UNCTAD, 2013, Table IV.13. Domestic value added is from OECD, http://stats.oecd.org/Index.aspx?DataSetCode=TIVA_OECD_WTO [accessed 2 Dec. 2013].

But a closer analysis reveals that there is no enigma at all and the relatively high global value chain participation rate and large share of parts and components trade actually overlaps with the data in table 10. Clearly, the Philippines has a sophisticated export structure with a large share of medium- to high-technology products. The domestic manufacturing sector has increasingly supported the export sector, with value added in medium- to high-technology products increasing from 30.7 to 45.3 per cent between 1993 and 2009.

Interestingly, the share of domestic value added to gross exports, which increased from 54.1 per cent in 2000 to 61.6 per cent in 2009 based on latest data from the Organisation for Economic Co-operation and Development, is comparable to that of Malaysia, Thailand and Viet Nam and even higher than the Republic of Korea (table 19). The existing structure of exports of the Philippines, in terms of a fairly high global value chain participation rate and an increase in the share of domestic value added in gross exports explain why only Thailand has a better record in terms of an increase in the share of domestic value added in its medium- to high-technology manufacturing (table 10).

Nonetheless, domestic value added of exports as a share of GDP remains low in the Philippines. For example, value added in electronics was only 5 per cent of total GDP in 2011 and 2012. This is consistent with the stagnant manufacturing sector and can be attributed to the low level of engagement in global value chains in terms of volume, as indicated by the low level of FDI inflows into the Philippines⁸ (table 5) and the low level of exports (table 17). In other words, even though the Philippine export sector is advanced in terms of depth, there is a discernible lag in terms of scale and breadth when compared with the other major South-East Asian economies.

Other studies, which offer a detailed explanation of the stagnation of the Philippine manufacturing sector (see Balisacan and Hill, 2003; Yap, 2009), cite four major factors:

- The Philippines lagged behind other major South-East Asian countries in terms of attracting FDI (as shown in table 5).
- The investment rate in the Philippines has been historically lower than that of major East Asian economies.
- The low investment rate is partly due to low public infrastructure expenditure. For example, between 2000 and 2010, public spending in Thailand and Malaysia on infrastructure averaged 8–10 per cent, while it was only 2–4 per cent in the Philippines (IMF, 2010). See table 6 for the poor quality of infrastructure.
- The peso appreciated in real terms between 1987 and 1997, while the currencies of Indonesia, Malaysia and Thailand depreciated – at a time when Japanese FDI to South-East Asia surged.

Reliance on regional production networks or global value chains, however, has its potential drawbacks, and policy-makers must be aware of them. This is strongly related to the FDI pitfalls. A recent UNCTAD (2013, Table IV.6, p. 149) report lists several potential drawbacks:

- Concerns exist that the value added contribution of global value chains is often limited where the imported contents of exports are considerable and where participation is limited to a small or lower value part of the overall global value chain or end product.
- A large part of global value chain value added in developing economies is generated by affiliates of transnational corporations. This raises concerns that value can be leaked, such as through transfer price manipulation. Also, part of the earnings of affiliates will be repatriated, with

⁸ Figure IV.16 of UNCTAD (2013) shows a positive relationship between global value chain participation and FDI inward stock.

possible effects on the balance of payments, although evidence indicates that these effects are limited in most cases.

- Pressures on costs from global buyers mean that global value chain-related employment can be insecure and involve poor working conditions.
- Stability of employment in a global value chain can be relatively low because oscillations in demand are reinforced along the chain, although firm relationships in the global value chain can also enhance continuity of demand and employment.
- Global value chains also can act as barriers to learning for local firms or limit learning opportunities to a few firms. Local firms may also remain locked into low-technology (and low-value-added) activities.
- Working conditions and compliance with applicable standards in firms supplying global value chains have been a source of concern where they are based on low-cost labour in countries with relatively weak regulatory environments. Impacts on working conditions can be positive within transnational corporations or their key contractors, where they operate harmonized human resource practices, use regular workers, comply with applicable corporate social responsibility standards and mitigate risks associated with cyclical changes in demand.
- Global value chains cause environmental impacts (such as greenhouse gas emissions) of demand in one country to be distributed across many other countries. Leading firms in global value chains are making efforts to help supplier firms reduce environmental impacts.
- Some forms of global value chain participation can cause long-term dependency on a narrow technology base and on access to transnational corporation-governed value chains for activities with limited value added.

3.3 The manufacturing sector and inclusive growth

This section explains how the stagnation in the manufacturing sector of the Philippines has contributed to a higher incidence of poverty, compared with its neighbouring countries (Table 3). This would also explain why regional economic integration did not foster inclusiveness in the Philippines.

Data from the Family Income and Expenditure Survey indicate that families whose household head has a low educational attainment have a higher incidence of poverty (table 20). For example, in 2009, the poverty incidence of families whose household head only completed an elementary education was 34.1 per cent. For families whose household head completed high school, the poverty incidence fell to 16.6 per cent. The poverty incidence for those who completed college was a mere 1.7 per cent.

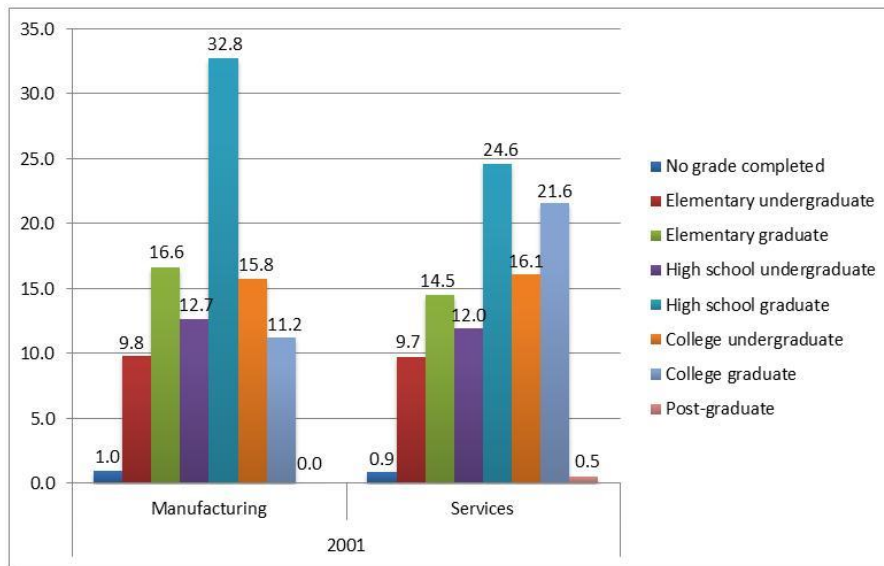
Table 20. Poverty incidence of highest educational attainment of household head, 2003, 2006 and 2009

Household head educational attainment	Poverty incidence		
	2003	2006	2009
All individuals	20.0	26.4	26.5
No grade completed	44.4	56.1	62.4
Elementary undergraduate	36.8	44.6	46.6
Elementary graduate	25.4	36.0	34.1
High school undergraduate	20.7	28.3	30.3
High school graduate	11.1	16.5	16.6
College undergraduate	4.5	6.9	7.5
At least college graduate	1.0	1.2	1.7
Post-graduate	0.8	0.0	0.0

Source: Reyes et al., 2012.

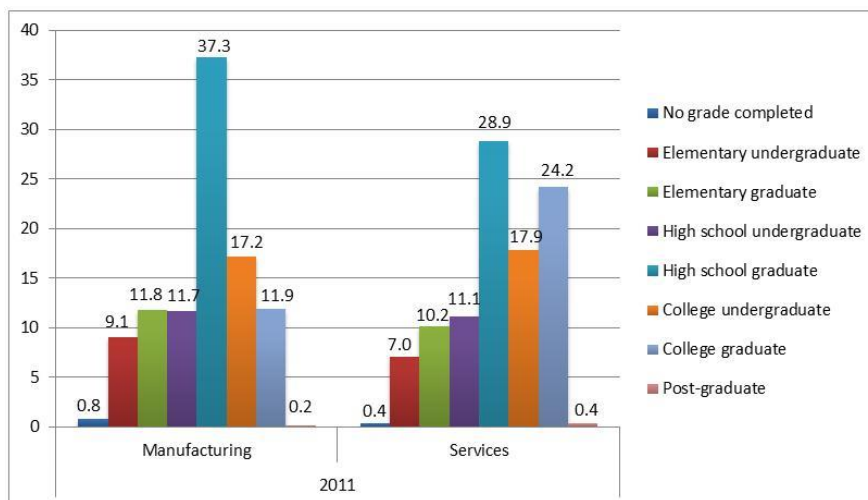
The next strand of the argument is that the educational attainment of the workforce in the manufacturing sector is relatively lower than among workers in the service sector. Figures 9 and 10 illustrate the frequency distribution of workers in both sectors, by highest educational attainment in 2001 and 2011, respectively.

Figure 9. Frequency distribution of educational attainment of workforce in manufacturing and services, 2001 (%)



Source: NSO, 2011.

Figure 10. Frequency distribution of educational attainment of workforce in manufacturing and services, 2011 (%)



Source: NSO, 2011.

The service sector employs more college graduates whereas the manufacturing sector employs more high school graduates. Data for 2001 and 2011 are presented to address the possibility that the service sector relies more on college graduates because of the surge in opportunities from the business process outsourcing sector. The pattern for both years is similar.

Another important strand in this argument is that because the manufacturing sector has higher labour productivity, there should be more high-productivity jobs in the sector. In other words, with the same educational attainment, a typical worker should find a higher-paying job in the manufacturing sector compared with either the agriculture or service sector. The data vouch that the manufacturing sector, on average, has 6.5 times more labour productivity than the agriculture sector and 2.2 times the labour productivity of the service sector (Table 11). This is supplemented by data showing that, on average, the manufacturing sector pays higher wages (Table 21). For example, the average wage rate in 2009 for the group composed of high school graduates and those with a high school education was 264.60 pesos (PHP). At the same educational attainment, the average wage rate in the service sector was PHP209.40.

Table 21. Average daily basic pay of wage workers in 2009 (PHP)

	Manufacturing sector	Service sector
Elementary graduates, elementary education	198.00	164.70
High school graduates, high school education	264.60	209.40

Source: NSO, 2010.

The main conclusion derived from this analysis is that a more dynamic – and perhaps more labour-intensive – manufacturing sector would have provided more higher-paying jobs to the less-educated workforce, thereby making poverty reduction faster. Of course, there are other reasons for non-inclusiveness and poverty in the Philippines, such as poor physical infrastructure, inequitable access to health and education, lagging performance of SMEs and weak institutions.

The Philippines presents a case in which the adjustment process that comes with increased economic integration and globalization induced socially undesirable outcomes (Intal, Borromeo and Largoza, 2010). Although the Philippines may have been successful in dramatically changing its trade structure and latching on to regional production networks (being the region’s major supplier of technology-intensive semiconductors), the country’s manufacturing sector stagnated and failed to generate needed growth and employment for the economy. The malaise in the manufacturing sector meant less high-productivity employment opportunities and lower wages for workers without any tertiary education. This could partly explain why improvement in the poverty situation has lagged behind many East Asian countries.

4. The Philippines and the ASEAN Economic Community

This section looks at how the establishment of the AEC can benefit the Philippine economy and reinforce the reforms suggested in the previous section. The latter will be in the form of commitments that are bound by international agreements. Policy-makers will thus have added leverage when advocating for meaningful economic reform. However, there are also possible drawbacks related to the AEC, and it would be useful for policy-makers to be aware of them.

4.1 Trade between the Philippines and ASEAN

ASEAN Member States have become an increasingly important trade partner for the Philippines. As shown in Table 22, at the 2010 peak, ASEAN absorbed 22.4 per cent of Philippine exports, more than either Japan or the United States. At the same time, 28.2 per cent of Philippine imports was sourced from ASEAN (Table 23). That ASEAN is an important trade partner augurs well for expanded total trade for the Philippines when the AEC opens in 2015. Trade diversion will be minimized and trade creation will be more dominant.

Table 22. Exports – Direction of trade, 1975–2012

Share of total exports										
Philippine exports by destination										
Country	1975	1980	1985	1990	1995	2000	2005	2009	2010	2012
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North America	28.9	27.4	35.7	37.8	36.7	31.5	18.9	18.6	15.8	15.6
USA	28.9	27.4	35.7	37.8	35.3	29.8	18.0	17.7	14.7	14.2
Europe	16.6	20.3	14.3	17.9	18	18.4	17.3	21.1	14.8	12.9
Asia	45.2	41.5	38.5	34.8	41.3	48.1	61.1	56.3	66.0	70.0
ASEAN	2.7	6.6	11.5	7.1	13.6	15.7	17.3	15.2	22.4	18.8
Japan	37.7	26.5	18.9	19.7	15.7	14.7	17.5	16.2	15.2	19.0
Oceania	1.4	1.8	2.1	1.3	1.0	0.9	1.3	1.7	1.2	0.9
Middle East	2.2	2.0	1.5	1.6	1.3	0.5	0.7	1.2	1.1	1.0
Others	5.6	7.0	7.9	6.6	1.7	0.7	0.7	1.1	1.0	-

Note: Details may not add up to total due to rounding.
Sources: 1990–2007=ADB, 2009; 2012=UNCTAD statistics, <http://unctadstat.unctad.org/> [accessed 26 Nov. 2013]; 2009–2010=UNESCAP, 2011.

Table 23. Imports – Direction of trade, 1975–2012

Share to total imports										
Philippine imports by country source										
Country	1975	1980	1985	1990	1995	2000	2005	2009	2010	2012
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
North America	21.8	23.1	25.1	19.4	19.5	19.3	19.7	12.2	12.3	12.2
USA	21.8	23.1	25.1	19.4	18.4	18.6	19.2	11.6	11.4	11.6
Europe	12.5	11	8.6	11.5	13.3	10.8	9.5	9.1	9.4	8.6
Asia	37.4	34.2	42.7	40.2	52.9	55.4	59.2	63.9	71.1	73.5
ASEAN	5.0	7.0	14.8	9.7	11.9	15.5	18.7	25.4	28.2	22.8
Japan	27.9	19.8	14.4	18.3	22.6	18.9	17.0	12.1	13.1	10.6
Oceania	4.6	3.8	3.6	3.7	3.7	3.0	2.0	2.9	3.0	3.2
Middle East	17.5	21.1	12.4	11.5	8.5	10.5	8.2	7.5	9.0	10.4
Others	6.2	6.8	7.5	13.7	2.1	1.0	1.4	2.1	1.7	-

Note: Details may not add up to total due to rounding.
Sources: 1990–2007=ADB, 2009; 2012=UNCTAD statistics, <http://unctadstat.unctad.org/> [accessed 26 Nov. 2013]; 2009–10=UNESCAP, 2011.

The increasing trade with ASEAN over the past three decades is largely a consequence of involvement in regional production networks. This is evident from the list of top commodity exports to and imports from ASEAN (tables 24 and 25). The commodity classification for both the number one export and number one import is “cathode valve and tubes”. This epitomizes the participation of Philippine-based firms in intra-industry trade, which is an important feature of regional production networks.

Table 24. Major Philippine exports to ASEAN, 1995, 2000, 2005 and 2012 (\$ '000)

1995	Value	%	2000	Value	%
Cathode valves & tubes	331 297.69	39.75	Cathode valves & tubes	3 508 216.12	65.25
Fertilizers	116 503.92	13.98	Parts, accessories for machines	841 031.08	15.64
Fixed vegetable fats & oils, crude, refined, fract.	91 341.62	10.96	Apparatus for electrical circuits; board, panels	218 399.44	4.06
Parts & accessories of vehicles	84 811.01	10.18	Petroleum oils or bituminous minerals >70% oil	214 808.78	4.00
Copper	53 238.37	6.39	Automatic data processing machines, n.e.s.	208 886.32	3.89
Gold, non-monetary (excluding gold ores and concentrates)	43 902.16	5.27	Parts & accessories of vehicles	161 526.75	3.00
Telecommunication equipment, n.e.s. & parts n.e.s.	39 766.41	4.77	Telecommunication equipment, n.e.s. & parts, n.e.s.	95 312.10	1.77
Petroleum oils or bituminous minerals >70% oil	34 426.96	4.13	Fixed vegetable fats & oils, crude, refined, fract.	51 831.73	0.96
Automatic data processing machines, n.e.s.	22 142.19	2.66	Fertilizers	41 131.99	0.77
Natural rubber & similar gums, in primary forms	15 954.56	1.91	Glass	35 286.50	0.66
TOTAL	833 384.89	100.00	TOTAL	5 376 430.83	100.00
2005	Value	%	2012	Value	%
Cathode valves & tubes	3 485 213.51	59.91	Cathode valves & tubes	3 338 975.76	49.20
Parts, accessories for machines	590 286.84	10.15	Other machinery for particular industries, n.e.s.	652 883.16	9.62
Automatic data processing machines, n.e.s.	508 099.55	8.73	Parts & accessories of vehicles	589 347.98	8.68
Parts & accessories of vehicles	433 274.18	7.45	Motorcycles & cycles	418 503.33	6.17
Petroleum oils or bituminous minerals >70% oil	202 921.89	3.49	Parts, accessories for machines of groups	341 827.90	5.04
Motor vehicles for the transport of persons	168 282.17	2.89	Rotating electric plant & parts thereof, n.e.s.	338 386.32	4.99
Telecommunication equipment, n.e.s. & parts, n.e.s.	137 630.19	2.37	Automatic data processing machines, n.e.s.	296 624.97	4.37
Petroleum oils, oils from bitumen. materials, crude	104 854.29	1.80	Petroleum oils or bituminous minerals >70% oil	282 514.23	4.16
Apparatus for electrical circuits; board, panels	98 485.41	1.69	Electrical machinery & apparatus, n.e.s.	273 305.30	4.03
Ships, boats & floating structures	88 548.13	1.52	Copper	254 063.14	3.74
TOTAL	5 817 596.17	100.00	TOTAL	6 786 432.09	100.00

Source: UNCTAD, <http://unctadstat.unctad.org/> [accessed 28 Nov. 2013].

Table 25. Major Philippine imports from ASEAN, 1995, 2000, 2005 and 2012 (\$ '000)

1995	Value	%	2000	Value	%
Copper ores and concentrates; copper mattes, cement	219 625.89	20.29	Cathode valves & tubes	1 348 106.68	44.17
Petroleum oils or bituminous minerals >70% oil	189 542.61	17.51	Parts, accessories for machines	497 617.68	16.31
Ships, boats & floating structures	104 436.65	9.65	Petroleum oils or bituminous minerals >70% oil	286 879.77	9.40
Petroleum oils, oils from bitumin. materials, crude	104 093.96	9.61	Telecommunication equipment, n.e.s.; & parts, n.e.s.	189 759.03	6.22
Sugar, molasses and honey	92 295.40	8.53	Petroleum oils, oils from bitumen. materials, crude	154 647.31	5.07
Telecommunication equipment, n.e.s. & parts, n.e.s.	91 786.94	8.48	Apparatus for electrical circuits; board, panels	130 907.84	4.29
Cathode valves & tubes	90 119.72	8.32	Other machinery for particular industries, n.e.s.	116 340.13	3.81
Rice	68 583.93	6.33	Rice	114 088.19	3.74
Other machinery for particular industries, n.e.s.	64 324.98	5.94	Automatic data processing machines, n.e.s.	113 008.46	3.70
Automatic data processing machines, n.e.s.	57 816.86	5.34	Coal, whether or not pulverized, not agglomerated	100 396.88	3.29
TOTAL	1 082 626.95	100.00	TOTAL	3 051 751.96	100.00

2005	Value	%	2012	Value	%
Cathode valves & tubes	1 909 620.57	35.19	Cathode valves & tubes	2 005 927.10	26.04
Petroleum oils or bituminous minerals > 70 % oil	978 998.49	18.04	Petroleum oils or bituminous minerals > 70% oil	1 331 641.99	17.29
Rice	522 423.33	9.63	Motor vehicles for the transport of persons	1 005 565.13	13.05
Parts, accessories for machines	520 641.30	9.59	Parts, accessories for machines	886 746.07	11.51
Apparatus for electrical circuits; board, panels	362 061.11	6.67	Coal, whether or not pulverized, not agglomerated	779 668.47	10.12
Petroleum oils, oils from bitumen materials, crude	298 475.81	5.50	Petroleum oils, oils from bitumen materials, crude	396 879.89	5.15
Copper ores and concentrates; copper mattes, cement	231 288.91	4.26	Rice	364 552.08	4.73
Motorcycles & cycles	206 795.02	3.81	Edible products and preparations, n.e.s.	353 670.44	4.59
Electrical machinery & apparatus, n.e.s.	200 220.30	3.69	Motor vehicle for transport of goods, special purpose	297 452.29	3.86
Motor vehicles for the transport of persons	196 645.80	3.62	Telecommunication equipment, n.e.s. & parts, n.e.s.	281 097.23	3.65
TOTAL	5 427 170.64	100.0	TOTAL	7 703 200.69	100.0

Source: UNCTAD, <http://unctadstat.unctad.org/> [accessed 28 Nov. 2013].

Because of the existing trade structure of the Philippines, the establishment of the AEC will likely expand its trade with ASEAN and also widen its involvement in regional production networks. The beneficial effect of the AEC will be driven by other factors, as explained in the next section. Policy-makers, however, need to implement measures and reforms needed for these benefits to be realized and also to minimize any adjustment costs.

4.2 Benefits of the ASEAN Economic Community

The participation of the Philippines in deeper ASEAN economic integration has a potential to generate significant benefits and cost reductions to the Philippine economy. The reduction or elimination of tariff and non-tariff barriers will enhance the Philippines' participation in the regional production chain and increase its access to the global market. ASEAN integration is also expected to reduce the transaction costs associated with the physical barriers to the movement of goods (such as customs stoppages) with the coordinated efforts to simplify procedures and facilitate trade. At present, there are varying technical regulations and products across Member States. This results in added costs to consumers and firms, which have to tailor their products to suit several standards. The harmonization of products and technical standards that accompanies deeper ASEAN integration should thus result in a substantial reduction of these costs.

Integration is likewise likely to attract FDI because most of ASEAN's foreign investment inflows are associated with production networks, in which case FDI and trade are complements. Also, a large regional market that is associated with an agglomeration of suppliers and support institutions and services, as well as economies of scale, is a natural magnet for investment sites. Other benefits of FDI include increased competitiveness due to the transfer of technology, strengthening of institutions, creation of supply capabilities, access to foreign markets, employment and human capital generation, and links to upstream and downstream industries, including SMEs. Foreign investors can be invited to participate in a proposed ASEAN Competitiveness Council to accelerate and maximize the gains from FDI. Overall, some analysts have estimated that as a result of regional integration, the Philippines' FDI stock, which was \$31 billion in 2012, could increase to as much as \$57.4 billion in the medium term (Aldaba, Yap and Petri, 2009).

Studies have found that for individual ASEAN economies, the trade-creating effects of being part of a single market and production base, as well as the increased competitiveness associated with economies of scale and productivity spillover effects of trade, are large. For the Philippines, Rashid et al. (2009), in a computable general equilibrium (CGE) study, conservatively estimated that the liberalization of tariffs and non-tariff barriers that will come with the AEC will increase the country's exports and imports by 45.5 per cent and 34 per cent, respectively, increase manufacturing output and increase the country's GDP by 3.2 per cent (Rashid et al., 2009).

Table 26 presents results from Plummer and Chia's (2009) CGE modelling on ASEAN economic integration at a more aggregate level. Scenario 1 (AFTA) eliminates all remaining tariffs in ASEAN; scenario 2 (AFTA+) removes non-tariff barriers in addition to the remaining tariffs and assumes a 5 per cent reduction in trade costs; scenario 3 (AEC) incorporates FDI effects. The results indicate that the wider and deeper that the integration is, the larger will be the benefits. All ASEAN Member States gain from the AEC in the long run, though some gain more than others. The gains range from a 2.8 per cent increase in real income for Viet Nam to a 9.7 per cent gain for Singapore. The Philippines, as stated earlier, is estimated to experience an increase of 3.2 per cent in its GDP.

Table 26. CGE modelling of welfare gains related to AEC

	\$ billion at 2004 prices			% of baseline GDP		
	AFTA	AFTA+	AEC	AFTA	AFTA+	AEC
Brunei Darussalam	0.2	0.4	0.5	2.6	5.4	7
Indonesia	1	6.2	27.6	0.2	1.4	6.2
Malaysia	2.7	2.9	5.7	1.4	1.5	3
Philippines	0.9	2.2	4.5	0.6	1.6	3.2
Singapore	2.6	14	15.1	1.6	9	9.7
Thailand	1.6	9.8	12.2	0.6	3.9	4.9
Cambodia	0.3	0.5	0.6	2.7	5.4	6.3
Lao PDR	0	0.1	0.2	0.6	2.5	3.6
Myanmar	0	0.2	0.6	0.3	1.2	4.4
Viet Nam	0.9	1.6	2.4	1.1	1.8	2.8
ASEAN-10	10.1	38	69.4	0.8	2.9	5.3

Source: Plummer and Chia, 2009, Table 2-6.

The AEC Blueprint adopted in 2007 states that “the free flow of trade in services is one of the important elements in realizing the ASEAN Economic Community, where there will be substantially no restriction to ASEAN service suppliers in providing services and in establishing companies across national borders within the region, subject to domestic regulations” (ASEAN, 2008). The liberalization of the service sector also is expected to result in lower-priced services, higher service exports, improved access to foreign investment and technology, better service sector efficiency and competitiveness, and improved access for SMEs and workers to the expanded services market. The removal of cabotage rules in the domestic maritime shipping sector, for example, has the potential of substantially improving Philippine transport infrastructure as well as invigorating interisland shipping, trade and tourism, in addition to lower prices, higher service quality and increased safety in the country’s shipping sector.

The aspect of service liberalization with more direct implications for employment and worker welfare relates to the movement of skilled and low-skilled labour. The AEC’s free flow of skilled labour is expected to result in, among others, the acquisition of human capital and spillover impacts across borders (see Box 1 for a generalized discussion of the advantages and disadvantages). ASEAN has moved cautiously regarding low-skilled labour, although it passed the Declaration on the Protection and Promotion of the Rights of Migrants in 2007. This action falls short of assuring equal opportunity and treatment but certainly is an important step towards improving the protection of migrant workers of all types. Filipino low-skilled labour migrants in Malaysia are one group that can benefit from progress in the protection of migrant workers’ rights. Ideally, the establishment of the AEC will accelerate the formulation of more meaningful and binding agreements among the relevant countries.

Regarding skilled labour and facilitating trade in services, seven mutual recognition agreements have been endorsed; they cover engineering services, nursing services, architectural services, quantity surveying, medical practitioners, dental practitioners and accountancy services. A Professional Exchange Programme that focuses primarily on business services was developed and endorsed in 2008. Mutual recognition agreements have been signed in engineering services (2005), nursing services (2006), architectural services (2007), surveying qualifications (2007), accountancy services (2008) and dental and medical practitioners (2008).

The issue of brain drain is associated with the migration of skilled labour. The Philippines has experienced substantial brain drain, with many of its talents having migrated to industrialized countries, particularly the United States. There are approximately 5 million Filipinos living abroad as permanent residents. Hence, the establishment of the AEC will contribute only marginally to this problem. At present, only 7 per cent of temporary Filipino migrants travel to ASEAN countries. The establishment of the AEC is not expected to dramatically change this. The more important issue is the protection afforded to the low-skilled migrants.

4.3 Maximizing employment through SMEs and regional rebalancing

The increase in GDP associated with the establishment of the AEC will definitely translate into higher employment because employment elasticities are positive. The challenge in the Philippines is to overcome the low and declining employment elasticity – particularly in the manufacturing sector – and significantly increase the number and quality of jobs that will be generated. This is especially true for the manufacturing sector, which is estimated to have the lowest employment elasticity.

Participation of SMEs in regional production networks must be encouraged. SMEs have a larger impact on employment than large firms. The studies of Wignaraja (2012), the Economic Research Institute for ASEAN and East Asia (ERIA) (2012) and Narjoko (2012) and provide analysis and recommendations on how this can be accomplished. The following highlights the major constraints that SMEs face and policy recommendations from Wignaraja's econometric results (2012, pp. 5–6, 22).

“Implicit in most of the ... theories is the notion that SMEs are at a disadvantage in participation in production networks compared with large firms. SMEs face, to a higher extent than large firms, resource constraints (in terms of finance, information, management capacity and technological capability). In addition, SMEs suffer disproportionately from external barriers like market imperfections and regulations. Accordingly, the probability of SMEs joining production networks (as direct exporters, indirect exporters or overseas investors) is lower than that of large firms. Furthermore, justification exists for public policies to support the entry of SMEs into production networks. In the main, such support should be geared to an enabling environment that opens access to markets, reduces bureaucratic impediments against SMEs and provides appropriate institutional support services (e.g. technological, marketing and financial support).

“Our research suggests that large firms [were] the leading players in production networks in ASEAN economies in the late 2000s while SMEs [were] relatively minor. Nonetheless, the available information also hints at a modest increase in the participation of SMEs in ASEAN economies between the late-1990s and the late-2000s, as measured by the share of SME exports. More developed ASEAN economies, like Malaysia and Thailand, which are more established in production networks, have higher SME export shares than other ASEAN economies. The outcome of the econometric exercise suggests that size, foreign ownership, educated workers, experienced CEOs, technological capabilities and access to commercial bank credit all positively affect the probability of SME participation in production networks. By contrast, age has a negative relationship.

“The exploration of policy influences on SME business activity provides additional insights. A trust deficit seems to hamper the requisite intra-firm cooperation needed for effective SME

participation in production networks. Supply-side factors – like lack of access to finance, high electricity costs, variable quality of transport systems and inadequately educated workers – are an additional hindrance to SMEs. On the policy and incentive side, behind-the-border issues, like high corporate tax rates, as well as economic uncertainty also play their part. Finally, the limited evidence from Malaysia and Thailand suggests that the affordability and quality of business support services are an issue. Tackling these constraints at firm and country level would help to unleash the full potential of SMEs as players in production networks in the future.”

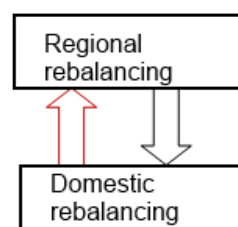
ERIA (2012, pp. 61–62) specifically recommended (with paraphrasing):

- Prioritize the implementation of measures in a strategic plan by focusing on setting up and strengthening the technology incubators, the establishment of a one-stop SME service centre and strengthening SME financial facilities by 2015.
- Intensify the initiatives to encourage business matching for SMEs, with multinational firms as well as with other well-performing SMEs within the region and in East Asia.
- Promote SME clusters, networks and alliances.
- Establish the ASEAN SME Policy Index by 2013 to ensure policy coherence between the regional initiatives and national SME policies. The SME Policy Index assesses the quality and level of implementation of policies in support of SMEs by quantifying and comparing some qualitative policy features.

Narjoko (2012) cited access to finance as a major constraint both for the development of SMEs and their participation in regional production networks. In particular, financial access has a heavy impact on SMEs’ innovation capability and participation in export markets. Narjoko proposed several policy reforms, including the establishment of industry organizations for SMEs that will represent the interests of Member States and provide market information and capacity building and introducing credit guarantee schemes that are subject to rigorous and viable business plans and a reliable credit rating and information system.

Increasing physical connectivity and enhancing the role of SMEs will be the pillars of the strategy to rebalance economic growth in East Asia and expand employment. Rebalancing will mean different things for different economies. For example, in China, there is a need to increase the share of consumption expenditures. Meanwhile, the investment to GDP ratio in the Philippines is relatively low and is one of the major constraints to economic growth. One approach is to link domestic rebalancing to rebalancing at the regional level (Figure 11).

Figure 11. Linking regional and domestic rebalancing



In this context, Asia’s outward-oriented development model does not need to be overhauled. What will be required is an adjustment in net exports and some shift towards production for Asian demand. In other words, the main thrust of regional rebalancing should be an increase in intraregional trade and

investment among East Asian economies, but with more of the final exports going to economies in the region instead of to the United States and Western Europe.

4.4 Addressing the possible costs of the ASEAN Economic Community

Regional economic integration has its drawbacks, and there are always winners and losers. In the case of the Philippines, two of the more vulnerable sectors are rice and sugar. These two commodities have been on the sensitive list for an extended period of time. There are general measures to mitigate costs of adjustment of “losers”, including social safety nets (Box 2).

Studies by Cororaton (2004, 2013) attempt to quantify the impact of greater trade liberalization on rice and sugar among ASEAN Member States – leading up to the AEC; they are the two-most heavily protected sectors in the Philippines. Rice is one of the top imports of the Philippines from ASEAN countries (Table 25). The results show that although market reforms in rice bring about a reduction in consumer prices that is favourable to all, the surge in rice imports generate displacement effects on poor households that rely heavily on palay and rice production and other related activities. The decline in palay production and its output price translate to lower demand for factor inputs in the sector, lower factor prices in agriculture and lower factor incomes for palay/rice-dependent households. Thus, poverty in these groups, as well as general income inequality, worsens. However, the results of the experiments involving various poverty-offsetting measures indicate that an increase in direct government transfers to these household groups can provide an adequate safety net.

The liberalization of trade in sugar is not as disruptive for the Philippines as it is with rice. The main reason is that the tariff adjustment is less severe. In addition, the Philippines has been a net exporter of sugar. The simulation results of Cororaton (2013) suggest that while imports of sugar from ASEAN increase sharply, they are offset by an increase in sugar exports to ASEAN countries that are sugar importers and to the rest of the world. The reduction in sugar tariffs lowers the cost of production of several sugar-using downstream sectors and, as a result, production in these sectors increases. Among them are milk processing, cocoa chocolate, ice cream and animal feed. There is thus an overall decline in poverty incidence, albeit a modest one.

Two recent measures will assist the Philippine economy in benefiting from the AEC and increase resilience of domestic firms to greater competition from other countries. An important reform with long-term effects is the K–12 programme that extends basic education from 10 years to 12 years. The changes to the curriculum were introduced in 2012 and the required legislation has made progress in Congress. Expanded basic education will enhance cognitive skills and improve the trainability of workers.

The Responsible Parenthood and Reproductive Health Act of 2012 was signed by President Aquino in December 2012, closing a controversial chapter in Philippine history after years of acrimonious and passionate discussions and debates. The so-called RH bill will push the Philippines into a period of significant demographic transition, thereby reducing upward pressure on the unemployment rate from the supply side.

These two measures are complemented by the ongoing conditional cash transfer programme. This social safety net has yielded positive results in terms of encouraging children to stay in school.⁹ There is also some evidence of its positive impact on employment and poverty reduction.

Box 2
Compensating the losers in regional economic integration*

To help sectors and individuals cope with the adverse effects of regional economic integration and globalization, policy-makers can consider the following programmes.

Training and job search programmes

Worker training and job search programmes that smooth transitions to new types of employment will particularly help workers become more productive sooner. The availability of effective programmes prior to further rounds of liberalization will also make workers less anxious about the prospects of integration. New skills taught to displaced workers should reflect the new profile of demands in the economy, regardless of whether those new demands derive from generalized technological change or tariff reductions.

Unemployment insurance

To shelter workers from labour market shocks when competitive pressures are strong and significant structural adjustment essential, it is preferable to rely mainly on unemployment insurance and in-work benefits than on employment protection legislation. Although protecting workers against labour market risk inevitably reduces efficiency, unemployment insurance can cover a larger segment of the labour force than employment protection while involving fewer efficiency losses.

Safety nets

Targeting employment and training programmes to workers in sectors affected by liberalization may be desirable, but most social welfare policies should not be linked to the process or policies of liberalization. Social safety nets should be available to those in poverty, regardless of the direct cause of poverty. In the context of reducing poverty and raising living standards, social safety nets must consider the welfare and capacities of all family members – not only those who have lost jobs.

Promotion of competitiveness in rural economic activities

Worldwide trade liberalization in agriculture is critical for making trade work for the poor. Poverty tends to be concentrated in rural, agricultural areas throughout South-East Asia. Continued subsidies in the agriculture sectors in the industrialized world keep the international price of commodities artificially low. There is also the problem of lack of technology and production alternatives. Regional integration in infrastructure, particularly in the Mekong subregion, is critical for generating opportunities in agriculture. Some unification of standards would facilitate exports. Assistance can be provided to small and medium-sized firms to help them meet the standards required for their agricultural products.

Education

The education of the next generation of workers should be a priority. A labour force with a high level of general skills will be best placed to take advantage of or weather the adjustments from changes in international prices and advancements in technology. Often, a basic set of skills is necessary before job-specific training is effective. If the relative demand for skills rises, the increasing returns to skills provide an additional incentive to stay in school longer. But this is not possible if the quality and quantity of educational opportunities are lacking. To meet the rising demand for skills that seems to follow liberalization, public investment in broad-based education becomes increasingly important.

*Text taken from Inter-American Development Bank, 2002.

⁹ Reyes et al. (2013) has more details about the CCT programme and its impact.

5. Policy recommendations

5.1 Diversifying the industrial base and expanding demand for employment: The case for industrial policy

There is a need for economic diversification in all three major sectors of the economy. To achieve this, the more important considerations are an effective industrial policy and maintaining a realistic exchange rate.

In addition to the low investment rate, other reasons for the lack of economic transformation relate to problems of market failure. Memiş and Montes (2008) cite three factors why they think the Washington Consensus developmental approach of relying on price signals to private investment is misleading. The first is the existence of dynamic scale economies and knowledge spillovers. Second, some agency, such as the State, might be needed to address coordination failures in private investment activities. Third, there are important informational externalities in the process of industrial investment.

Industrial policies are those that address market failure while promoting diversification of production activities into new areas, facilitating restructuring of existing activities and fostering coordination between public and private entities to make all of this happen. These policies need not be restricted to the industry sector. They also apply to the development of non-traditional activities in agriculture and services. The use of industrial policies need not imply that governments make production and employment decisions. Instead, it requires that governments take a “strategic and coordinating role” in the development of non-traditional activities – activities in which the underlying costs and opportunities are unknown to begin with and unfold only when they start (Rodrik, 2004). A success case in the Philippines is the business process outsourcing sector wherein the representations made by the Government to US companies facilitated FDI into the outsourcing activities.

Following this example, an office similar to the Competitiveness Council can be established, with the main responsibility of attracting FDI. But to maximize the gains, there should be spillover effects on the domestic sector. The Singaporean Government implemented a Local Industries Upgrading Programme that encouraged multinational firms to source their inputs from domestic firms. While the main objective was technology transfer, it had the effect of turning domestic SMEs into attractive input and service suppliers. The overall effect was to increase the demand for domestic labour. The success of this programme was clearly indicated by the increasing employment elasticity of Singapore in the 1990s and beyond.

This type of policy also can be used to integrate domestic SMEs, which are more labour-intensive than large firms, to growth areas. In situations in which globalization and competition have left no other recourse for exporting firms but to employ capital-intensive production technologies developed in industrialized countries, these firms can turn around and engage domestic SMEs for production-support services. Such a policy can be considered by economic managers in their attempt to generate more employment.

In addition to Singapore’s Local Industry Upgrading Programme, another type of industrial policy is one that can be used to integrate domestic SMEs, which are more labour-intensive than large firms, into growth areas. One successful case of such a policy is the Republic of Korea, where, however,

industrialization in the 1970s and 1980s was largely attributed to large-scale enterprises; subcontracting with small and cottage producers was widely practised, especially in later years. With the electronics industry, which was the main driver of the Republic of Korean economy in the 1990s, the Government took active steps to encourage the formation of a domestic equipment and supply industry (Matthews and Cho, 2000). For example, government policy has encouraged the clustering of supply firms on the Chonan Second Industrial Complex in the country's central region. Because of that encouragement, several emerging supply firms, such as DNS Korea, Mirae and POSCO-Huls, are now located there or in its vicinity.

This “local production strategy” is similar to the national autonomy strategy pursued by Japan to avoid import dependence (Matthews and Cho, 2000). Such a policy can be considered by economic managers in their attempt to stem the decline in employment elasticity.

The food processing industry of India also can be considered in the context of industrial policy. This is a labour-intensive industry that has strong direct links with the agriculture sector. Less than 2 per cent of fruit and vegetable production in India is processed, compared with 30 per cent in Thailand and 80 per cent in Malaysia (Sundaram and Tendulkar, 2002). Several market analysts have cited food processing as an industry with considerable potential to expand. However, there are a number of constraints that have thus far prevented its expansion. The most important are: cultivation of traditional varieties of fruit and vegetables unsuitable for processing; weak infrastructure for post-harvest preservation and quality control; and lack of modern storage, transportation, processing and packaging facilities. Some of these constraints may result from misguided government policies, but coordination failures abound in preventing the growth of a sector in which there are so many inputs and players.

In the context of a long-term development strategy, an industrial policy would therefore have two major objectives. One is to generate more employment by involving SMEs in global and domestic production networks and supply chains. This can be facilitated by improving their technological capability, which has a direct impact on labour productivity. The latter, together with the improving technological capability of larger firms, would be the second objective of industrial policy. This would improve firm-level competitiveness by improving product design and product development, thereby facilitating product diversification.

5.2 Product space

Usui (2012) suggests an approach to industrial policy in the Philippines that uses the concept of “product space” developed by Hidalgo et al. (2007). Product space depicts a country's degree of economic diversification. It also allows the mapping of unexploited products, which are those that the Philippines has not yet developed a comparative advantage. Of particular interest would be those products that are “nearby” – which is not a distance concept but is related to how close the products are to the current export basket in terms of the capabilities it requires (table 27).

This is essentially the approach recommended when the various industry roadmaps were consolidated by the Philippine Institute for Development Studies (Aldaba, 2013). A product-approach yields more tractable policies in addressing horizontal and vertical constraints. This framework also facilitates the identification of coordination failures.

Table 27. “Nearby” products with potential

Criteria	Leamer	Nearby: Detailed commodity group (SITC 4 digit)
Highest level sophistication	Machinery	Complete digital processing machines; watches; photographic cameras; TV, radio-broadcasting, transmitters; clocks; electrical line telephonic; portable radio receivers; microphones; calculating, accounting machines; sewing machines; domestic electromechanical appliances & parts
Highest spillover effect	Capital Labour Animal Agriculture Cereal	Fabrics, woven of continuous synthetic textile materials Precious jewellery; porcelain or china housewares; pianos Fish, dried, smoked; fish fillets frozen Refined sugar Flours & meals; meat; fish
Highest labour intensity	Labour Capital Machinery	Synthetic or reconstructed precious or semi-precious stones; pianos; pens; small wares & toilet articles; precious jewellery; porcelain Knitted not elastic nor rubberized of fibres other than synthetic; fabrics, woven of continuous synthetic textile materials Clocks; watches; photographic cameras; sewing machines

Source: Usui, 2012.

Table 20 provides a list of nearby products, classified according to Leamer’s categories.¹⁰ They are also juxtaposed against possible criteria for selecting the product: (i) having a high level of sophistication; (ii) high spillover effect; and (iii) high labour intensity. Because job creation is a priority, the Government can work with the private sector in developing products with high labour intensity. Examples of the latter are: synthetic or reconstructed precious or semi-precious stones, pianos, pens, small wares and toilet articles, precious jewellery and porcelain.

Another major consideration is to what extent these products will likely expand the role of Philippine-based firms in regional production networks and global value chains. The export structure of the Philippines is already geared towards such participation (tables 10 and 19). It is a matter of scaling up, and the AEC should provide a strong boost in this direction. The UNCTAD report (2013) has a useful set of policies and guidelines on how to approach this issue, which includes measures to minimize risks associated with global value chain participation.

The recommendation thus is not to pick winners but rather to focus on coordination failures. Approaching the problem of relatively high unemployment and underemployment on a product basis may likely lead to more tractable policies. Constraints to manufacturing these products may reveal that the problems cut across many product lines, such as extensive smuggling or a high cost of electricity. Viewing these products from the lens of the forthcoming AEC would also highlight opportunities for entrepreneurs, especially in the context of participation in regional production networks.

The product approach is best suited for closer interaction between government and the private sector. For example, Rodrik (2004) recommended “coordination and deliberation councils” for more effective dialogue, such as the previously mentioned Competitiveness Council.

¹⁰ Leamer’s product classification is as follows: petroleum, raw materials, forest products, tropical agriculture, animal agriculture, cereals, labour intensive, capital intensive, machinery and chemicals.

5.3 Supply side policies for employment

It is widely accepted that investments in education are critical for economic growth. At the aggregate level, societies would like to prepare their labour force for the increasing sophistication of production, the challenges of globalization and rapidly changing market demand. At the firm level, production decisions are shaped by the type of workers available to it. If highly skilled workers are relatively abundant, firms would likely choose to produce high-value products. Conversely, with low-skill workers, firms will tend to produce low-value products. At the individual level, workers decide to invest in skills that will facilitate productive employment in rapidly changing production environments. Individuals may not be compensated fully for investing in high-skill education (there are differences between private and social returns to investment in knowledge) resulting in underinvestment. In this situation, firms react by choosing to produce low-value products, thereby triggering a “low-skill, bad-job trap” (Felipe and Hasan, 2006).

Felipe and Hasan (2006) also point out the importance of gearing human resource programmes for trainability. They define “trainability” as the capacity to understand how to use a given technology and for assimilating new technologies effectively. It is related to improvement of cognitive skills. This means good basic education rather than gearing for a tertiary-level diploma for the majority of students. In addition, low-quality basic education can mean that higher education is merely performing remedial training to cover what was lost in basic education. As noted earlier, the recent extension of basic education in the Philippines from 10 to 12 years is a significant step.

Better cognitive skills will reduce training costs for firms for the majority of its entering workers. Felipe and Hasan (2006) also emphasize the importance of making the structure and content of education appropriate for the economic environment in which most students will live. Without this slant, education can turn out to be urban-biased and contribute to rural-to-urban migration or, similarly, foreign-labour-market biased, thus contributing to an exodus of trained workers abroad.

In the case of vocational training, the emphasis should be on improving the link between industry needs and training provision by allowing industry associations to participate fully in both the planning and conduct of the training.

East Asian and South-East Asian economies have demonstrated how investments in education have kept their workers productively employed as well as propelled their economies into much faster growth. Some (such as the Republic of Korea and Taiwan (China)) have invested ahead of demand. Others (such as Thailand) were forced to reconsider their human capital policies after it became clear that a severe skill shortage was hampering their growth potential. In both cases, the emphasis was on high-quality basic education, and the policy change was accompanied by complementary capital investment.

However, experiences of other countries have also revealed that investment in human capital does not necessarily improve the chances for productive employment and contribute to economic growth. It can even cause new sets of problems. In the Philippines, for instance, the highest unemployment rates are found among workers with secondary education or higher (Figure 5), partly indicating misplaced investments. In addition, investment in human capital has produced what appears to be a dualistic education system in which a few expensive high-quality schools cater to a small set of students while the bulk of the students are enrolled in cheap but low-quality training institutions. As a result, only the

high-wage formal sector benefits from the high-quality training of elite school students but the rest of the economy has to make do with the bulk of poorly trained workers. This situation is also observed in India, where elite schools are presumably providing highly trained workers for a few world-class service sector firms. Thus, investments in education in these cases have contributed to – rather than eradicated – the dualities in the labour market.

Moderating the growth of the population would also be critical in containing unemployment, particularly for countries whose population is still rapidly growing. This is obvious in the case of the Philippines, where low employment elasticities and moderate economic growth failed to reduce the unemployment rate. The RH bill mentioned earlier is important in this context.

5.4 Improving physical infrastructure

The establishment of the AEC will be accompanied by a commitment on the part of Member States to expand regional public goods, especially in the area of physical infrastructure. This will enhance the connectivity of the region. One important example is the proposed ring-shipping route in the West Philippine Sea (or the South China Sea). The Philippines stands to benefit but, at the same time, policy-makers should implement long overdue domestic reforms.

Complementary policies to the AEC are important because trade facilitation may only be of secondary importance in expanding economic activity in the region. For example, Cheewatrakoolpong, Sabhasri and Bunditwattanawong (2013) argue that investment promotion has been more important than free trade agreements in building regional production networks. Hence, the AEC has to go beyond the free flow of factors or production. Policies and reforms to attract investment have to be implemented, and none would be more important for the Philippines than improved physical infrastructure.

The state of infrastructure in the Philippines is depicted in table 6. Almost all ASEAN Member States outrank the Philippines in terms of the quality of infrastructure. An ADB study concludes that “low levels of investment in and poor conditions of infrastructure in the Philippines have increased the cost of doing business in the country and has had significant adverse impact on the perceived competitiveness and attractiveness of the Philippines as an investment destination” (ADB, 2007, p. 5). In other words, poor infrastructure has adversely affected the provision of logistics services and the competitiveness of domestic firms.

Policies to address this problem have been the subject of many studies (see Balisacan and Hill, 2003; ADB, 2007). Some of the recommendations include: catching up with the Electric Power Industry Restructuring Act; increasing reliance on public–private partnerships under the build-operate-transfer law and its variants; and enhancing the partnership and coordination between national and local governments to adequately develop and improve infrastructure. Greater fiscal space will also allow the Government to make a greater contribution to better physical infrastructure.

Other recommendations to improve logistics services in the Philippines:

- invest in modern ports operation;
- utilize the Subic Bay Port and the Batangas Port far more extensively; and
- allow other international airlines to land and pick up cargo business from the Diosdado Macapagal International Airport in Clark, Pampanga.

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ASEAN Community 2015: Managing integration for better jobs and shared prosperity in the Philippines

The economic record of the Philippines since the Second World War has been patchy, making it one of the laggards in South-East Asia. The major reason for the Philippines trailing many of its neighbours in South-East Asia is its inability to participate extensively in regional production networks. Its manufacturing sector, therefore, has declined and employment in manufacturing has also stagnated. The inability to provide medium-skill, high-productivity jobs has much to do with the country's relatively high poverty incidence. The establishment of the ASEAN Economic Community (AEC) in 2015 has the potential to attract more foreign direct investment to the Philippines. This will be an opportunity to revive the manufacturing sector, but only if there is bias towards small and medium-sized enterprise development, which will help overcome the sector's low employment elasticity. Additionally, the AEC will provide added leverage to policy-makers to counter the vested interests of the oligarchy. The AEC will create more regional public goods, especially in terms of physical infrastructure. This is required to increase connectivity in the region, which is necessary to generate more investment. The Philippines stands to benefit immensely, given the existing poor quality of its overall infrastructure.

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