The big question on people’s minds these days is: “What are the prospects of the Philippine economy after the presidential election of 2004?” No one can give a crystal clear answer. But at least, one can analyze beyond what the candidates are saying and think about what they would do if elected.

Before this, however, it is necessary to give a good account of the real economic problems that the president faces once given the mandate to govern after May 10, 2004.

**Philippine economic problems**

There are a few critical problems which may be summarized under four headings that currently afflict the economy. These are: (a) business and investment climate; (b) fiscal deficit and low saving rate; (c) high population growth rate; and (d) weak long-term performance.

* Edited version of an extended paper based on a luncheon talk on “Assessing Philippine Election Politics,” before a group of international investors in the Philippines organized by Citigroup at the Makati Shangri-la Hotel, Philippines, 9 March 2004.

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To some extent, these problems are interdependent. Fix the business climate and some improvement in the economy would happen. Fix the fiscal deficit and the economy could improve further. And so on. The point, however, is that these problems are not as easy to solve as talking about fixing them.

With that said, let me discuss these problems in reverse order.

Weak long-term performance

Philippine long-term economic growth has lagged behind those in East Asia and other leading economies in the ASEAN. One characteristic of this long-term performance is that it has not been steady. Episodes of instability interspersed with periods of good growth characterize said performance. Such episodes mask periodic macroeconomic weakness.

Philippine real economic growth of around 4 percent per year over a long period of time has meant a relatively slow growth of per capita real output. With population growth per year still at a rate that is among the highest in Southeast Asia — at around 2.3 percent per year — only a little is left to lift the standard of living.

Many Filipinos disagree on the causes of the poor economic performance. Some blame politics and weak institutions. They trace these problems to the collapse of the Marcos years, the bickering of the succeeding years, the electricity crisis of the Aquino government, and the years of economic promise cut short by poor leadership. Others advance with the problems of cronyism and corruption. These same problems, however, also afflict other successful countries. But because politics account for the making and implementation of economic policy, these explanations are partly correct.

Meanwhile, economists, including myself, offer a different diagnosis. For them, the long regime of industrial protectionism and discriminatory policies that had favored nationals over the years led to an excessively inward-looking economy that failed to produce export winners. These policies were not wrong in themselves. In fact, all countries pursue some form of protection and favor for their citizens at one time or another. The rhetoric of policy making in fact is often justified to favor the citizens of the country.

The economic policies in the Philippines had taken much longer to reform. By the 1990s, however, the critical changes in reorienting trade and industrial policies had been instituted. The succeeding governments in the post-Marcos years pulled the economy toward a genuine liberalization of economic policy. These policy directions in terms of trade and industry are inevitable if the country is to benefit from the ASEAN Free Trade Agreement (AFTA) as the future regional goal. Membership in the World Trade Organization (WTO) further assures the commitment to the principles of open trade.

These directions would require strong complementary domestic policy measures to assure the growth of investments. While the creation of export processing zones, for instance, has brought about the growth of manufacturing export industries in the past three decades, the mainstream domestic economy, however, has faltered in turning out competitive industries or has
continued to complain about the lack of support. In fact, the highly protectionist and discriminatory policies have produced firms that are essentially weak when opened to the market.

Policy weaknesses continue to impede progress in taking advantage of the economic liberalization program. For the moment, these policies form major stumbling blocks to the domestic economic integration that is essential to the strengthening of the internal economy and the broadening of export growth.

The challenge posed by this problem is how to raise the growth rate so that the Philippines can expand along the same path as the rest of East Asian countries, if not achieve more. This would essentially mean raising the growth rate of the gross domestic product or GDP (not GNP, which is higher than GDP because of remittances of overseas Filipino workers) to around 6 percent per year, a challenge of large proportions. It would also mean addressing the problem of macroeconomic instability. To remove the sources of instability, the macroeconomic fundamentals, which are discussed below, need to be strengthened.

High population growth rate
The country’s population is growing at a rate that is quite high especially in relation to the population growth rates of neighboring countries.

The high growth rate of the population is a problem simply by itself in relation to job creation. The simple arithmetic of improving the standard of living requires that the number of jobs created be higher than the population growth rate.

Employment growth, in fact, has to be greater than the rate of growth of the dependent, young members of the population. Otherwise, the pool of the unemployed persons would increase. This is already being persistently demonstrated by Philippine labor force statistics.

The unemployment rate in the country has been recorded at around eight percent of the labor force. The labor force excludes the population of young people from 15 years old and below. At the same time, official statistics track down underemployment which registers at the range of 16 to 20 percent of the labor force, with visible underemployment at 10 percent.

In short, too many people are seeking jobs that government policy fails to provide. This failure to provide all the needed jobs contributes to a greater poverty among the poor, leading to insecurity for the already poor, and aggravates the already skewed distribution of income.

The growth of the base of young people ultimately creates a large demand on the government and the population of adults to provide resources for food production, housing, social services like education, health and nutrition, and the expansion of the social overhead just to maintain existing living standards.

On the part of the government, the resource demands are large and instead of devoting resources to improve physical infrastructure, the government is perennially faced with resource demands for economic and social services to help provide for the needs of the young, the poor and the unemployed.

The challenge posed by this problem, therefore, is for the national leader—the president—to raise efforts in having family planning more widely adopted, educating the nation in such pursuit, and getting the private sector to work fully on this program.

Fiscal deficit and low domestic saving
In recent years, after 1998, the deterioration of the fiscal deficit has raised concerns about its sustainability. In 2003, the deficit was 5.3 percent of GDP, as compared to a low 1.9 percent of GDP in 1998. Evidently, the fiscal deficit needs to be put under rein.

Because of the fiscal deficits, the government has become a net consumer of domestic private saving rather than a source of public saving. As a result, the...
The fiscal problem is further aggravated by debts of government entities (public corporations) that are unable to pay for their own operational upkeep. Often, and in the case of the large government entities, these debts are raised through the foreign capital markets.

The same problem extends to parts of the private sector today, especially the highly indebted segment. Many domestic industries are still dependent on industrial protection. Some of these enterprises have difficulty generating profits and are in dire financial straits. Thus, they produce low savings, if at all. This is another explanation for the poor saving rate of the Philippine economy. Poor private domestic saving is part of the story of industrial protectionism in the Philippines.

The contrary experience has been observed elsewhere in the region which basically constitutes the main story of the so-called Asian miracle. When industries are competitive internationally, they make profits. These industries contribute to a growth of saving. Their employees are also often prosperous. The personal earnings of wage earners add further to the flow of domestic saving.

There are other reasons for the problems arising from the fiscal deficits. Domestic reasons for the fiscal deficits are tied to tax reform issues. The revenue effort in recent years has deteriorated from above 15 percent of GDP to around 10 percent of GDP. A shift in the tax structure of excise taxes and problems related to tax administration helped to reduce the revenue effort. One instance is the case of highly revenue-productive excises that used to have ad valorem basis being restored to per physical unit taxes. Once inflation set in, the tax rates were not adjusted because this required legislation.

Another face of the fiscal deficit arises from the expenditure side. Many observers criticize the government for wasteful spending, from having too large a payroll, and for being unable to deliver services efficiently. This problem is endemic. It is related to the weak state of institutions in the country and requires long-term efforts at correction.

Still another face of the fiscal deficit problem, which relates to the government entities’ case that was mentioned earlier, is the growing contingent liability arising from these government corporations. Said corporations are often public utilities that should be able to recover their costs. However, they continue to run operational deficiencies partly as a result of the inability to get approval for their tariff rate increases. Moreover, there are cost inefficiencies associated with operational processes in these firms.

The privatization program was supposed to take care of these problems to improve cost efficiency and to remove the problems from government responsibility. Unfortunately, the privatization program got held up during the time of the Estrada and Macapagal Arroyo administrations. Instead of actively pursuing the program, the incumbent president did not pursue any major privatization activity in three years.

The fiscal deficit can actually be fixed more quickly than the other problems. In recent years, however, it is the one that has worsened. While the peace and order situation and other kinds of crises related to the new climate of anti-terrorism have redirected some public finances, the story about taxes and other aspects of public resource mobilization cannot put blame on these problems.

When the deficit unravels and becomes large, it could also be the source of the
most damaging of problems. Even though it is sustainable in the short run, it could lead to undesirable outcomes. The fiscal deficit competes with private use of resources—credit—which is lifeblood to the private economy. External analysts often look at the fiscal deficit as the bellweather indicator for sovereign debt evaluation. It could upset domestic prices, and further contributes an impact on the peso exchange rate.

When the government has good control over budgetary expenditures, the fiscal sector is perceived in favorable ways. The government would no longer compete with private domestic credit. Private investors could be more actively engaged in the country’s future. This would by itself help to attract new investments and stimulate interest among foreign direct investors.

Until the fiscal sector is brought under control, the domestic rate of saving would continue to be low. The present rate of around one-fifth of GDP is not anywhere close to the high saving rates in East and Southeast Asia. What the country needs is to stimulate private domestic saving. Clearly, domestic saving rises only under a period of rising incomes. It helps when the fiscal sector is put in balance, and if possible, with a surplus, so that state finances add to the domestic rate of saving. The fiscal sector ought to be able to contribute toward raising the total level of saving in the economy, through an increase of public saving.

Reforming the fiscal sector poses a serious challenge to the country’s leadership. It has to raise taxes, boost public expenditure cost effectiveness, and require public corporations to produce resources for the public coffers rather than serve as a source of drain. This requires a leadership that is able to form sufficiently strong coalitions of followers in the legislative branch to produce the necessary laws to improve fiscal performance.

Business environment and the investment climate
The business environment needs to improve in many dimensions. Of course, many of the problems in the country are no different from those found in other countries. But there are also problems that are unique to the Philippines which pose challenges to any incumbent president such as: a) the separatist insurgency in Mindanao, b) the communist New Peoples’ Army revolt, and c) from the right, the clandestine elements in the military which, in the past, wanted to force a change in the government. A leader capable of forging national unity would use political leverage to solve these problems politically.

Sometimes, though, these problems appear to be blown out of proportion, especially in the perception among the international community. (In part, this is due to the openness of the Philippine press that tends to sensationalize news events, especially when adverse or negative.)

Perceptions and psychology often lead to overreaction to adverse news arising from these problems. Market irrationality often results from knee-jerk reactions to developments about the country. They translate in terms of perceptions about the country’s stability and the sustainability of its policies, sometimes affecting the value of the peso.

In my view, however, the most important problems affecting the business and investment climate go beyond the above problems. And the nation’s leaders have to address two major areas of reforms, which are very politically sensitive. Addressing these issues correctly could produce the greatest impact on the economic future of the country. Working on them halfheartedly, on the other hand, could assign the Philippines to a low economic performance level in development for many decades further.

What are these two issues?

Economic provisions of the Philippine Constitution
One refers to the economic provisions of the Constitution. They need to be reexamined. The provisions are the handmaidens
Many decisions of the Philippine Supreme Court on investments that have to do with land ownership, with exploitation of natural resources, and those that may yet come on the ownership of public utilities, have affirmed the basic provisions of the nationalistic provisions in our present Constitution.

These economic provisions relate to the nature of equity ownership of public utilities and the exploitation of natural resources reserved to Philippine corporations having a minimum limit of 60 percent equity ownership. In addition, no foreigners can own land in the country.

These provisions have become the binding constraint that prevents the entry of foreign direct investments in public utilities, participation in land ownership, and investments in natural resource exploitation. The nationalistic economic provisions were imbedded in the 1935 Constitution. These provisions have continued to remain sacrosanct despite many constitutional changes undertaken in the past. The economic provisions represent the hardcore economic issues of stimulating more efficient financing of investments in the economy.

There is an active discussion of constitutional issues in the country that requires amendment. But the focus of the public discussion—mainly brought forward by politicians—is on the political structure of the country and not on the economic provisions. The scandal of a finished modern airport that is not being used is intertwined with the complicated problems of financing infrastructures for the country. The slow development of the waterfront of Manila that represents a large investment in real estate reclamation is another example. The decline in mining activity in the country has been the result of lack of capital and technology.

The country today faces the binding constraints of insufficient domestic saving. The build-up of external debts to finance current investments is a simple illustration of the binding financial constraints facing Philippine development efforts. The country has to finance requirements for building the investments for a modern economy based on the convenience of physical infrastructure, efficient and well-financed public utilities, and highly capital-intensive industries that would integrate the existing domestic industries with the growth of export industries.

One consequence of inaction on the constitutional front would be for the country to be bypassed by foreign direct investments at a critical time when the country needs to finance large-scale infrastructure investments to energize the economy.

Many decisions of the Philippine Supreme Court on investments that have to do with land ownership, with exploitation of natural resources, and those that may yet come on the ownership of public utilities, have affirmed the basic provisions of the nationalistic provisions in our present Constitution. In recent decisions, for instance, the Supreme Court declared unconstitutional the participation of a foreign company in land reclamation and development. The Court also declared unconstitutional a law on the mining industry on the ground that service contracts with the government did not meet constitutional prerequisites.

The inadequacy of risk capital in these public utilities and in the provision of infrastructure services has contributed to high external debts to finance much of these projects. When public utilities are poorly financed, the owners make short cuts in their services, and they are badly hampered in expanding these. The electricity crisis of the 1990s is a reminder that the lack of a vibrant private sector provision of public utilities in electricity service can cause untold economic costs to the country.

The nationalistic provisions of the constitution led to perverse results. It enabled generations of national leaders to deed vast areas of the country’s natural resources to undercapitalized cronies—many political and other economic supporters—that encouraged the unmitigated and indiscriminate exploitation of the country’s natural resources. Today, the country’s
need to finance the large requirements of physical infrastructure—transport and port facilities, water resource management, and energy investments—depends on an ability to help mobilize foreign risk capital to participate in these investments.

The key to the unlocking of the participation of foreign risk capital in the country’s economic development depends on how fast these constitutional provisions can be amended. When this is undertaken, it would relieve the country of the huge constraint that it now faces. The lack of domestic saving could be supplemented by foreign private risk capital. In this setting, foreign loan capital will likely further supplement private foreign ventures.

If the foreign ventures are well capitalized, they can borrow from world markets or from their own financing partners more cheaply than a sovereign borrower whose borrowing costs will be above prime rates if its credit rating is not sufficiently high (as is the case with Philippine sovereign credit ratings over the years as long as it is subject to fiscal tightness).

This will free a lot of resources to the government, thereby allowing it to undertake a better management of the country’s fiscal resources. It would make the government reduce the burden from foreign borrowing in the public accounts. An effective leader in charge of the nation’s destiny could educate the politicians and the people on this very important issue.

The fact that it is not being discussed at present does not mean it is a dead issue. The huge demand on fiscal resources today requires the government to look for alternative means of financing the country’s continuing infrastructure needs. A prime candidate for imaginative solution is to open foreign direct participation in these economic activities. This means facing to the politics of amending the economic provisions of the Constitution.

Reform of labor market policies

Accepting globalization means opening up to the risks and rewards of international trade competition. This, however, requires a review of labor market policies because this is one area that has not been touched upon in the many reforms undertaken by the government. For many years, the main bulk of labor-intensive export operations in garments, shoes, textiles, and articles for the home made the countries in East and Southeast Asia richer, more prosperous, and paved the way for their deeper industrialization. That stage evaded the Philippines.

Philippine labor policies have built a body of laws that has pushed abundant Filipino labor out of labor-intensive industries. The welfare provisions of the labor laws also introduced great rigidities that have robbed enterprises in decisions affecting the adjustment of employment size in their operations.

The unit labor cost of Philippine labor is one of the highest in the region. At the same time, unemployment and underemployment rates are also among the highest as earlier stated.

In industries that have employed manufacturing labor and brought this into highly competitive export industries, the experience with the growth of labor productivity has, in general, been a solid one. In these firms, labor productivity grows because of higher investments in capital.

The unit labor cost of Philippine labor is one of the highest in the region. At the same time, unemployment and underemployment rates are also among the highest...
Like the issue of the revision of the economic provisions of the Constitution, no politician talks about this important issue. The reform measures, at first glance, would appear to be charged against labor and that would, in fact, be how they would be played out in the battle for change. Yet, these reforms would favor labor, especially in the long run. The reform carries enormous opportunities for the country to exploit. What is needed is to design a way by which the short run costs can be overcome in order to gain headway in promoting greater flexibility in the labor market.

With flexibility in the labor market, the country can improve the attractiveness of labor both in the mainstream domestic market and, of course, in the export industries. It would strengthen competitiveness of Philippine labor in the market place. This would encourage investments in small and medium industries and help speed up the hiring of more labor for domestic industry. The danger of the current situation of highly rigid provisions of the labor laws is that loss of competitiveness would increase poverty because of the exodus of jobs and continued high unemployment rates in the country.

When the future of the AFTA became clear and the country joined the rules of world trade under the WTO, foreign direct investments, including those already operating within the country, looked for cheaper sites for directing their manufacturing and trading operations. Quite a number of them closed shop in the Philippines and transferred their manufacturing operations to Thailand and Indonesia. Moreover, some of the companies that used to employ labor for the assembly of some semiconductor parts moved their operations to China and other countries.

It could be further concluded that companies that had planned to put manufacturing operations in the region had considered the Philippines. But the same factors that made other companies move out might have caused them to migrate elsewhere. For how do we explain that the increases in foreign direct investments in the abovementioned countries, including Vietnam, had been more buoyant than the investment flows to the Philippines?

The government needs to refocus labor policies to deal with all of the labor force and not only with employed labor in particular. A capable leader should be able to educate, inform, and change the directions of debate on these issues in order to reform these policies. Such a leader could address the larger issues of forging social compacts with labor to assure industrial peace while securing more investments in the country. It is possible to design severance package and retraining of workers within the firm to minimize the costs of the adjustment in reforming labor contracts.

In short, the country's leader would need to address very difficult national economic issues that challenge long held beliefs about economic nationalism and labor welfare in order for the country's investment climate to improve immensely.

The GMA scenario and the Philippine economy

Gloria Macapagal Arroyo has a track record of more than three years. This experience speaks for itself. As they say it, what you see is what you get. This presidency has been rocky. Would another six years mean better results? Her track record represents decisions that she has made in the course of her presidency, and that quantity leaves a trail of past actions.

Under her presidency, the country's economy would continue to move according to its natural course: rocky but forward. How would she face the major problems that were discussed above? In the three years that she was in charge, she has not pointed out the major issues as stated above. Perhaps she considers these issues as too divisive. By avoiding the hard issues, no progress would move forward in correcting them. Is this political expediency or simply tactical?

GMA projects the strict schoolmaster image. Her choice of economic issues has
been to avoid the controversial reform issues. She has taken a risk-averse attitude to them. Yet she works hard on the basis of office visits to critical government offices and projects, travels to provinces, and meets with the cabinet where she herself presides (a marked contrast to Estrada when he was president).

Nonetheless, she has not been the cementing type of leader. She has failed to make Congress work for her program effectively. Her leadership is essentially in gridlock with the legislature whose output on economic issues is few, and zero on the most critical—reform of the ill-performing tax system.

To some extent, this meager outcome might have emanated from her need for a true electoral mandate. But she had the powers of the office to implement the programs of government. She succeeded in the shoes of Estrada who was driven out by a second people power revolt.\(^1\) She is competent and understands what she does. But she tends to be more political in her decisions, with economic issues often in retreat for political accommodation. Her program has not put forward major discussion of reforms that the nation needs for further development.

She has reversed the liberalization program—raising tariffs across a wide range of industries. Her excuse: the tariff liberalization went too far. She was courting support of the protectionist industrial class. She has postponed programs tied up with the liberalization of trade in agriculture.

Under her care, the fiscal deficit has become a problem again. In addition, contingent fiscal deficit keeps rising. The privatization program for the reform of the energy sector and the programs related to food grains marketing did not materialize—not yet anyway. Such delays have contributed to the slowed flow of larger foreign direct investments in some sectors.

Still, she has made inroads in some sectors of the economy. Recent lifestyle checks of public officials in the critical and often presumed to be corrupt public agencies had put some teeth to the anti-corruption efforts. There is need for the government to follow up these efforts with convictions. There is an apt term that Filipinos use to describe half-hearted efforts—ningas cogon. Follow through is what counts, but ningas cogon often leaves agenda unattended once the main splash on public attention is made. If only these were made early in her presidency and not during an election period, then we would know whether some results are bearing fruit.

There is one strikingly successful program for which she can with good reason claim credit. The government has provided much significant support to the development of the IT sector. Here, the facilitation by government has promoted essentially market-driven strategy and it is working. It did not require government resources to be redirected, as the government is hard up financially. But by allowing the private sector to move together with the government in opening the way, the industry has accomplished much to foster the enabling environment.

As a result, the information and telecommunications sector has become a growth industry in the IT service industry. The growth of the IT sector is essentially market-driven, with the private sector taking the lead and foreign direct investments taking into account the excellent opportunities offered by the competitive segment of the labor force which the country has.

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\(^1\) This arose during the vote in the Senate impeachment proceedings which prevented the opening of an incriminating envelope that was to provide smoking gun evidence against Estrada in the impeachment for corruption and plunder. After Estrada’s supporters in the Senate won the vote by a margin of one, the nation broke into a political protest that brought down the government.
Export leadership: Does success in one breed failure in another?

by Ma. Teresa S. Dueñas-Caparas and Sandra M. Leitner*

A look at the Philippine electronic and garment sectors

T. Friedman

Introduction
The phenomenal export success of Asian economies was basically anchored on two industries—electronics and garments. The rise of the electronic industry may be regarded as a natural course of event in economic transition given the birth of the technological age complemented by rapid changes in technology. In a similar fashion, the garment sector continues to benefit from strong world demand where much of the technological changes occur through process technology.

In the Philippines, the electronic industry is undoubtedly the export leader with approximately 60 percent of the country's foreign earnings generated by the industry in 2000. Prior to this, however, the export leader slot belonged to the garment industry. Together, these two industries provided the country a notable growth in exports. The electronic and garment sectors posted average export growths of 11 percent and 8 percent, respectively, for the past 20 years, even higher than the total manufactured exports (Table 1).

Two interesting and uncommon observations can be deduced from the pattern and structure of Philippine exports.

Table 1. Growth of exports (in %)

<table>
<thead>
<tr>
<th>Year</th>
<th>Merchandise Exports</th>
<th>Garments</th>
<th>Electronics</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td>(17.43)</td>
<td>(1.51)</td>
<td>(34.47)</td>
<td>(9.14)</td>
</tr>
<tr>
<td>1990</td>
<td>4.51</td>
<td>8.31</td>
<td>8.54</td>
<td>(1.86)</td>
</tr>
<tr>
<td>1996</td>
<td>1.75</td>
<td>(4.68)</td>
<td>9.56</td>
<td>1.17</td>
</tr>
<tr>
<td>1997</td>
<td>13.28</td>
<td>(8.35)</td>
<td>26.94</td>
<td>17.29</td>
</tr>
<tr>
<td>1998</td>
<td>9.23</td>
<td>4.22</td>
<td>7.78</td>
<td>12.53</td>
</tr>
<tr>
<td>1999</td>
<td>0.09</td>
<td>(3.40)</td>
<td>1.89</td>
<td>0.38</td>
</tr>
<tr>
<td>2000</td>
<td>16.38</td>
<td>9.51</td>
<td>20.08</td>
<td>16.72</td>
</tr>
<tr>
<td>Average</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1982-1990</td>
<td>4.50</td>
<td>13.64</td>
<td>10.47</td>
<td>(1.67)</td>
</tr>
<tr>
<td>1982-2000</td>
<td>7.37</td>
<td>8.54</td>
<td>10.69</td>
<td>7.03</td>
</tr>
</tbody>
</table>

Source: Selected Philippine economic indicators

* Respectively, Supervising Research Specialist at the Philippine Institute for Development Studies and Visiting Researcher. At present, both authors are Ph.D. candidates for the program Economics of Technology and Technical Change at the University of Maastricht, the Netherlands. This phenomenon is of research interest in the field of industrial organization. Unfortunately, theoretical and empirical analysis of this occurrence is beyond the scope of this paper.
Two, there is a peculiar pattern observed in the export shares. In 1992, the share of the electronic industry slowly increased while that of the garment industry gradually fell. While this seesaw was taking place, the export share of the rest of the manufacturing sector remained relatively constant at approximately 50 percent (Figure 1). This pattern suggests that improvements in the export performance of the electronic sector as measured by share to total manufactured exports simultaneously occurred at the detriment of the garment sector. Putting it crudely, the electronic sector was “eating up” the share of the garment sector.

Studies analyzing the rise of the electronic sector and the fall of the garment industry in the Philippines separately point to a well-positioned market access and poor quality upgrade due to lack of technological development as contributing factors to said trends (Lall 2000). Surprisingly, none of the studies linked the two industries together despite the fact that both are high export performers.

This paper explores a possible explanation to the export leadership observation by providing an alternative view in interpreting some observable data from the top exporting sectors in the Philippines. It proposes that apart from the internal and external factors that affected the regression of the garment sector, the success of the electronic industry was also a significant contributor to the garment industry’s failure. In analyzing the two sectors, this paper adopts a different approach by treating them as partly dependent on each other rather than as mutually exclusive sectors. As a result, it was uncovered that aside from being high-export performers, the two industries share a common element—an intensive use of the unskilled labor. This research thus puts forward the idea that rivalry between sectors for export leadership is conceivable through the factor market arena.

Export leadership: a new ballgame?
Conceptual underpinnings for rivalry
Competition between firms is a widely established occurrence. Firms compete against each other to gain a large market share and maximize profit. As firms engage in competition, the challenge for them essentially is to become more efficient.

Rivalry takes on two forms. The common form is that of rivalry between firms selling their products in the same market (called product market.) The other form of rivalry, which is not so explicit, is between firms that intensively use similar factors of production. This form of rivalry takes place in the factor input market.

Given that there is an abundant source of factor input, comparative advantage dictates that this specific factor input will be used extensively in production. The crucial element in the analysis is the extent by which said factor input is utilized by the firms. If two industries aim to be export leaders, and both industries are intensively making use of the same factor input (say, labor), then it follows that the expansion of one industry (output-wise) would have an effect on the other industry ceteris paribus. In order to attract the required factor input, better incentives will be offered by that sector which values its laborer more. An observed precondition for firms to be considered rivals in the factor market is the presence of similar or converging factor input intensities.

The Philippine case: brief overview
The export leadership position in the Philippine manufacturing industry has
been confined to two industries for the past 20 years – electronics and garments.

Electronic products were the main export products in the 1980s until the garment industry flourished and earned the top exporting slot in the 1990s. Unfortunately, as mentioned earlier, this post was not sustained by the garment sector when external and internal concerns flooded the industry.

The switching in the export leadership position was in effect a response to the dictates of the world market as well as to national policies. As an export leader, a firm or an industry naturally gets the opportunity to reach bigger markets and make higher profits. It also enjoys certain incentives and support measures that are granted by the government to enable it to establish and maintain such a leadership position. Certainly, these are attractions that egg a firm or industry to vie for an export leadership post, as they did for both the electronic and garment industries as they strove for dominance in the export field.

The Philippine garment industry is the country’s second highest foreign exchange earner, roughly accounting for 18 percent of the total manufactured exports in the year 2000. Average export growth for the period 1981-2000 was approximately 11 percent, surpassing that of total manufactured exports. The industry slowly gained export momentum in the early 1980s and reached its peak in 1991 with its share to total exports reaching 36 percent. After this period, though, its robust export performance gradually diminished due to a host of macro and microeconomic factors such as rising labor cost, poor technology development and lack of industry direction (Abrenica and Tecson 2001, Cororaton 1997 and Austria 1996).

The industry is a small player in the world market and caters mostly to low-end and low-price markets. It strongly competes with producers from Mexico, Bangladesh, Vietnam, Thailand and Taiwan. Its structure and performance had been shaped by past industrial policies that transformed it from a cottage-based industry in the 1950s to a high export performing sector in the 1990s. The export-oriented stance of the government opened the industry to direct foreign competition that led to an increase in the number of players and a reduction in industry concentration. Labor and capital productivity significantly improved and industry value added rose from traditional tailoring to high-value embroidery and ready-made garments (Table 2).

Unfortunately, even as the government recognizes the need to improve the industry’s competitive position in the world market (which is partly shaped by the ability of the producers to offer competitive prices, adopt common compliance standards for buyers, shorten turnaround time, produce zero defects in products, and a variety of factors), the garment industry was not able to cope with the challenges and failed to upgrade and improve its quality to be able to maintain a competitive position in the world market. Today, it is headed for oblivion.

Considered a dying industry, Philippine garment firms are now losing their competitive edge and are threatened by firms from other rising Asian economies like Vietnam and China. Lall (2000) observes that the local industry, initially the front-runner in manufactured exports, currently suffers from the following: poor utilization of cheap but skilled labor force; low

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of firms</th>
<th>Employment</th>
<th>Value of output (₱)</th>
<th>Value added (₱)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>28,178</td>
<td>152,260</td>
<td>3,391,710</td>
<td>1,594,344</td>
</tr>
<tr>
<td>1985</td>
<td>413</td>
<td>86,163</td>
<td>4,837,617</td>
<td>1,954,395</td>
</tr>
<tr>
<td>1990</td>
<td>1,550</td>
<td>167,676</td>
<td>23,547,320</td>
<td>10,184,670</td>
</tr>
<tr>
<td>1991</td>
<td>1,776</td>
<td>172,874</td>
<td>33,293,046</td>
<td>13,700,259</td>
</tr>
<tr>
<td>1992</td>
<td>1,861</td>
<td>177,531</td>
<td>32,522,747</td>
<td>13,548,693</td>
</tr>
<tr>
<td>1993</td>
<td>1,722</td>
<td>161,609</td>
<td>36,848,131</td>
<td>14,733,760</td>
</tr>
<tr>
<td>1994</td>
<td>1,612</td>
<td>145,980</td>
<td>36,536,223</td>
<td>17,678,645</td>
</tr>
<tr>
<td>1995</td>
<td>1,495</td>
<td>144,586</td>
<td>36,035,820</td>
<td>15,763,895</td>
</tr>
<tr>
<td>1996</td>
<td>1,892</td>
<td>155,609</td>
<td>53,998,216</td>
<td>16,885,639</td>
</tr>
<tr>
<td>1997</td>
<td>2,003</td>
<td>158,987</td>
<td>50,577,028</td>
<td>19,094,857</td>
</tr>
</tbody>
</table>

Source: Annual Survey of Establishments
technological and design activities and weak technical support for domestic firms. Thus, the decay of the industry is significantly affected by its lack of technological development and poor industry foresight.

On the other hand, the electronic industry (mainly semiconductors) is currently considered the Philippines’ economic powerhouse. Once a fledgling industry that began in the 1960s, it is now the top export performer in the country with total export receipts reaching close to US$17 billion in the year 2000. In terms of export share, it ate up 33 percent of total manufactured exports in the same year. There are approximately 575 companies registered in the Semiconductor and Electronics Industry of the Philippines Association, majority of which are engaged in the assembly of computer components and devices, telecommunications, office equipment and consumer electronics.

The country boasts of a large pool of highly skilled, educated and English-speaking labor that is a major attraction to foreign electronic firms. Most of the semiconductor units assembled in the country, such as microprocessor and specialized chips, are basic components of technology equipment subcontracted by foreign customers. Foreign giant companies like Intel, Motorola, Texas Instruments and Philips dominate the industry. Increasing global demand continues to put positive pressures in the industry and is expected to lead to higher growth in the future (Table 3).

The combined outputs of the garment and electronic industries comprise the bulk of Philippine exports. Unfortunately, one major structural weakness of these two leading export-oriented industries is their lack of technological development. This is highlighted by macroeconomic issues that include the quality and relevance of the country’s education and training system to the industries’ requirements, and the incompatibility between industry needs for employment and school training. Thus, while it is said that the worldwide rise of the electronic industry came at the onset of technological advancements, the Philippine electronic industry nevertheless has remained unsophisticated and is classified as a high-technology industry that requires low-skilled labor for its operations. For its part, on the other hand, the garment industry’s poor absorption of technological advancement makes it a low-technology sector that similarly requires low-skilled labor.

### Table 3. Selected indicators for the electronic industry

<table>
<thead>
<tr>
<th>Year</th>
<th>No. of firms</th>
<th>Employment</th>
<th>Value of output (₱)</th>
<th>Value added (₱)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>293</td>
<td>49,405</td>
<td>5,042,739</td>
<td>1,487,039</td>
</tr>
<tr>
<td>1985</td>
<td>148</td>
<td>37,608</td>
<td>10,806,309</td>
<td>2,899,687</td>
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<tr>
<td>1990</td>
<td>228</td>
<td>76,003</td>
<td>48,593,302</td>
<td>17,141,476</td>
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<tr>
<td>1991</td>
<td>272</td>
<td>89,834</td>
<td>71,121,135</td>
<td>23,882,279</td>
</tr>
<tr>
<td>1992</td>
<td>296</td>
<td>102,025</td>
<td>80,458,679</td>
<td>22,730,314</td>
</tr>
<tr>
<td>1993</td>
<td>265</td>
<td>98,645</td>
<td>81,397,328</td>
<td>23,308,284</td>
</tr>
<tr>
<td>1994</td>
<td>271</td>
<td>107,910</td>
<td>102,220,695</td>
<td>25,341,974</td>
</tr>
<tr>
<td>1995</td>
<td>287</td>
<td>127,058</td>
<td>125,954,805</td>
<td>34,953,900</td>
</tr>
<tr>
<td>1996</td>
<td>300</td>
<td>122,529</td>
<td>142,934,042</td>
<td>48,626,026</td>
</tr>
<tr>
<td>1997</td>
<td>302</td>
<td>131,820</td>
<td>188,857,877</td>
<td>59,239,546</td>
</tr>
</tbody>
</table>

Source: Annual Survey of Establishments

What are the possible explanations to this occurrence?

The initial step in trying to understand this phenomenon is to determine the factors that influenced the performance of both sectors. Previous studies have identified these factors which range from well-positioned market access for the electronic industry to poor quality upgrade due to lack of technological development for the garment sector (Abrenica and Tecson 2001, Lall 2000). None of the studies, however, as noted earlier, linked the two industries together.
A way of linking the two sectors together in analyzing sectoral performance is to start with the basic building block of trade. Basic trade theory states that a country exports a product that intensively uses the country’s most abundant factor input. This is the essence of comparative advantage. In the Philippines, this abundant factor input is, undoubtedly, labor. Between the two export performers, the garment industry is the bigger source of employment (Figure 2). During the period 1980-90, the share of the garment industry to total employment reached as high as 30 percent. This, however, dropped significantly starting 1990. Almost simultaneously, meanwhile, that of electronics was seen to be gradually increasing. It is interesting to note that while the labor shares of both industries were converging (from 1989 to 1996), the share of the rest of the manufacturing sector remained stable—a pattern similarly exhibited in its export share performance.

The type of labor can be broken down into skilled and unskilled. While skilled laborers acquire firm and industry-specific knowledge over time, the same cannot be said for unskilled laborers. Unskilled labor is basically defined as manual labor where actual work is limited to operating simple machines and does not acquire firm or industry-specific knowledge. This definition implies that any firm in any sector can employ unskilled laborers. This essentially makes unskilled laborers very mobile.

Perhaps the most revealing observation is inferred from the nonproduction labor share (NPLS), which is calculated as the ratio of skilled over unskilled labor per industry (Figure 3). The NPLS for the electronic sector dropped constantly beginning in 1985 while that of the garment sector remained at around 0.06. This implies that the skill-composition of the electronic industry became more unskilled-labor intensive in spite of its supposedly hi-tech nature. This is not surprising because most of the production activities are confined to assembly and simple testing procedures that require minimal skills. The low ratio in the garment sector also indicates that the sector is highly unskilled-labor intensive.

Again, what is interesting is that the calculated skill ratio for the rest of the manufacturing sector is relatively stable compared to the two industries. With unemployment rates fairly constant at 6 percent, the ratios imply that most of the unskilled workers from the garment sector moved to the electronic sector during the declining stage of the former. It was observed in some studies that during economic stagnation, the unskilled workers are laid off first while the skilled workers are hoarded. This practice makes it fairly easy for unskilled laborers to move across other sectors.

The possible movement of workers from the garment to the electronic sector is more than viable. Given the attractive compensation package provided by the electronic firms, as seen in Figure 4, it becomes clear to the labor market that they value their employees well. In contrast, the compensation packages offered by the garment firms were not as impressive in spite of the industry’s ability to meet world demand. The labor situation became more burdensome when some garment firms ran into financial troubles and would only hire workers on a six-month contractual basis (Cororaton 1997).

Figure 2. Labor shares (in %)

Source: Annual Survey of Establishments, various years.

2 Compensation is defined as basic salary and other allowance that includes overtime pay, transportation and cost of living allowances.
The above discussion shows that the two top export performers in the Philippines intensively utilize unskilled labor in their production. Because both sectors primarily rely on this factor input, the possibility arises that they are rivals in the factor market. The idea is stretched further by espousing the possibility that the electronic sector is siphoning off workers from the garment sector.

Two circumstantial evidences can support this hypothesis.

One, the geographical clustering of the electronic and garment firms, especially in the export processing zones, makes it easy and accessible for workers to transfer from one firm to another. The flow of labor-related information, such as job openings and salaries, is simple and transparent in this kind of environment. And two, the workers in focus are unskilled and, theoretically acquire minimal (or none) firm-specific training. Said minimal training—if at all—is certainly not enough to potentially lock them to a firm. Thus, information like the expansion of a certain electronic firm could entice an unskilled worker from the garment firm to transfer, given the other firm’s higher wage and job security packages.

If the worker-siphoning occurrence is considered, it then gives rise to the question: Why would an electronic firm be attracted to hire, or even pirate, a garment worker given the large pool of other available workers?

The possible explanation lies beyond the statistics. While it is true that these workers’ skills may not be that high, their acquired work attitude and behavior are attractive enough. A certain work ethic and attitude is developed from working in firms with a global vision. This is an attractive factor which drives electronic firms to consider hiring garment workers over other aspiring workers. Garment workers have acquired and developed a particular work attitude from working in a sector that used to be the top exporter in the country.

Figure 3. Nonproduction labor share (NPLS)

Emerging issues

This paper raises some alarming issues based on the preceding observations. Foremost is the suggested rivalry for unskilled labor between the two top export performers. Two key factors are emphasized: rivalry and unskilled labor. The prominence of unskilled laborers in these industries gives rise to the second issue, which is the reliance on this type of workers for the industries’ growth and development. More specifically, while unskilled laborers play an important role in the development of these industries, in particular, the electronic industry, any progress built on the basis of using unskilled labor is bound to have problems on sustainability.

The implicit competitive behavior of these industries in the factor market is most likely anchored on the race for export leadership. Two possible scenarios could explain the movement of unskilled workers from one sector to another: an aggressive effort of the electronic firms to siphon off workers from the garment firms, and the increased absorptive capacity of the electronic firms as a result of the contraction of the garment industry. Whatever case it may be, the transfer of workers suggests that there is a systematic process involved in acquiring unskilled workers in the development of these sectors. This more than suggests that the simultaneous success of the electronic
industry and the failure of the garment industry are not merely coincidental. Hence, treating these sectors as mutually exclusive of each other will not provide a complete assessment of a sector’s progress (or stagnation, as in the case of the garment sector).

An immediate effect of the increased demand for unskilled labor is reflected in the rising wages of said workers over time (Figure 5). While the increase in the quantity of gainfully employed unskilled workers may have a desirable income effect, this situation is only in the short term. If the quality of the worker remains unchanged, the prospect for higher pay per worker remains bleak. This observation is based on the declining skills requirement of the electronic sector and the low but constant skills requirement of the garment sector as shown in Figure 3. As long as the electronic sector limits its activity to assembly and simple testing, and the garment firms do not upgrade their technology, these sectors will continue to simply require unskilled laborers for their production.

And this leads to a more alarming issue that concerns the sustainability of performance of both sectors. At present, the Philippine electronic and garment industries benefit from strong world demand. Their respective performances are anchored on their level of competitiveness relative to the world market. Given the fact that their individual outputs are secured on unskilled labor, however, brings about the issue of sustainability. The improvement in the quality and quantity of products depend on a corresponding upgrade in skills and capital formation (Grossman and Helpman 1991). For example, the electronic sector’s lack of wafer fabrication in the sector’s line of production becomes a major challenge in its sustainability. As such, there must be a complementary labor force skilled enough to operate the plant. On the other hand, the garment sector has to upgrade the quality of its products and adopt new technology. And like the electronic sector, this requires the acquisition of appropriate human resources.

Summary and conclusion
This paper examines the export performance of the electronic and garment sectors in the Philippines in the last 20 years. It does not contradict previous studies on the rise and fall of the electronic and garment sectors but merely presents a different perspective in analyzing export performance. In its analysis, the paper shows that both sectors, over time, have relied on unskilled workers for their production, thereby inferring that the intensive usage of unskilled labor could be the linking factor between these two top export industries. This continued heavy

\[ Quality\text{ in work improves with acquisition of skills and knowledge.} \]
reliance on unskilled labor, though, raises some disturbing questions about human resource development, sectoral growth and sustainability. Certainly, these are valid issues that have strong policy implications and must be seriously looked into. DRN

References


Data Appendix

✦ Average wages/salaries per unskilled employee - wages and salaries for production workers over total number of production workers.
✦ Export share - industry exports over exports of overall manufacturing.
✦ Labor share - industry specific labor (i.e., skilled and unskilled) over employment in total manufacturing.
✦ Nonproduction labor share - industry specific skilled over unskilled labor (i.e. paid managers over production workers).
✦ Paid employees - all persons working in the establishment receiving pay as well as those working away from the establishment when paid by and under the control of the establishment. Also included are persons either working fulltime or parttime.
✦ Salaries and wages - payments in kind or cash, prior to deductions, to all employees. Included are basic pay, overtime pay, and other benefits.
✦ Skilled labor - paid managers.
✦ Total compensation - includes salaries and wages and employees contribution to SSS/GSIS and the like (SSS/GSIS are mandatory deductions akin to public health insurance).
✦ Total employment - refers to the average number of persons who worked in or for the establishment during the year and consists of paid employees and unpaid workers.
✦ Unpaid workers - include owners who do not receive regular pay, apprentices and learners without regular pay, and persons working without regular pay for at least one third of the working time normal to the establishment.
✦ Unskilled labor - production workers only (excluding “Others”).

Editor’s Notes from page 1

laid down are enormous, whose responses call for a sense of urgency. To address them, the president must be ready to make unpopular decisions and face the wrath of various sectors. In the end, only a firm, deliberate and focused response to the key issues will help the nation survive and progress. Certainly, a price worth paying for.

Just as it is for the country’s top two export industries—for them to maintain their positions and survive in the world of competitiveness, especially the current leader, the electronic industry—some rethinking is called for in the type of structure and the kind of outputs that they wish to produce. Are they to remain as exporters of “assembly” type of products? What will happen to the large expanse of unskilled laborers? Again, difficult challenges to face. But then again, the promise of greater rewards beyond the present structure is something that is worth the change.

In agonizing to reach a definitive decision amidst contentious and difficult issues, a good leader winces and rationalizes the decision made. A great leader winces, pushes ahead with the decision and lets the chips fall into their rightful places. DRN
RP should push for opening of Japan's health care industry to Filipinos

The Philippines should push for the liberalization of the Japanese health care industry in negotiating for a bilateral economic agreement with Japan.

This was suggested by Dr. Tereso S. Tullao Jr., professor at the De La Salle University, and his associate Michael Angelo Cortez in their study with the Philippine APEC Study Center Network (PASCN) and the Philippine Institute for Development Studies (PIDS) titled Movement of Natural Persons Between the Philippines and Japan: Issues and Prospects.

According to Tullao and Cortez, there is a need to restructure the composition of Filipino workers in Japan beyond entertainers who stay in Japan for a six-month contract. They suggested that one alternative is to push Japan to open its health care sector to foreign workers, particularly for Filipinos.

"It will be of mutual interest to both countries if the entry of Filipino caregivers is liberalized given the aging population in Japan, on one hand, and the ability of the Philippines' human resource development institutions to train workers, on the other hand," they maintained.

Thus, Tullao and Cortez recommended that the Philippine government should examine how Filipino caregivers and other health professionals including doctors, nurses, dentists and physical therapists can enter the Japanese health care sector.

Subsequently, it should work out a mutual recognition agreement with Japan on educational qualifications, professional requirements and other technical standards so that the qualifications of Filipino health professionals can be comparable and recognized in Japan.

However, the researchers noted that there is a need to strengthen the regulatory measures of government agencies in the Philippines to ensure the quality of graduates from institutions offering short-term training programs on caregiving.

"Since language and culture is a major barrier to access to the Japanese market, the Technical Education and Skills Development Authority (TESDA) can assess, certify and monitor the operations of language training centers. All Japan-bound health professionals could be required to take the Japanese Proficiency Test and some units in Japanese culture," they suggested.

Aside from enhancing market access for individual caregivers, Tullao and Cortez likewise proposed that the Philippines should also explore the liberalization of commercial presence for Filipino caregiver agencies in Japan.

—Teresa Tullao Jr.
Open skies pact should be part of RP-Japan free trade deal - study

The Philippine government should push for the inclusion of a bilateral open skies deal in the ongoing talks for a free trade agreement with Japan.

Winston Padojinog and Cherry Lyn Rodolfo, professors at the University of Asia and the Pacific, argued in their study for the Philippine APEC Study Center Network (PASCN) and the Philippine Institute for Development Studies (PIDS), that opening up air traffic routes between the two countries would encourage more Japanese to visit the Philippines.

Japan is a country with a total population of 126 million and with a GDP of US$4.2 trillion, seven times that of China and twice that of the rest of Asia put together. Per capita income is US$33,333. It has a relatively large number of households earning above US$50,000 per annum. However, the study noted that the Philippines has not been as competitive as other Southeast Asian countries in attracting the Japanese market.

“Arrivals to Thailand, which is seven hours away from Japan, for instance, are almost four times than what the Philippines has captured from the 20 million Japanese outbound travel to Asia Pacific,” the researchers stated.

Padojinog and Rodolfo pointed out that apart from marketing and promotions and peace and order, infrastructure is another area that needs improvement in the Philippines. In its communication to the World Trade Organization during the Symposium on Tourism Services in February 2001, for instance, the Japan Association of Travel Agents (JATA) cited (a) strong presence through tourism promotion officers, (b) improvement in tourism infrastructures, (c) easy access such as more airline seats and lower group airfares, (d) availability of competent local Japanese, (e) visa waiver program, (f) hygiene of host destinations, and (g) safety and security as critical factors for the development and promotion of a tourist destination for the Japanese travel market.

Thus, Padojinog and Rodolfo maintained that removing restrictions in air traffic rights between the two countries can lead to more flights, which in turn, will result in competition and eventually lower air fares. “Fares are more expensive between Tokyo and Cebu at US$590 than [between] Tokyo and Phuket at US$300. In addition, the bilateral air service between the Philippines and Japan restricts weekly capacity to 45 frequencies for each country’s carriers,” they noted.

Moreover, they explained that a more liberal air deal between Japan and the Philippines will give flexibility to other carriers like Cebu Pacific to explore and develop the market without being constrained by capacity and aircraft utilization or lack of competition policy in the allocation of additional traffic routes or rights by government.

Removing air traffic restrictions between Philippines and Japan can lead to more flights and lower air fare rates, thus attracting more tourists to the country.
Quezon City. Recent developments in this sector have provided a major slice of the IT outsourcing market that has been migrating to countries where capacity in the IT sector has enormous potentials. In this, the Philippines has shown a major potential, and that growth is being demonstrated.

In general, however, Macapagal Arroyo’s handling of the major economic issues had been wanting. When she assumed the presidency, she said, she wanted simply to be a good president, not a great president. It is a low ambition. What the Philippines needs today is a great president with a clear vision to make up for some disastrous presidencies in the past. By winning a new mandate, she could aim higher.

Conclusion
The country is headed toward an unpromising future. True, the economy will grow but it would not be impressive progress. The downside scenario is that this would make the economy more prone to crisis. Sometimes, lack of good leadership brings about the crisis. It is altogether possible that the incumbent, after owning an electoral mandate, would display unusual leadership ability. This lucky accident does happen in the history of nations. After all, a real mandate could inspire an elected leader to greatness. Sometimes, track records belie what lies ahead.

Assuming that luck is on our side, the right choice of policies to reform could be placed in the national agenda. The new president would be convinced of their urgency and would pursue them relentlessly. Under this kind of leadership, the investment and business environment would definitely improve. And the country could well be put on the path toward a brighter future. DRN