

Formulating the Philippine services strategy for inclusive growth

Ramonette B. Serafica

The services sector has significantly contributed to employment, investment, and revenue generation for the country. However, there are still vast opportunities left untapped to fully exploit its role in the economy. This *Policy Note* explains why a Philippine services strategy is essential to maximize the sector's potential in contributing to the attainment of inclusive growth.

Why do we need a services strategy to achieve inclusive growth?

Competitive services are necessary for inclusive growth. Services do not only directly contribute to the creation of jobs and value added in the economy but affect the performance of other sectors through critical intersectoral linkages. In this regard, improving the competitiveness of all services is essential to transform the economy and achieve broad-based growth. If services are inefficient, costly, of poor quality, and inaccessible especially to the poorer segments of

the population, inclusive growth would not be attainable.

In technical terms, services are the result of a production activity that changes the conditions of the consuming units, or facilitates the exchange of products or financial assets (UN 2009). Wholesale and retail trade links producers with consumers. Business services improve the efficiency of the firm and enhance product quality. Financial services enable the transformation of savings to investment. Telecommunications facilitate the dissemination of knowledge. Transport and logistics services move goods and people within and between countries. Education and health services enhance the productivity of the workforce. The contribution of services to gross value added has been increasing over time and now accounts for 57 percent (Figure 1).

PIDS Policy Notes are observations/analyses written by PIDS researchers on certain policy issues. The treatise is holistic in approach and aims to provide useful inputs for decisionmaking.

The author is a consultant of PIDS. The views expressed are those of the author and do not necessarily reflect those of PIDS or any of the study's sponsors.

The demand for services as an intermediate input and for final consumption explains its rising share of value added in the economy. As incomes rise, the proportion that is spent on nonfood items increases. In turn, the demand for services,

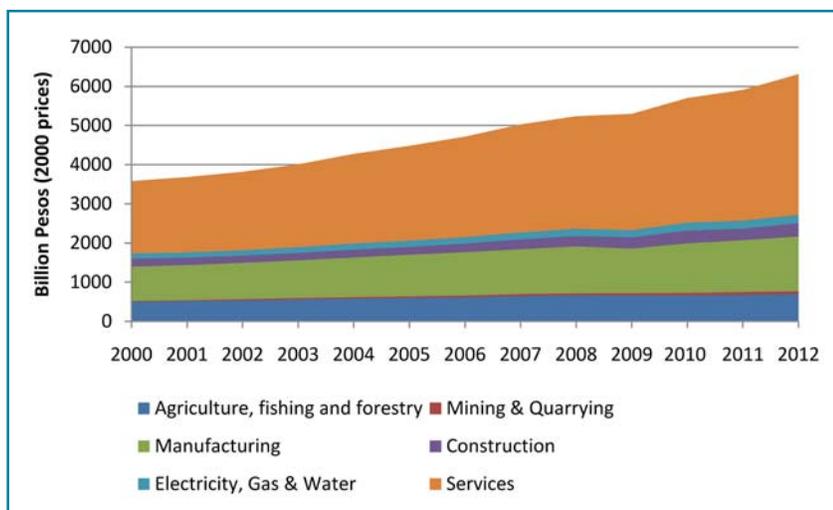
which are used both for intermediate and final consumption, increases.

As a share of intermediate inputs used in production by industries, services take up 30.89

percent. The services sector itself is the most intensive user. It accounts for 62.15 percent of its own intermediate inputs. Figure 2 shows the breakdown in select industries.

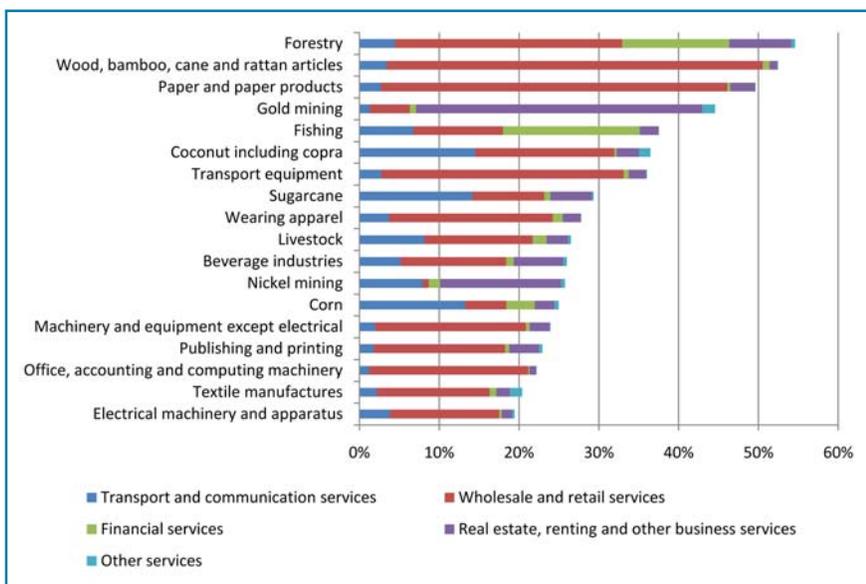
The role of services in the country's trade is significant. In gross terms, the share of service industries is just 23.53 percent of exports. However, in terms of service industry value added that is embodied in gross exports, the contribution of services is 44.15 percent. With the share of services to Philippine exports almost doubling when measured in value-added terms, the share of manufacturing is reduced to 50 percent from 75 percent (Table 1).

Figure 1. GDP by industrial origin



Source: Author's estimates based on National Statistical and Coordination Board (NSCB) data

Figure 2. Services as a share of intermediate inputs of various industries



Source: Author's estimates based on the NSCB 2006 Input-Output Table of the Philippines – 70 sectors

How well has the services sector performed?

Table 2 classifies the various services subsectors in terms of employment and labor productivity growth from 2008 to 2011. The cut-off is the aggregate or total industry growth rate. "High" means it is above the cut-off (i.e., the sector's performance was above total industry) while "Low" means it is below the cut-off (i.e., the sector's performance was below total industry). In some cases, there was a decline in growth as indicated accordingly.

Employment growth low, Productivity growth low. The services that fall in this category are critical to the efficient movement of goods and information (in the case of communications). Constraints in these services increase trade costs that disproportionately affect small and medium enterprises and also lead to higher market prices for consumers.

Employment growth low, Productivity growth high. These subsectors are not sources of jobs as they make up less than 1 percent of total employment in services. However, except for sewage and refuse disposal, these are good-quality jobs as labor productivity in these subsectors is higher than the aggregate level.

Employment growth high, Productivity growth low. These subsectors are good for employment generation especially for women, and account for a significant share of total employment in the services sector. However, they are not necessarily good-quality jobs. Productivity must be increased especially in subsectors where the productivity level is below the aggregate level (i.e., retail trade, hotels and restaurants, other service activities).

Employment growth high, Productivity growth high. These are the dynamic segments of the economy and their performance bodes well not only for job creation but in generating good-quality jobs as the productivity levels in these subsectors are above the aggregate level.

Table 1. Structure of Philippine exports, 2009

Sector	In Gross Terms (%)	In Value-Added Terms (%)
Primary products	2.0	6.2
Manufacturing	74.5	49.6
Services	23.5	44.1

Source: Author's estimates based on the OECD-WTO Trade in Value Added (TIVA) - May 2013 database

Table 2. Productivity and employment performance of various services, 2008–2011

	Productivity Growth Low	1.36%	Productivity Growth High
Employment growth Low	<ul style="list-style-type: none"> Wholesale trade (negative productivity growth) Water transport (negative productivity growth) Land transport (negative productivity growth) Postal and telecommunications 		<ul style="list-style-type: none"> Activities auxiliary to financial intermediation Air transport Insurance Sewage and refuse disposal (negative employment growth)
Employment growth High	<ul style="list-style-type: none"> Nonbank financial (negative productivity growth) Real estate activities Hotels and restaurants Retail trade Education services Other service activities (negative productivity growth) 	2.8%	<ul style="list-style-type: none"> Renting of machinery and other business activities Maintenance and repair of motor vehicles Recreational, cultural, and sporting services Banking institutions Health and social work Supporting and auxiliary transport

Source: Author's estimates based on data from the Labor Force Survey, NSO and Gross Value Added, NSCB National Accounts of the Philippines, Consolidated Accounts.

Can the Philippines be the heart of services trade in the Asia Pacific?

Despite competitiveness issues in key sectors, the Philippines has made solid achievements in the export of some services. Capitalizing on these accomplishments, a comprehensive and high-profile services export initiative should be established.

The Philippines is a net exporter of services. This is buoyed by a strong information technology-business process outsourcing (IT-BPO) sector as reflected by the revealed comparative advantage (RCA) of “other business services” and “computer and information services”. An RCA greater than 1 (or outside the red border) indicates the export competitiveness of that sector (Figure 3).

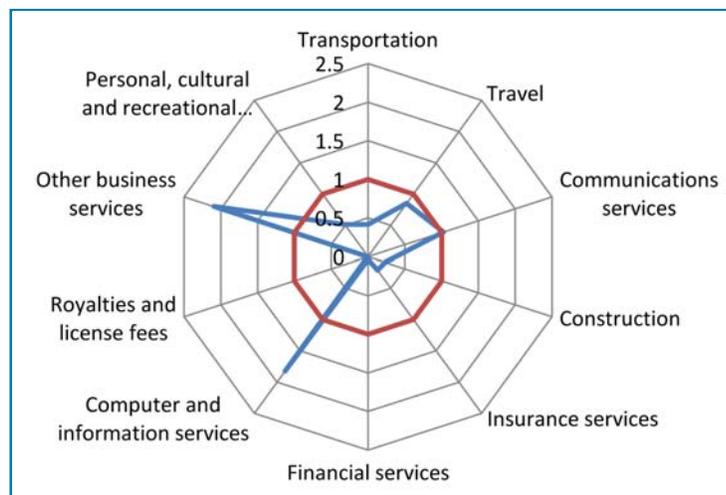
The export of “personal, cultural, and recreational services” has also displayed strong growth recently. There are various examples of successful Philippine service suppliers in different sectors and modes of supply that demonstrate the country’s potential export competitiveness in other services.

The main source of the country’s comparative advantage is its pool of skilled, semiskilled, and low-skilled workers. In terms of Mode 4 (Movement of natural persons), Filipino service suppliers of various skill levels are engaged in

different sectors and occupations. The confluence of other factors within the last decade (e.g., liberalization of telecommunications, technological changes in information and communication, restructuring of business models of multinationals toward outsourcing and offshoring of services) has enabled the country to leverage its human capital and excel in the delivery of services in the IT-BPO sector through trade via Mode 1 (Cross-border supply). Human resources can likewise be credited for the country’s ability, albeit still modest, to export education and medical services through Mode 2 (Consumption abroad). The country’s abundant labor was also cited as one of the reasons for its potential to become a major hub for ship repair, another form of services trade by consumption abroad. In the case of Mode 3 (Commercial presence), the Philippines’ labor endowment has contributed to the success of construction services overseas although firm-level factors could also explain success in this mode of supply. There are other advantages that the country offers. Its geographic location is ideal as a logistics hub for cargo and its deep seashores make it suitable as a ship repair hub. Finally, the more than 10 million Filipinos abroad are a natural market for Philippine services.

The country’s decades of experience and success as a supplier of labor of different skill levels, its strategic location both physically and virtually (being a key player in the BPO industry), and the growing network of Filipino service suppliers and consumers around the globe provide the building blocks to establish the Philippines as the heart of services trade in the

Figure 3. Revealed comparative advantage (RCA) of services of the Philippines, 2012



Note: Author’s estimates based on World Trade Organization (WTO) data: www.wtostats.org (accessed 30 September 2013)

Asia-Pacific region. As part of the services strategy to achieve inclusive growth, there should be a comprehensive services export initiative that would consolidate successes already achieved in different modes of supply and sectors as well as facilitate the overseas expansion of other services and service suppliers with potential to internationalize. An umbrella program dedicated to services exports would help create the Philippines as a valuable brand in services trade over time.

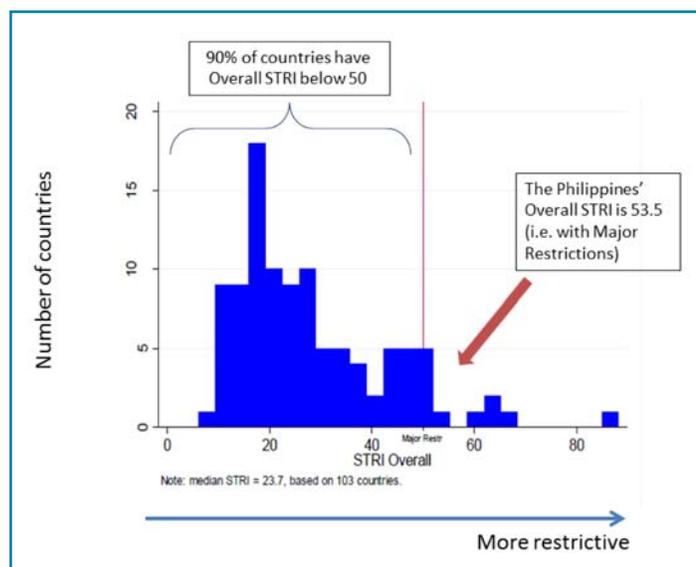
What should we do to create an environment conducive to competitive services?

Based on the World Bank's services trade restrictiveness index (STRI), the Philippines has one of the most restrictive policy environments for services (Figure 4).

The STRI is a measure of the restrictiveness of a country's policy regime based on policy information. Specifically, it measures the degree of discriminatory restrictions in financial services, telecommunications, retail, transport, and professional services. The higher the score, the more restrictive is the policy environment. Table 3 shows the scores of the Philippines. Among the sectors included in the index, it is in professional services where the extent of restrictiveness is highest at 80.

In addition to restrictive policies, anticompetitive business practices also exist (Abad et al. 2012). Such practices undermine the efficient supply of services in the country. Ex-ante and ex-post analysis of services reform (Francois and Hoekman 2010; Dee 2013) indicate significant benefits from removing restrictions to

Figure 4. Frequency distribution of country-level STRI



Source: Figure 1 in Borchert et al. (2012) with author's additions

Table 3. STRI scores of the Philippines, 2008

Sector	Score
Overall	53.5
Financial services	45.1
Telecommunications	50
Retailing	50
Transportation	44.2
Professional services	80

Source: <http://iresearch.worldbank.org/servicestrade/> (accessed 12 July 2013)

the supply of services. Moreover, gains are greater when comprehensive sectoral reforms are undertaken that not only remove discriminatory measures but also create a procompetition environment. As part of the services strategy, a trade-related audit of the laws and regulations affecting the services sector should be conducted with the view of removing measures whose policy objective is no longer relevant or could be

To further create an environment conducive to improving competitiveness, strategies involving government policy on innovation and human resource development are needed as well. Innovation is broader than just science and technology. It involves the use and dissemination of new technologies and practices that improve productivity.

achieved by less restrictive measures. From an economic perspective, there must be a closer alignment between a regulation and the market failure it seeks to address.

To further create an environment conducive to improving competitiveness, strategies involving government policy on innovation and human resource development (HRD) are needed as well. Innovation is broader than just science and technology. It involves the use and dissemination of new technologies and practices that improve productivity. Creating an overall climate that encourages innovation includes appropriate incentives and mechanisms to support innovators, removing obstacles to innovative initiatives, establishing responsive research structures, and fostering a creative and receptive

population through appropriate educational systems. Many countries both developed and developing are using innovation as the foundation of competitive industries from agriculture to services (World Bank 2010). HRD policies cover the quality of the labor force and the regulation of the labor market. HRD has multiple dimensions, which include educational attainment, workforce skills, population health, and the set of employment policies that provide businesses with workers that possess the right skills and the ability to adapt quickly to new challenges. Each of these dimensions contributes to creating an environment conducive to the growth of both domestic and foreign enterprises (OECD 2012).

References

- Abad, A., K. Gonzales, M. Rosellon, and J. Yap. 2012. Unfair trade practices in the Philippines. PIDS Discussion Paper No. 2012-39. Makati: Philippine Institute for Development Studies.
- Borchert, I., B. Gootiiz, and A. Mattoo. 2012. Policy barriers to international trade in services: Evidence from a new database. World Bank Policy Research Working Paper 6109. Washington, D.C.: World Bank.
- Dee, P. 2013. The benefits and costs of further services liberalization in ASEAN. Unpublished.
- Francois, J. and B. Hoekman. 2010. Services trade and policy. *Journal of Economic Literature* 48:642–692.
- Organization of Economic Co-operation and Development (OECD). 2012. Chapter 8. Human resource development in policy framework for investment user's toolkit. <http://www.oecd.org/investment/toolkit/> (accessed 18 October 2013).
- United Nations (UN). 2009. *System of National Accounts 2008*. Geneva: UN.
- World Bank (WB). 2010. *Innovation policy: A guide for developing countries*. Washington, D.C.: WB.

For further information, please contact

The Research Information Staff
 Philippine Institute for Development Studies
 NEDA sa Makati Building, 106 Amorsolo Street, Legaspi Village, 1229 Makati City
 Telephone Nos: (63-2) 894-2584 and 893-5705
 Fax Nos: (63-2) 893-9589 and 816-1091
 E-mail: ramonette@gmail.com; publications@pids.gov.ph

The *Policy Notes* series is available online at <http://www.pids.gov.ph>. Reentered as second class mail at the Business Mail Service Office under Permit No. PS-570-04 NCR. Valid until December 31, 2014.