

ADDRESSING THE JOBS CHALLENGE TOWARD INCLUSIVE GROWTH



PIES 2013 ECONOMIC POLICY MONITOR

Addressing the jobs challenge toward inclusive growth

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Foreword

The *Economic Policy Monitor* (EPM) is a key publication of PIDS that began four years ago. It was conceived to further strengthen the link between research and policymaking. Like a year-in-review, it takes a retrospective approach by analyzing the macroeconomic conditions and the policy developments in the previous year. One or two research papers related to the theme, which for the past three years had also been the theme of the Development Policy Research Month (DPRM) in that year, makes an in-depth examination of certain issues and provides recommendations for policymakers based on research evidence. The DPRM is a nationwide celebration every September headed by PIDS by virtue of Presidential Proclamation No. 247 to provide a means to promote and draw broad-based awareness on the importance of policy research in national development.

I initiated some changes in the EPM beginning in this issue. To be more relevant, the EPM has to take a more forward-looking approach. This is reflected in two aspects. First, whereas before the macro chapter (Chapter 1) is just a review and analysis of macroeconomic developments in the past year, it now contains the prospects for the coming year along with an analysis of the potential policy challenges particularly in relation to the EPM theme.

Second, the EPM theme is no longer the previous year's DPRM theme. Instead, the DPRM theme for the coming year is the theme of the EPM in the current year. This is to set the stage for and stir discussions on the theme, which will culminate in the DPRM celebration in September.

The theme for this fourth issue of the EPM is "Addressing the Jobs Challenge toward Inclusive Growth", which is also the theme of DPRM 2014. The pursuit of inclusive growth through the expansion of quality job opportunities for the country's labor force is one of the main policy issues that PIDS endeavors to address in its current research and advocacy initiatives. I deem it timely to revisit the Philippine labor market policies given global and regional developments that directly impact our economy and have a bearing on the competitiveness of our labor force. Thus the theme paper featured in Chapter 3 reviews the effectiveness of our labor market policies and regulations. I commend the research team of Drs. Vicente Paqueo, Aniceto Orbeta, and Leonardo Lanzona, and Mr. Dean Dulay for producing a thought-provoking piece that challenges conventional notions on the welfare effects of minimum wage and crafting an alternative agenda that can serve as a guide for our policymakers on how to address the perennially high rates of unemployment and underemployment in the country and accelerate poverty reduction.

I would also like to express my gratitude to all the people who contributed to this year's EPM—the senior research fellows and researchers who authored the three chapters, and the Research Information Department for the usual exceptional assistance that it renders to PIDS endeavors to disseminate its policy research studies.

Gilberto M. Llanto

President

July 2014

Acknowledgment

The *2013 Economic Policy Monitor* (EPM) is the result of the combined efforts of several people. Chapter 1 was written by Gilberto M. Llanto and Adoracion M. Navarro.

Chapter 2, which highlights policy developments in important areas of the economy, consisted of contributions from Celia M. Reyes (updated poverty reduction program), Rafaelita M. Aldaba (industrial policies), Roehlano M. Briones (agricultural policies), Danilo C. Israel (policies on fishery, forestry, mining, and natural disasters), Marife M. Ballesteros (housing policies), Valerie Gilbert T. Ulep and Ida Marie T. Pantig (health policies), Adoracion M. Navarro (infrastructure policies), and Erlinda M. Medalla (trade policy environment).

Chapter 3, the paper on "Jobs Expansion and Development Initiative", was the collaboration of Vicente B. Paqueo, Aniceto C. Orbeta, Jr., Leonardo A. Lanzona, Jr., and Dean Gerard C. Dulay.

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Executive Summary

This fourth issue of the *PIDS Economic Policy Monitor* (EPM) focuses on the need to pursue inclusive growth through the expansion of quality job opportunities. Job creation is one of the overarching goals of the present administration to achieve broad-based and inclusive growth. The *Philippine Development Plan 2011–2016* recommends a number of strategies to enhance job generation, which include, among others, opening legitimate channels for all forms of employment and mutually beneficial work arrangements, and exploiting the country's comparative advantage in labor-intensive activities. This EPM explores these and other strategies particularly in the third chapter, which revisits the jobs issue and provides recommendations on how to address it, taking into consideration the socioeconomic and political landscape and historical experience of the Philippines.

Chapter 1 analyzes the macroeconomic scenario of the past year and provides an outlook of the economy in the coming year. The 7.2-growth rate in 2013 is examined along with global and regional developments, the productive capacity of the economy to sustain this high-level growth, and the inclusiveness of economic growth. The Philippine economic performance in recent years has been remarkable amid the lingering slowdown in the global economy, particularly among some of its trading partners, and the occurrence of natural disasters, which did not dampen the growth momentum.

The Philippines is now in the cusp of major international and regional developments. The formation of an ASEAN Economic Community (AEC) in 2015 would benefit the Philippines as it drives market expansion, economic transformation and modernization, and creates more job opportunities. These, along with the country's investment grade rating, bode well for sustaining a high-growth path. But the country also has to do its homework to take full advantage of the formation of AEC 2015, by addressing both border and behind-the-border issues, some of which are discussed in Chapter 2.

Inclusivity remains a critical challenge for the country. Despite an outstanding growth performance in 2013, widespread poverty and joblessness persist—signs that growth continues to benefit only a few. Three million Filipinos were without jobs in 2013 and 7.51 million were underemployed. Poverty incidence barely improved. By 2012, the proportion of the population living below the poverty line was 25.2 percent. The natural calamities in 2013 (Typhoon Yolanda and the earthquake in Bohol) combined with man-made crisis (Zamboanga siege) exacerbated the slow progress in poverty reduction.

With inclusive growth as a goal, there is a need to determine what policy measures and interventions can make a serious dent on high income inequality and poverty incidence. This will entail, among others, a serious look at labor policies and regulations that hamper the economy's ability to generate ample and productive job opportunities and make use of the country's abundant labor resources.

Chapter 2 reviews the laws, regulations, and policies formulated and adopted by the government in 2013 in support of the goal to sustain economic growth and achieve social equity. One such policy is the new poverty reduction program that adopts a spatial approach in addressing poverty, by identifying priority provinces, grouping them into three categories (Category 1: provinces with the highest number of poor families in 2012; Category 2: provinces that are also poor but have small populations, are less dense, and located in remote areas; Category 3: highly vulnerable areas that are prone to multiple hazards), and formulating specific strategies for each category. Recommendations such as enhancing job creation by tapping new sources of growth such as agro-industry and food manufacturing and strengthening both supply and service value chains, improving physical infrastructure and logistics, effective provision of basic social services, and improving disaster risk reduction and management (DRRM) resonate in the poverty reduction strategies for the different categories.

In this light, the Comprehensive Manufacturing Industry Roadmap completed in 2013 aims for the revival of the manufacturing industry. It is supported by an investment strategy and focuses on the role of education, value/supply chain, effective regulation, and industrial clusters/agglomeration. Its implementation is anticipated to accelerate structural transformation and create more quality jobs, which will help in achieving inclusive growth.

Rice self-sufficiency remained the centerpiece of agricultural policy in 2013. A significant share of the agriculture budget was allocated for expenditure items to meet the rice production targets of the Food Staples Sufficiency Program that targets zero rice importation and reliance on domestic production. In keeping with the self-sufficiency target, the National Food Authority reduced the volume of imports with the expectation that full sufficiency would be achieved by the start of 2014. However, the reduction in imports was not adequately compensated for by a commensurate increase in domestic production. As PIDS analysis shows, this was the cause of the rice price spike in the second semester in 2013. To avoid a similar scenario, the government is advised to revisit the self-sufficiency policy, particularly the unrealistic goal of no imports, and to avoid requesting for an extension of its quantitative restriction on rice imports.

In addition, the 15th Congress passed the Food Safety Act of 2013 that is deemed critical to meet some key competitiveness benchmarks as the Philippines enters the AEC in 2015. The law is envisaged to bring Philippine food safety systems at par with or close to those of leading countries in the Association of Southeast Asian Nations (ASEAN), such as Thailand and Singapore.

In 2013, several regulations were passed to promote sustainable fisheries, among them the ban against destructive and illegal forms of fishing. In the forestry sector, the focus of policies was to speed up the implementation of the National Greening Program. The campaign on responsible mining was reinforced through the formation of the Philippine Extractive Industries Transparency Initiative that aims to promote transparency and accountability in the extractive industries as well as in government.

The huge devastation caused by Typhoon Yolanda was an eye opener for the country to take serious steps in DRRM. As a direct response to the tragedy, a state of national calamity was declared in November to enable the national government and local population to respond more effectively to the crisis. In addition, the position of Presidential Assistant for Rehabilitation and Recovery was created to oversee and hasten the rescue, recovery, relief, and rehabilitation efforts in the areas affected by Typhoon Yolanda.

The other policy initiatives in 2013 endeavored to address issues on social inequity (apart from unemployment and underemployment), such as homelessness and inadequate provision of health services, and infrastructure issues that not only stifle economic growth but also make it all the more less inclusive.

Two housing policies were passed. The NHA Enhanced Resettlement Package increased the maximum cost of socialized housing units developed by the National Housing Authority (NHA) for off-city and in-city resettlements. The adjustment, which is made affordable to program beneficiaries through the adoption of usufruct arrangement in lieu of land ownership, allows for a bigger housing size and disaster-resilient shelter design. The financing program of the Socialized Housing Finance Corporation was also expanded to include high-density housing or housing in urbanized cities such as Metro Manila for better access to basic facilities and infrastructure.

Two program improvements were undertaken to support the universal health care program. Through the passage of the revised National Health Insurance Act, the coverage of PhilHealth was expanded to include indigents and the informal sector. Primary care benefit, which covers outpatient service, and the Z benefit package, which covers selected chronic diseases that require prolonged hospitalization, were also expanded. PhilHealth classifies disease conditions from the simplest and cheapest to treat the most severe and costly. Type Z cases, which are at the farthest end of the scale if illnesses are to be ranked from A to Z, are the most serious and require very expensive treatments and prolonged hospitalization and therefore are perceived as economically and medically catastrophic.

Programs like no-balance billing, which ensures that the poor will not have to pay a single cent in a government hospital, and the case-based rate, where there is a predetermined fixed rate for health care providers, were also strengthened. Access to quality health care facilities was intensified by allocating additional budget to the Health Facility Enhancement Program to fund the upgrade, construction, and enhancement of rural health units and hospitals all over the country.

As a broad sector encompassing transport, energy, water supply and sanitation, and information and communications technology (ICT), infrastructure is a critical component in the effective and efficient performance of the agriculture, manufacturing, and services sectors. Several long-overdue policy initiatives were undertaken in 2013 to address long-standing

concerns that impinge on the economy's productivity and competitiveness. Developments in the transport sector consisted of a law that exempts international carriers from income taxes on the basis of reciprocity, and directives on the setting up of Metro Manila integrated transport terminals, the Metro Rail Transit (MRT)-3 buy-out, and the Skyway Stage 3 project. Energy-related issues were given emphasis through the issuance of policies to strengthen the National Electrification Administration, address the Mindanao electric power shortage, and implement retail competition and access. Policy developments in the ICT sector included the Supreme Court's ruling on the constitutionality of the anticybercrime law and the executive order issued to government agencies to migrate to the web hosting service of the Department of Science and Technology-ICT Office. Some cross-cutting policies also took effect in 2013, most of them to facilitate public-private partnerships.

These infrastructure-related policy developments, which can enhance both domestic and foreign trade, take on greater significance with the breakthroughs reached in the 9th Ministerial Conference of the World Trade Organization (WTO) held in Bali last December. One of these is the signing of the long-awaited Trade Facilitation Agreement (TFA), which is expected to bring down the transaction costs of international trade and therefore increase the trade revenues of WTO member-countries. Trade facilitation is one area where the Philippines has conducted and continues to carry out reforms, such as the development of a national single window which is part of the country's commitment to the ASEAN in support of AEC 2015. Aside from TFA, two other major developments in the trade policy environment were reached in the Bali meeting, both in the area of agriculture. One is the 'peace clause' protection on domestic support for traditional staple food crops, which allows countries to continue their domestic support without the risk of legal sanctions under the WTO. The other is the expansion of 'general services' in Annex 2 of the Agreement on Agriculture that can receive domestic support. The additional items include "land rehabilitation, soil conservation and resource management, drought management and flood control, rural employment programmes, issuing land ownership titles, and settlement programmes". Both deals appear to be trade distorting and contrary to the trade liberalization objectives of the WTO. Nevertheless, they can buy time for and give developing countries like the Philippines the policy space for the discussion and crafting of appropriate policies and programs to develop and strengthen their agriculture sectors, including the additional areas, in preparation for further liberalization reforms in the WTO.

The Philippine labor market is investigated in depth in the final chapter. Chapter 3 looks into the causes of the economy's inability to generate substantial and quality employment opportunities despite a high-level growth by looking beyond the issues that other studies have already examined, such as stagnant industrialization due to the lack of structural transformation, sluggish inflow of foreign investments, and slow growth of enterprises

that can absorb the large population of lower-skilled workers. Instead, the study featured in this chapter analyzed the effectiveness of labor market policies and regulation through an empirical study to determine if they are growth and welfare enhancing. The focus of the analysis was the minimum wage given the need for a more realistic pricing of labor and capital inputs to expand employment in labor-intensive sectors. The high cost of labor in the Philippines, relative to capital, has been identified as one of the key causes of huge shedding of labor-intensive manufacturing activities in the past and their failure to hire more workers. The empirical study used data from a sample consisting of labor-intensive manufacturing industries with at least 10 employees for the years 1980–2008 from panel data extracted from the Annual Survey of Philippine Business and Industry (formerly called the Annual Survey of Establishments), and the annual Labor Force Survey.

Using various econometric methods, the study finds that raising the minimum wage reduced employment in smaller firms—a result that is instructive for the Philippines considering that more than 99 percent of the total number of firms in the country are micro, small, and medium enterprises. In terms of employment, smaller firms also dominate, accounting for more than 60 percent or 3.4 million jobs. In addition, the study reveals that a rapid increase in minimum wage resulted in lower household income and a higher probability of falling into poverty.

Given these findings, the study recommends an alternative path to address the challenges that impinge on the productive employment dimensions of the economy. Along with recommendations for a minimum wage reform, expansion of gainful job opportunities from the labor-intensive manufacturing sector, and greater investments in education and other human development aspects, the study proposes a 12-point agenda called "Jobs Expansion and Development Initiatives" (JEDI). In summary, JEDI proposes the following measures:

- simplifying labor dispute resolution processes;
- making the rules on hiring and firing decisions more flexible;
- instituting measures that will minimize the imposition of labor regulations and practices detrimental to and discriminatory against the poor and other disadvantaged populations;
- allowing firms to hire low-skilled and poor workers who want to voluntarily opt out of the mandatory minimum wage norm;
- experimenting with a Singaporean style policy, which provides limited grants to targeted ultrapoor workers;
- moving toward a quadripartite system from a tripartite process to give the poor, unemployed, underemployed, and self-employed direct representation in the determination of labor regulations and policies;
- encouraging labor unions to take part in raising the competencies and productivity of workers;

- lengthening the compulsory regularization of young workers to two years from six months to expand their learning experience and build their skills on the job;
- ensuring quality implementation of the K-12 reform, undertaking institutional reform of the Technical Education and Skills Development Authority, and pursuing ongoing Commission on Higher Education initiatives like the Unified Student Financial Assistance System for Higher and Technical Education;
- implementing the extension of demand-side education assistance of the *Pantawid Pamilyang Pilipino Program* to high school students and complementing it with policies and programs that facilitate on-the-job training and employment in private enterprises;
- increasing the innovation capacity of the country by promoting research and development activities; and
- facilitating the emergence of a well-organized coalition of stakeholders devoted to crafting effective approaches that will advance the interest of poor workers.

List of Acronyms

4Ps – Pantawid Pamilyang Pilipino Program

ADB – Asian Development Bank

AEC – ASEAN Economic Community

AO – Administrative Order

APEC – Asia-Pacific Economic Cooperation
APIS – Annual Poverty Indicators Survey

ARMM – Autonomous Region in Muslim Mindanao ASEAN – Association of Southeast Asian Nations

ASPBI – Annual Survey of Philippine Business and Industry

BFAR – Bureau of Fisheries and Aquatic Resources

BFP – Barangay Forest Program

BLES – Bureau of Labor and Employment Statistics

BOI – Board of Investments

BOP – balance of payments

BOT – build-operate-transfer

BSP – Bangko Sentral ng Pilipinas

BTr – Bureau of the Treasury

CBA – collective bargaining agreement

CBD – central business district

CBR – case-based rate

CEPT – common effective preferential tariff

CLMV - Cambodia, Lao PDR, Myanmar, and Viet Nam

CMP – Community Mortgage Program

CPBI – Census of Philippine Business and Industry

CPF - Central Provident Fund
CSO - civil society organization
DA - Department of Agriculture

DBCC – Development Budget Coordination Committee

DBM - Department of Budget and Management

DC – Department Circular

DENR – Department of Environment and Natural Resources

DFA – Department of Foreign Affairs

DID – difference in difference

DILG – Department of the Interior and Local Government

DND - Department of National Defense

DOE – Department of Energy
DOF – Department of Finance
DOH – Department of Health

DOJ – Department of Justice

DOLE – Department of Labor and Employment

DOST-ICTO – Department of Science and Technology-ICT Office
DOTC – Department of Transportation and Communications
DSWD – Department of Social Welfare and Development

DTI – Department of Trade and Industry

EC – electric cooperative
EO – Executive Order

ERC – Energy Regulatory Commission

EU – European Union

FAO – Fisheries Administrative Order FAO – Food and Agriculture Organization

FDI – foreign direct investment
FMR – farm-to-market road
GDP – gross domestic product
GNI – gross national income

GOCC – government-owned and -controlled corporation
GPPB – grassroots participatory planning and budgeting

HDH – high-density housing

HFEP – Health Facility Enhancement Program
 ICC – Investment Coordination Committee

ICT – information and communications technology

ILO – International Labour Organization
 IMEM – Interim Mindanao Electricity Market

IMF – International Monetary Fund

IRRs – implementing rules and regulations

ISFs – informal settler families IV – instrumental variable

JEDI – Jobs Expansion and Development Initiative

Lao PDR – Lao People's Democratic Republic

LFS – Labor Force Survey
LGU – local government unit
LMW – legal minimum wage
MC – Memorandum Circular

MC9 – 9th WTO Ministerial Conference MDG – Millennium Development Goal

MICC – Mining Industry Coordinating Council

MMDA – Metro Manila Development Authority

MO – Memorandum Order MRT – Metro Rail Transit

MRTC – Metro Rail Transit Corporation

MSG – multistakeholder group

NAIA – Ninoy Aquino International Airport NAPC – National Anti-Poverty Commission

NBB – no-balance billing

NCR - National Capital Region

NEA – National Electrification Administration

NEDA – National Economic and Development Authority

NFA – National Food Authority
NGO – nongovernment organization
NGP – National Greening Program
NHA – National Housing Authority

NHTS – National Household Targeting System

NISUS – National Informal Settlement Upgrading Strategy Program

NMW – natural minimum wage

NSCB – National Statistical Coordination Board

NSW – national single window
OP – Office of the President
PCB – primary care benefit

PDP – Philippine Development Plan PDR – Philippine Development Report

Philfeco – Philippine Federation of Electric Cooperatives
PhilHealth – Philippine Health Insurance Corporation

PHL-EITI – Philippine Extractive Industries Transparency Initiative

PIDS – Philippine Institute for Development Studies

PMI – Purchasing Managers' Index
PSA – Philippine Statistics Authority
PSE – Philippine Stock Exchange

QE – quantitative easing
QR – quantitative restriction

RA – Republic Act

REER – real effective exchange rate

RHU – rural health unit ROW – right-of-way

RTWPB - Regional Tripartite Wages and Productivity Board

Salintubig – Sagana at Ligtas na Tubig sa Lahat

SEIPI - Semiconductors and Electronics Industries in the Philippines, Inc.

SHFC – Socialized Housing Finance Corporation
SITT – Southwest Interim Transport Terminal

SME – small and medium enterprise SWS – Social Weather Stations

TFA - Trade Facilitation Agreement
TFP - total factor productivity
TTC - trade transaction cost

TVET - technical and vocational education and training

TWG – technical working group

UDHA – Urban Development and Housing Act

UNIFAST – Unified Student Financial Assistance System for Higher

and Technical Education

US – United States WB – World Bank

WIS - Workfare Income Supplement
WTO - World Trade Organization
WTS - Workfare Training Support

Macroeconomic Trends in 2013

Adoracion M. Navarro and Gilberto M. Llanto

ith a gross domestic product (GDP) growth rate of 7.2 percent, the Philippines is the second best-performing country in Southeast Asia in 2013 after Lao People's Democratic Republic (PDR). GDP growth averaged at 5.9 percent in the last three years (2011–2013) and the economy is expected to continue with its record performance in 2014. The Philippines' economic performance in recent years has been remarkable amid the lingering slowdown in the global economy, particularly in the Euro zone countries and other trading partners. The devastation brought about by Typhoon Yolanda (Haiyan) and other calamities in 2013 has not dampened the strong growth momentum. International credit rating agencies have maintained the rating upgrades given to the Philippines and there have been distinctive improvements in the country's ranking in various global competitiveness reports. The World Economic Forum (2013, 2012) reported that the Philippines' ranking climbed six notches to 59th place (among 148 countries) in 2013 from 65th (among 144 countries) in 2012. Overall, there is a growing optimistic outlook for the economy in the coming years along with the expectation that it will be a major player in the forthcoming ASEAN Economic Community (AEC).

The Philippines is now in the cusp of major international and regional (East Asia and Southeast Asia) developments. Over the years, a more global economy characterized by closer international and regional economic integration and cooperation has emerged, shaped by freer movements of capital, goods and services, advances in technology and communication, and innovations. Economic integration has brought beneficial impacts on participating economies in the form of lower prices for consumers and producers, higher productivity, and reduction in poverty. Nevertheless, it has made domestic economic management all the more challenging.

Economic integration, even as it confers benefits, creates volatility and uncertainty in goods and asset prices across countries. This reflects the need for a more efficient domestic macroeconomic management, and coordination of international policies and intervention measures. The past global financial crisis, which hit most of the developed world seriously, has created prolonged woes in economies relying on trade and finance from these developed countries. Given such global and regional perspectives, political and economic leaders have learned the virtue of dialogue, consultation, and information sharing to stabilize and strengthen domestic as well as international economic systems. Recent signs of an economic rebound and recovery in the world economy, chiefly in the United States (US) and to some extent in Japan and the Euro zone, augur well for the Association of Southeast Asian Nations (ASEAN) and the Philippines in particular.

In Southeast Asia, the formation of an AEC in 2015 and ongoing deliberations on the Regional Comprehensive Economic Partnership signal the region's quest for a more open and integrated regional economy. East Asia and the (envisaged) AEC are expected to continue to drive global growth. These developments require ASEAN countries in particular to find the right economic policies and political framework for stronger regional stability and cooperation. The Philippines has been an active participant in the global and regional sphere, making its mark in the economic, political, social, and cultural arenas. It has engaged with the European Union (EU), the United States, Japan, its fellow member-countries in the ASEAN, and recently, with the emerging economic powers such as China and India, through trade in goods

and services, foreign direct investments (FDIs), and capital flows, including remittances. The country is being recognized as an emerging major player in the region in view of its recent exceptional economic performance and improvement in governance and institutions. It should take advantage of opportunities presented by rapid changes in the global and regional markets, such as the rise in FDIs and greater integration of economic activities through regional production networks. It should also capitalize on surging domestic consumption and investments by both the private sector and government, fuelled by the growth of remittances and a positive fiscal position, respectively, to modernize and transform the economy.

However, the economy continues to face shortcomings in addressing high poverty incidence (estimated at 19.7% among families in 2012)1 and income inequality (estimated Gini coefficient of 0.4484 in 2009), underpinned by lagging achievement in some Millennium Development Goals particularly in universal access to basic education and maternal mortality rates. Despite recent rapid economic growth, income inequality and poverty incidence have remained high and stable in the last two decades after a significant decline in the past. In contrast, other neighboring countries were able to achieve significant poverty reduction as their respective economies grew. This is a serious issue that policymakers should consider. Why have poverty and income inequality been impervious to economic growth? What policy instruments can make a serious dent on high income inequality and poverty incidence?

Part of the answer may be found by examining the country's unemployment rate, which has been almost constant over the years, hovering at around

¹ This was lower compared with the poverty incidence in 2009, which was 20.5 percent (http://nscb.gov.ph/poverty/default.asp).

Table 1.1. Global economic growth and outlook (2008–2015)												
Country	Country 2008 2009 2010 2011 2012 2013 2014 ^a 2015 ^a											
World	2.8	-0.6	5.1	3.9	3.1	3.0	3.7	3.9				
United States	-0.3	-3.1	2.4	1.8	2.8	1.9	2.8	3.0				
Japan	-1.0	-5.5	4.5	-0.6	1.4	1.7	1.7	1.0				
Euro area	0.4	-4.4	2.0	1.4	-0.7	-0.4	1.0	1.4				
China	9.6	9.2	10.4	9.3	7.7	7.7	7.5	7.3				

Notes: ^a Projections from the International Monetary Fund (IMF) *World Economic Outlook*, January 2014 update. Source: IMF - *World Economic Outlook*, various years.

7 percent. Equally important and more worrisome is the relatively high underemployment rate at 19.8 percent, which reflects the failure of the economy to generate quality or productive jobs. This entails a serious look at labor policies and regulations that have hampered the economy's ability to generate ample and productive employment opportunities. A typical explanation for this failure is the slow structural transformation that has constrained the generation of more productive and quality jobs. However, behind this slow transformation is an array of policies and regulations, including those affecting the efficiency of labor markets that ignore, and even discourage, the use of the country's abundant labor resource and impedes the recovery of the laborintensive manufacturing sector. The result is an (estimated) employment-output elasticity of less than one that has led to "jobless growth", which is clearly the most pressing development issue facing policymakers today.

Global and regional developments

Global growth was in low gear in the first half of 2013 but economic activities especially in the high-income countries picked up in the second half of the year. As a result, full-year global growth was at 3 percent (Table 1.1). Economic activities, expected to be backed by demand expansion in advanced

economies and a corresponding export rebound in emerging economies, are projected to improve further, and thus global growth is estimated to be slightly higher in 2014 at 3.7 percent and in 2015 at 3.9 percent.

For the most part of 2013, fears of the US' tapering of its quantitative easing (QE) policy and the asset bubble in China dominated the discussions on global economic prospects. Japan's own QE added complications to the analysis of prospects. Meanwhile, the projected turnaround from recession in the Euro zone and positive global trade growth in 2013 are generating a positive outlook. China will continue to be an important global player although growth is forecast to be flat and there are early signs of trouble in certain sectors. In the ASEAN, the political leaders' commitment to reform policies and institutional frameworks that are required for the formation of an AEC in 2015 fuels the optimism on regional growth.

The US QE policy is an expansionary monetary policy whereby the US Federal Reserve buys back bonds (US Treasury notes and mortgage-backed securities) from its member-banks by adding credit to the banks' reserve accounts (US Federal Reserve 2008). Moreover, the Fed's buying of Treasury notes is meant to keep Treasury yields low. Treasury yields serve as the basis for long-term interest

rates, including long-term, fixed-interest housing mortgage rates. The lowering of domestic interest rates helped in the recovery of the US economy but much of the increased liquidity sought higher yields in the emerging economies, which inflated asset prices as mobile capital took advantage of yield differentials.

The QE policy was implemented in December 2008 when the US Fed started purchasing USD 600 billion worth of mortgage-backed securities (US Federal Reserve 2008). Successive rounds of QE ensued and led to an open-ended purchase of USD 85 billion worth of bonds per month beginning in December 2012 (US Federal Reserve 2012). In May 2013, news of improvement of the US economy presaged an end to the QE policy or the beginning of a tight monetary policy, which provoked reactions in the global financial markets including the Philippine financial market. For example, on June 25, 2013, the Philippine Stock Exchange index lost all of its gains in 2013 as it slid to 5,789.06 points, which was lower than the end-2012 closing record of 5,812.73 points. Net outflow on that single day was USD 43 billion. Actual QE tapering began in 2014 when the Fed reduced its bond purchases by USD 10 billion in January and February (US Federal Reserve 2013 and 2014b). In a recent press release, the US Fed (2014a) announced that starting April 2014, it would reduce purchases further by USD 10 billion, to a total USD 55 billion. In reaction to this and other external developments, the Monetary Board of the Bangko Sentral ng Pilipinas (BSP) increased the reserve requirement rate for domestic banks by 1 percentage point effective April 4, 2014 and announced that it would consider further adjustments in policy tools going forward (BSP 2014), a move that signaled monetary tightening and possible future increases in the cost of capital.

The expansion and subsequent tightening of US monetary policy is not a new phenomenon

Table 1.2. Real effective exchange rate (REER),¹
Philippines, 2013 vs. 1994 monthly
average (1980 = 100)

20	13	19	94
	REER ²		REER ³
May	90.33	February	73.99
June	87.17	March	73.14
July	85.78	April	73.26
August	84.41	May	74.75
September	84.46	June	74.86
October	85.17	July	76.08
November	85.18	August	77.39
December	84.97	September	77.60

Notes: ¹ The real effective exchange rate of the Philippine peso relative to the currencies of all major trading partners with respect to merchandise exports and imports. ² Australia, Euro area, United States, Japan, Hong Kong, Taiwan, Thailand, Indonesia, Malaysia, Singapore, South Korea, China, Saudi Arabia, and the United Arab Emirates are the trading partners considered. ³ United States, Japan, European Union, and the United Kingdom are the trading partners considered.

Source: Bangko Sentral ng Pilipinas (BSP)

in global financial markets. It seems that the difference only lies in the order of magnitude. The International Monetary Fund (IMF) relates three previous episodes (1994, 1999, and 2004) of "sustained monetary tightening in the US" after monetary expansion (IMF 2013). According to the IMF, there is some similarity between the current tapering and the 1994 episode of monetary tightening in the United States in that both led to large capital flows out of emerging economies. The main difference is that now, there is a stronger monetary policy framework in these economies as characterized by greater exchange rate flexibility and higher foreign exchange reserve buffers. Emerging economies have allowed large real exchange rate depreciations since May 2013, unlike in 1994 when there was virtually no change in the real exchange rates (IMF 2013). In the case

of the Philippines, the real effective exchange rate (REER) depreciated by only 1 percent a month after February 1994 (when the Fed announced planned hikes in the federal funds rate). In contrast with the 1994 episode, the REER depreciated by 3 percent from May to June 2013, and by 6 percent relative to the May level by December 2013 (Table 1.2).

Data from the BSP on the foreign exchange reserve position of the Philippines in 2013 relative to its position in past episodes reveal that the country is in a much better position now to weather the impacts of the US monetary tightening on the financial market than before. The stock of international reserves is much higher in 2013 and can cover about 12 months of import financing and can service almost 742 times the repayment for the outstanding short-term external debt with maturities of one year or less (Table 1.3).

The QE policy of the United States hurt the Japanese economy through the sharp appreciation of the yen. This and other economic problems, including tepid consumption and the deflation that have dogged Japan since the early 1990s,

motivated the Bank of Japan to employ its own version of QE. This involved buying long-term Japanese government bonds at JPY 7 trillion per month. The QE in Japan is part of what is called the three pillars of "Abenomics" or the economic policies advocated by Prime Minister Shinzo Abe. The other two pillars are (i) fiscal policies, including a 3-percent increase in consumption tax and streamlining of social welfare expenditures; and (ii) structural reforms to attain a 2-percent real growth in a couple of years (Tabata 2013). Japan's QE policy began in April 2013 and showed no clear signs of abating as of December 2013. The Bank of Japan announced that it would continue the policy until a stable 2-percent consumer price increase has been achieved, implying an inflation rate of around 1 percent. Japan's QE policy, however, is projected to have a lesser contribution to the volatility of capital flows in developing countries, including the Philippines, compared with the effect of the US QE policy. The World Bank estimates that only 3 percent of Japanese portfolio outflows are directed to developing countries, whereas the comparable rate in the US case is 8.3 percent (WB 2013).

Table 1.3. Foreign exchange res	serves in 1994, 1	1999, 2004,	and 2013 (in l	JSD million)
	1994	1999	2004	2013 ^r
Gross international reserves	7,142.10	15,063.99	16,227.91	83,187.04
Reserve adequacy measures				
Import cover ¹	3.09	3.68	3.55	12.05
Short-term external debt cover ²				
Original maturity	170.01	304.38	321.60	741.95
Residual maturity	101.25	187.34	163.03	541.91

Notes: ¹ Number of months of average imports of goods and payment of services and income that can be financed by reserves. ² Short-term external debt cover refers to the adequacy of reserves to cover outstanding short-term debt. For data on residual maturity (1994–2004) and original maturity (2013), the data reflect a revised denominator using end-month outstanding short-term external debt (with a two-month lag), except for months that are not end-of-quarter where outstanding short-term external debt by banks are not yet available. For data on residual maturity (2013), the data refer to adequacy of reserves to cover outstanding short-term debt based on original maturity plus principal payments on medium- and long-term loans of the public and private sectors falling due. ^r Revised based on the final International Reserves report as of end-December 2013. Source: BSP

In China, fears had to do with an overheating property sector. When China's economic expansion slowed down to 7.7 percent in 2012, the lowest in 13 years, speculations surfaced about the troubles ahead for the economy. The property sector came into focus. It was surmised that speculation and the flow of cheap money had inflated asset prices in China, creating a risk of a property bubble. Chinese authorities themselves later admitted that the speculation in the real estate market was a key risk. The skyrocketing home costs in 2013 prompted them to introduce measures to cool the sector. These measures included banning third-home purchases, stricter implementation of the 20-percent capital gains tax on home sales, and high loan rates for those buying a second home in certain cities.²

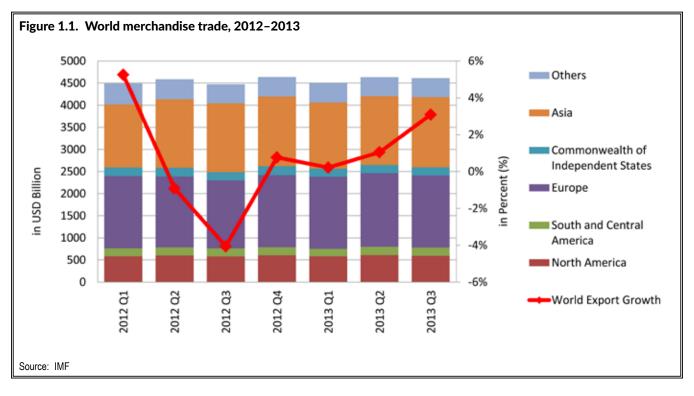
China's currency carry trades and its shadow banking system have played a huge role in financing the overheating property sector. The availability of low-interest funds outside China, such as in the United States, allowed Chinese financing companies to borrow at low interest rates and convert these into yuan for further lending at high interest rates at home. This carry trade ended up raising China's money supply. Even though authorities attempted to put restrictions on mainstream big banks' lending, some observers say trust companies, investment products, and wealth management products continued to thrive and financed even nonprofitable ventures, including ghost cities (Business Insider 2013). In a country not known for openness to information access, estimates of the size of the shadow banking system vary but one estimate places the asset size at 10 trillion yuan (The Economist 2014), or almost 18 percent of its GDP.

Nevertheless, China defied expectations of further slowdown as it maintained a flat growth

of 7.7 percent in 2013. Still, indicators point to an industrial sector that is losing steam and early signs of a property bubble. Industrial production in China increased to 9.7 percent year-on-year in December 2013 while it averaged 13.2 percent from 1990 to 2013 (Trading Economics 2014). An overheating property sector largely financed by risky lending in an opaque shadow banking system remains a concern and the fallout from potential loan defaults could have serious global financial consequences. The developments in China present both positive and negative impacts for the Philippines. The slowdown in the world's second largest economy could be an opportunity for the Philippines to undertake a more aggressive participation in the global supply chain currently dominated by China, but the consequences of a Chinese asset bubble burst could also affect the Philippines in case of undiscriminating and sympathetic sell-off in emerging markets.

The recession in the Euro zone had lingering effects but there were also some positive developments. The World Bank (2014) reported that strong export growth helped three-Iceland, Portugal, and Spainof the five high-spread economies in the European Unon in exiting recession in 2013. The recession was also easing in the other two high-spread economies— Italy and Greece. A turnaround in the European Union bodes well for the Philippines because it is among the EU's top-50 trading partners. However, the Philippines still falls behind most of its ASEAN neighbors in trading with the European Union. For instance, in 2012, Viet Nam exported 3.6 times more than the Philippines, or a total of EUR 18,514 million of Vietnamese exports versus only EUR 5,128 million of Philippine exports (The Delegation of European Union to the Philippines 2013).

² Nevertheless, the policy measures proved insufficient to prevent Zhejiang Xingrun Real Estate Co., a major property developer, to default on its USD 600-million loan on March 17, 2014 (*The Wall Street Journal*, 18 March 2014).



Overall, global conditions suggest that world merchandise growth is gradually normalizing after the drastic drop in 2012. World exports, which declined by 4 percent in the third quarter of 2012, continuously showed positive gains in 2013 and posted a 3-percent growth in the third quarter of 2013 (Figure 1.1). The World Bank has pointed out that trade is likely to accelerate as growth normalizes in the high-income economies (WB 2014). The IMF also projected that global trade volume will grow by 4.5 percent in 2014 and 5.2 percent in 2015, a major improvement relative to the 2.7-percent growth in 2012 and 2013. The import demand of advanced economies is projected to grow by 3.4 percent in 2014 and 4.1 percent in 2015; in the case of emerging market and developing economies, the figures are 5.9 percent in 2014 and 6.5 percent in 2015 (IMF 2014). The Philippines should be primed to take advantage of emerging favorable global and regional outlook.

Meanwhile, in Southeast Asia, preparations for the AEC 2015 are accelerating. The AEC 2015

vision is to have regional economic integration resting on these pillars: single market and production base, competitive economic region, equitable economic development, and integration into the global economy.

To date, there have been substantial achievements in laying down the necessary institutional frameworks. With respect to tariffs, the average common effective preferential tariff (CEPT) in the ASEAN-6 (Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, and Thailand) is now virtually zero and tariff elimination in the CLMV countries (Cambodia, Lao PDR, Myanmar, and Viet Nam) is continually being worked out (2.6% in 2010). With respect to trade facilitation, five ASEAN member-states now have operational national single window (NSW) systems for customs clearances and two member-states are in the advanced stages of NSW development. However, three other memberstates still require a huge effort to have a working NSW by 2015. The ultimate objective is to have

an ASEAN Single Window that will significantly boost intraregional trade. Mutual recognition arrangements for seven professional services have also been signed. Recognizing that there will still be necessary post-2015 measures to achieve regional economic integration, the ASEAN memberstates are gradually forging commitments under the ASEAN Framework Agreement on Services, which consists of liberalization in certain sectors, logistics measures, a single aviation market, and a single shipping market.

ASEAN economic integration will be beneficial for the Philippines as it will help address core issues that it shares with most other ASEAN members—the need to expand markets, transform and modernize the economy, and expand employment opportunities for a generally young ASEAN population. To take full advantage of a larger and more dynamic market for goods, services, and capital, the Philippines has to address both

border and behind-the-border issues. It has been gaining ground in addressing border issues (e.g., CEPT, NSW, among others). However, it must pay serious attention as well to reforming behind-the-border (domestic) issues, such as upgrading and modernizing infrastructure (roads, ports, airports), improving domestic resource mobilization (e.g., more effective taxation), investing in human capital (more and better spending for education and health), and reforming the judicial system including regulatory frameworks.

The Philippine economy in 2013

The Philippine economy grew by 7.2 percent in 2013, a substantially higher performance compared with its 6.6-percent growth in 2012. This performance is the second highest in the ASEAN region (Table 1.4), next to Lao PDR's growth, which in the past years was primarily driven by investments in natural resource extraction and hydropower. The

Table 1.4. GDP growth rates in the ASEAN, 2010-2015									
	2010	2011	2012	2013	2014	2015			
Brunei Darussalam	2.6	2.2	1.3	1.2	n.a.	n.a.			
Cambodia	6.0	7.1	7.3	7.0	7.0	7.0			
Indonesia	6.1	6.5	6.2	5.8	5.3	5.5			
Lao PDR	8.5	8.0	8.2	8.0	7.7	8.1			
Malaysia	7.2	5.1	5.6	5.1	4.8	4.9			
Myanmar	5.3	5.9	6.5	6.8	6.9	6.9			
Philippines	7.6	3.6	6.8	7.2	6.5	7.1			
Singapore	14.8	5.2	1.3	3.7	n.a.	n.a.			
Thailand	7.8	3.1	4.8	5.9	4.5	5.0			
Viet Nam	6.8	5.9	6.3	5.2	5.4	5.4			

Notes: The 2012 and 2013 GDP growth rates of Brunei Darussalam and the 2013 GDP growth rate of Malaysia are IMF estimates. The 2013 GDP growth rates of Brunei Darussalam, Cambodia, Lao PDR, and Myanmar are World Bank (WB) estimates. The projected 2014 and 2015 GDP growth rates for all countries are based on WB forecasts, except for Singapore, which was forecast by the Singapore Department of Statistics. n.a. – not available

Sources: WB, IMF, Central Bureau of Statistics of Indonesia, Malaysian Institute of Economic Research, Philippine Statistics Authority (PSA), Department of Statistics-Singapore, Ministry of Trade and Industry-Singapore, Ministry of Finance-Thailand. General Statistics Office of Viet Nam.

Philippines' growth in 2013 was mostly due to the strong growth of the industry and services sectors on the supply side and the more vigorous investment spending on the demand side. Net primary income from the rest of the world accelerated in 2013 (9.4% growth in 2013 against 4.8% growth in 2012), leading to a gross national income growth of 7.5 percent (Table 1.5). GDP per capita grew by 5.4 percent, higher than the 5-percent growth in 2012. Given that the population was estimated to have reached 97.4 million in 2013, GDP per capita now stands at PHP 69,477 in real terms (constant 2000 prices) or PHP 118,600 in nominal terms.

Growth forecasts for the next two years in the ASEAN region show that Philippine growth will remain high, though it is expected to decelerate in 2014 and then accelerate in 2015 (Table 1.4). Relative to the goal of achieving rapid and sustained growth stated in the Philippine Development Plan 2011–2016 (NEDA 2011), the economy's performance in the last two years and the outlook for the next two years seem to suggest that the Philippines is making a significant headway. What the country needs is to sustain its rapid growth to get out of the middle-income trap where it has remained in the last few decades. Recent literature suggests that the Philippines needs at least an annual GDP per capita growth of 4.7 percent in at most 28 years to enable it to cross over to the next income level (Box 1.1). The cross-over time to transition to high middleincome status can be cut by more rapid structural transformation.

Sectoral contributions to GDP growth

Breaking down the GDP growth components on the expenditure side reveals that similar to the pattern in the past years, household consumption contributed the most to GDP growth, accounting for 3.9 percentage points³ of the 7.2-percent GDP growth. The second biggest contributor was capital formation, which contributed 3.4 percentage points, a big improvement relative to its pulling GDP growth down by 1 percent in 2012. Net exports pulled GDP growth down by 1.7 percent. This negative contribution is explained by negligible exports growth relative to higher imports growth in 2013. In terms of growth, the highest-growing sector is capital formation at 18.2 percent, followed by government final consumption expenditure at 8.6 percent (Table 1.5).

Capital formation contributed the most during the first quarter (Figure 1.2). A closer look at the components of capital formation reveals that fixed capital, particularly spending on durable equipment, had the highest contribution. Among the types of durable equipment, transport equipment had the highest contribution.

The election period did not have a huge impact on the pattern of final consumption since the contribution of household spending on growth was the least during the second quarter of 2013 (Figure 1.2), the period covering the election of legislators and provincial and town/city officials. Nevertheless, government consumption slightly picked up during that quarter. Household consumption contributed the most during the third and last quarters, the period when natural calamities battered the country in succession (i.e., Typhoons Labuyo, Maring, and Habagat in the third quarter, and the Bohol earthquake and Typhoon Yolanda in the fourth quarter). Although the fastest-growing components of household consumption were spending on housing, water, electricity, gas, and other fuels, and spending on miscellaneous goods and services, the highest contributor to GDP growth was spending on food and nonalcoholic beverages.

³ The contribution to GDP growth by sector is GDP growth weighted by sectoral share in change in GDP.

Table 1.5. Selected macroeconomic indicators, Philippines
Annual growth rates and share to GDP

At constant 2000 prices, in percent unless otherwise stated

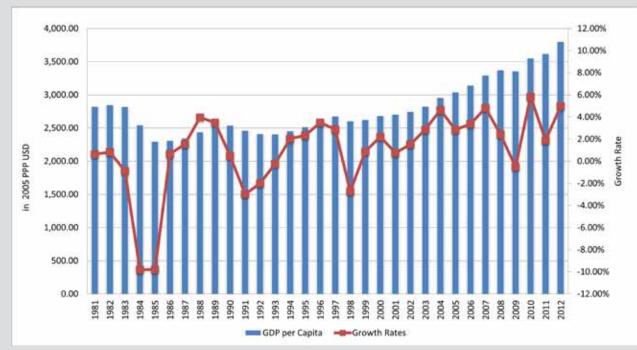
	2007	2008	2009	2010	2011	2012	2013	Forecas for 2014
Gross national income (GNI)	6.2	5.0	6.1	8.2	2.8	6.5	7.5	7.0
Gross domestic product (GDP)	6.6	4.2	1.1	7.6	3.6	6.8	7.2	6.6
GDP by expenditure shares								
1. Household final consumption expenditure	4.6	3.7	2.3	3.4	5.7	6.6	5.6	
Percent share to total GDP	71.6	71.2	72.1	69.2	70.6	70.4	69.4	
2. Government final consumption expenditure	6.9	0.3	10.9	4.0	2.1	12.2	8.6	
Percent share to total GDP	9.8	9.4	10.4	10.0	9.9	10.3	10.5	
3. Capital formation	-0.5	23.4	-8.7	31.6	2.0	-3.2	18.2	
Percent share to total GDP	15.9	18.8	17.0	20.8	20.4	18.5	20.4	
4. Exports	6.7	-2.7	-7.8	21.0	-2.8	8.9	0.8	
Percent share to total GDP	52.9	49.4	45.0	50.6	47.5	48.4	45.5	
5. Imports	1.7	1.6	-8.1	22.5	-1.0	5.3	4.3	
Percent share to total GDP	50.1	48.9	44.4	50.6	48.3	47.6	46.4	
GDP by industrial origin								
1. Agriculture, hunting, forestry, and fishing	4.7	3.2	-0.7	-0.2	2.6	2.8	1.1	
Percent share to total GDP	12.9	12.8	12.5	11.6	11.5	11.1	10.4	
Agriculture, hunting, and forestry	12.8	12.7	9.9	9.2	9.3	9.0	1.2	
Fishing	0.1	0.1	2.6	2.4	2.2	2.1	0.7	
2. Industry sector	5.8	4.8	-1.9	11.6	1.8	6.8	9.5	
Percent share to total GDP	32.2	32.4	31.5	32.6	32.0	32.0	32.7	
Mining and quarrying	18.6	-1.4	16.1	11.4	7.0	2.2	-2.5	
Manufacturing	3.6	4.3	-4.8	11.2	4.7	5.4	10.5	
Construction	14.6	7.0	6.8	14.3	-9.8	15.7	11.1	
Electricity, gas, and water supply	5.5	6.8	-0.9	9.9	0.6	5.1	4.0	
3. Service sector	7.6	4.0	3.4	7.2	4.9	7.6	7.1	
Percent share to total GDP	54.9	54.8	56.0	55.8	56.5	56.9	56.8	
Transportation, storage, and communication	8.4	3.9	-0.1	1.0	4.3	8.1	5.5	
Trade and repair of motor vehicles, motorcycles, personal and household goods	8.6	1.4	1.4	8.4	3.3	7.5	6.5	
Financial intermediation	10.2	1.8	5.5	10.1	5.2	8.2	12.4	
Real estate, renting, and business activities	7.9	9.0	4.1	7.5	8.4	7.5	8.4	
Public administration and defense: compulsory social security	1.4	2.0	6.1	5.8	1.9	6.1	4.0	
Other services	6.1	6.0	6.5	8.4	5.6	7.7	5.4	
Headline inflation (2006=100)	2.9	8.3	4.2	3.8	4.6	3.2	3	4
Nominal interest rate (91-day T-bills)	3.4	5.4	4.2	3.7	1.4	1.6	0.3	
Nominal exchange rate (PHP/USD, average)	46.15	44.47	47.64	45.11	43.31	42.23	42.45	45

Box 1.1. Getting out of the "middle-income trap"

In recent literature, the Philippines was classified as one of the countries that had fallen into the so-called "middle-income trap". Felipe et al. (2012) gauged that 28 years are the threshold number of years that countries spend in the lower-middle-income group before graduating to the next income group; for the upper-middle-income group, the threshold is 14 years. The Philippines, which is considered a lower-middle-income country (i.e., with per capita income of USD 2,000 in 1990 PPP dollars), is said to have fallen into the trap because it has been in this income group for 34 years as of 2010.

Felipe and colleagues further estimated that a country like the Philippines has to attain an average annual growth rate of per capita income of at least 4.7 percent for at most 28 years to be able to cross over to the next income level.

Although data show a generally increasing trend in Philippine GDP per capita growth, it is not enough. Going back from 2012, the average annual growth rate was only 0.97 percent in the past 30 years, only 2.3 percent in the last 20 years, and only 3.3 percent in the last 10 years (Box Figure 1.1).

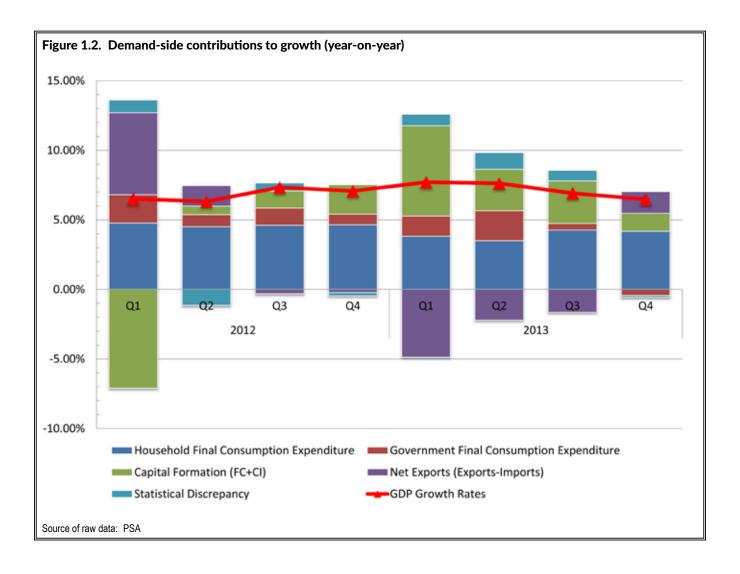


Box Figure 1.1. GDP per capita (in 2005 PPP dollars)

Note: GDP per capita are now computed in 2005 PPP dollars in the WB database. Source of raw data: WB - World Development Indicators 2013

How can the Philippines get out of the middle-income trap? The literature indicates that the most direct strategy is to accumulate productive capabilities and express them in (i) a more diversified export basket, and (ii) more complex products or those that require more capabilities.

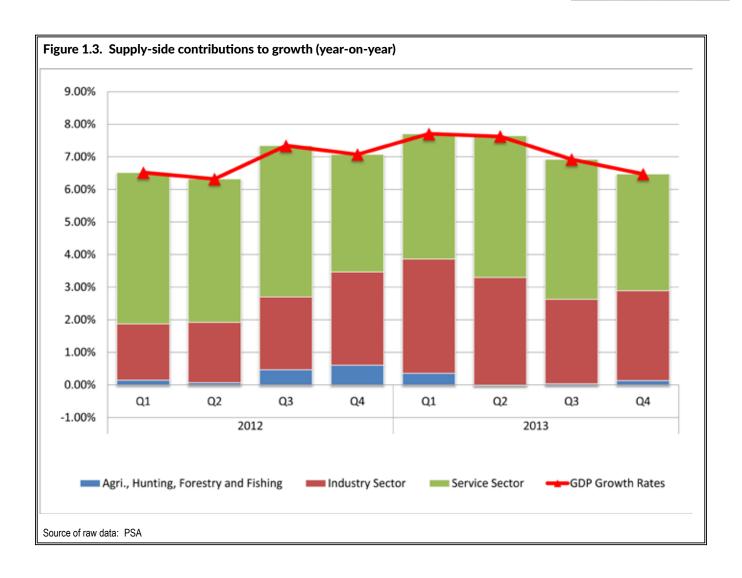
Acquiring productive capabilities in more sophisticated products will require more vigorous efforts to address critical development constraints identified by recent Philippine literature: (a) fiscal space, (b) infrastructure, (c) access to finance, (d) investments in human capital, and (e) governance and institutional frameworks (ADB 2007).



Among the components of GDP by industrial origin, value added in the services sector contributed the most (4 percentage points) to GDP growth, followed by value added in the industry sector (3 percentage points). In terms of growth rates, the industry sector was the fastest-growing sector (9.5% growth) followed by the services sector (7.1% growth) (Table 1.5). In the services sector, growth was highest in the financial intermediation subsector and the highest contributor to GDP growth was the trade and repair subsector (i.e., trade and repair of motor vehicles, motorcycles, personal and household goods). In the industry sector, growth was highest in the construction subsector

and the highest contributor to GDP growth was the manufacturing subsector. In fact, an in-depth look at all subsectors in the supply-side GDP accounting revealed that manufacturing contributed the most (2.32 percentage points) to GDP growth.

The overall contribution of agriculture, hunting, forestry, and fishing was a mere 0.1 percentage point. Growth in this subsector was also low at 1.1 percent (Table 1.5). Figure 1.3 shows that the sector was at its lowest pace during the second and third quarters of 2013. The subsectors of agriculture that exhibited negative contribution to GDP growth were banana, coconut, sugarcane, coffee, and corn.



Exports and manufactures

Exports, particularly the more complex and sophisticated export products, are seen as a key to getting out of the middle-income trap. An examination of the share of the Philippines in global merchandising export shows a disturbing trend. The Philippines' share fell to 0.28 percent in 2012 from 0.61 percent in 2000 (Table 1.6). The export of manufactures exhibited the largest drop—from 0.77 percent share in 2000 to only 0.34 percent share in 2012. Meanwhile, the Philippines' resource-based exports, which contributed only a small value added according to past studies, had gone up. Ores and metals exports had increased by 227 percent from

2000 to 2012, but their share in global exports only rose slightly, to 0.28 percent from 0.04 percent.

In 2013, sluggish global demand for electronics led to a significant reduction in shipments of electronic exports. This led to the lackadaisical export performance in the first three quarters of 2013 (Figure 1.2). A turnaround was exhibited in the last quarter as electronics exports picked up in December, 26 percent higher year-on-year, according to the Semiconductors and Electronics Industries in the Philippines, Inc. (SEIPI).

Meanwhile, the Philippines' export of services is becoming more significant, expanding from 5 percent of GDP in the early 2000s to 10 percent of

Table 1.6. Global merchandising exports (in current USD million)											
	GI	obal		Philipp	ines						
	2000	2012	2000	% of Global	2012	% of Global					
Food	454,966.96	1,475,798.32	1,989.15	0.44%	4,679.55	0.32%					
Agricultural raw materials	129,990.56	368,949.58	397.83	0.31%	519.95	0.14%					
Fuels	779,943.36	2,213,697.48	397.83	0.05%	1,039.90	0.05%					
Ores and metals	1,949,858.40	922,373.95	795.66	0.04%	2,599.75	0.28%					
Manufactures	4,744,655.44	12,728,760.51	36,600.36	0.77%	43,155.85	0.34%					
Total Merchandising Exports	6,499,528.00	18,447,479.00	39,783.00	0.61%	51,995.00	0.28%					
Source: WB - World Development In	dicators 2013										

GDP since 2011. In 2013, export of services grew faster than export of goods (3.49% for export of services versus 0.08% for export of goods) and had a higher contribution to GDP growth (0.35 percentage point for export of services versus 0.03 percentage point for export of goods).⁴ This suggests the need for serious efforts to further increase service exports alongside the growth of the manufacturing sector to boost goods exports.

Internationally traded services include services related to financial intermediation, telecommunications. information technology, tourism, recreational, and professional services. Global outsourcing of services has become more prevalent. The types of information-based services that can be consumed anywhere in the world have also multiplied in today's more interconnected world. The Philippine statistical measurements for exports of services, however, are no longer responsive to the rapid changes happening in the drivers of growth and have failed to capture significant information on trends in services exports. For example, in the 2013 GDP accounts of the Philippine Statistics Authority, 77 percent of exported services are reported as the vague and catch-all category of "miscellaneous services". Categories such as transportation, insurance, travel, and government are not sufficiently representative of the major types of internationally traded services. Current discussions also point to the significant potential contribution of the creative economy to GDP growth.

While sustaining and enhancing the growth of Philippine exported services are important, these are not enough. The economy cannot rely solely on the services sector to be the main driver of inclusive growth because it employs mostly skilled labor, leaving out a huge pool of semiskilled and unskilled labor. High-productivity and internationally traded services such as business process outsourcing do not employ low-skilled workers who have better chances of employment in the labor-intensive manufacturing sector. Current efforts to revive and strengthen Philippine manufacturing are in the right direction and will address concerns over the lack of inclusiveness of growth.

The manufacturing sector is showing signs of recovery, with some positive implications for

Computed from GDP breakdown released in various years by the former National Statistical Coordination Board, now the Philippine Statistics Authority.

goods exports. Manufacturing value-added growth was 10.51 percent in 2013, a high figure relative to the growth rates reported in 2011 and 2012, at 4.73 percent and 5.39 percent, respectively. Manufacturing value added also contributed 2.32 percentage points to GDP growth in 2013. Among the manufacturing industry groups, chemicals and chemical products posted the highest growth rate (97.76%) and had the highest contribution to GDP growth (1.48 percentage points). The monthly Purchasing Managers' Index (PMI)⁵ for manufacturing showed that the sector was on an expansionary mode (above 50%) in 2013. The 2013 indices were also higher than the 2012 indices (except in March). The latest available PMI for manufacturing was 54.61 percent in November 2013, suggesting signs of expansion despite lower business activities due to Typhoon Yolanda. However, since Philippine export goods have long been at the low end of the value chain, the challenge remains for the manufacturing sector to move up the value chain and produce more sophisticated export goods.

Fiscal performance

The current administration inherited a fiscal deficit of 3.9 percent of GDP in 2009. As of end-2010, this was reduced to 3.5 percent. To resolve the fiscal deficit issue, the government targeted to reduce it further to 3.2 percent by 2011, 2.6 percent by 2012, and 2 percent by 2013. The actual accomplishments have surpassed these targets (2% in 2011,⁶ 2.3% in 2012, and 1.4% in 2013), resulting in more fiscal space for critical government programs and projects.

The Development Budget Coordination Committee (DBCC) targeted to limit the 2013 fiscal deficit to 2 percent of GDP or a programmed budget deficit ceiling of PHP 238 billion. The actual deficit went down to 1.4 percent of GDP or PHP 164 billion in 2013 (Table 1.7).

Nevertheless, the government still has much catching up to do in the area of revenue generation. The revenue collected in 2013, amounting to PHP 1,716.1 billion or 14.8 percent of GDP (Table 1.7), is still below the amounts generated by its peers in the Southeast Asian region. The average revenue-to-GDP ratio in the ASEAN excluding Brunei Darussalam (which has a ratio skewed by its large petroleum revenues) was 18.6 percent in 2012. The Philippines' revenue generation effort is second from the bottom in ranking (Figure 1.4).

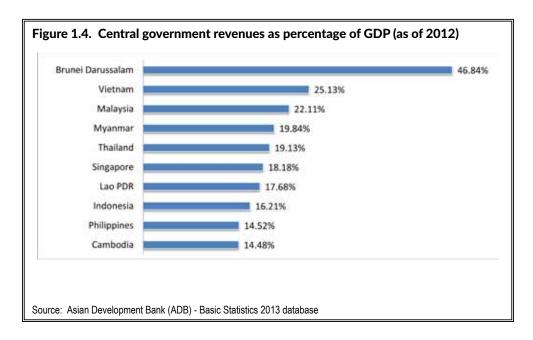
The Department of Finance is aiming to generate revenues amounting to 18 percent of GDP by the end of President Aquino's term. The Bureau of Internal Revenue's efforts to increase tax revenues, including the "Run After Tax Evaders" program, are therefore in the right direction. However, these programs will be more effective if the present administration would be able to prosecute, with as much zeal as in the cases against professionals and celebrities, the big cases that had escaped the arm of the tax man. The administration appears to have the political will to prosecute big cases, expose sophisticated tax evasion modes to the public, and serve tax-evasion-deterrent examples to big-time offenders.

The widening of fiscal space was sustained as the country's debt-to-GDP ratio declined to 39.7

⁵ The PMI is based on interviews with purchasing/supply chain managers conducted by the nongovernment Philippine Institute for Supply Management. It is meant to complement official government statistics. The PMI for manufacturing is a composite index generated from five key tracking indicators—new orders, production, employment, supplier deliveries, and inventories.

⁶ The 2011 accomplishment, however, came at the expense of underspending on capital outlays on infrastructure and other public expenditure items. This was also the year when GDP growth was low at 3.6 percent due to the negative net exports and government underspending. This implies that the reduction of the fiscal deficit should not be at the expense of cutting down or slowing down spending for productive and productivity-enhancing activities or sectors.

Table 1.7. Indicators of fiscal performance (in PHP billion)									
Programmed Actual Percent Jan-Dec 2013 Differenc									
Revenues	1,745.90	1,716.10	1.74%						
Expenditures	1,983.90	1,880.20	5.52%						
of which:									
Interest payments	332.20	323.4	2.72%						
Other expenditures	1,651.70	1,556.70	6.10%						
Primary fiscal surplus / (deficit)	94.20	159.40	-40.90%						
Total surplus / (deficit)	Total surplus / (deficit) (238.00) (164.10) 45.03%								
Note: Figures may not add up due to rounding. Sources: Department of Budget and Management (DBM) and Bureau of the Treasury (BTr)									



percent of GDP as of third quarter 2013, lower than the 40.3 percent debt-to-GDP ratio in third quarter 2012. The general government debt level stood at PHP 4.468 trillion as of third quarter 2013. Sourcing the government's credit requirements more from the domestic markets than from abroad helped in debt management as the former offered lower interest rates and longer maturities. Currency risk was also obviated by tapping more domestic debt to finance public sector requirements. The borrowing mix as of third quarter 2013 was 66:34

in favor of domestic debt, whereas the mix in third quarter 2012 was 61:39.

Balance of payments

The balance-of-payments (BOP) surplus of the Philippines reached USD 5.08 billion in 2013. Although it is 44.9 percent lower than the 2012 figure, a surplus nevertheless reflects a healthy BOP position, which has been the country's position for the last few years (Table 1.8). Trade in goods was in deficit and net primary income was negative but

these were offset by the surplus in trade in services and the large secondary income, which resulted in a 35.6-percent growth in current account surplus. Secondary income, previously called current transfers in BOP accounting, includes workers' remittances and other personal transfers in cash or in kind.

Portfolio investments in 2013 were 58.7 percent lower than the 2012 figure (Table 1.8), with the last quarter of 2013 exhibiting a reversal of portfolio flows as investors reacted to the Fed's tapering of its QE policy.

Remittances from overseas Filipinos continued to remain strong and reached USD 22.97 billion in 2013 (Table 1.9). The volume of remittances has grown steadily over the years. Remittances may have been increased by overseas Filipinos to offset the reduction in the peso equivalent per dollar of their remittance due to the appreciation of the

peso. This may be an indication that they want to maintain the standard of living of their families who depend on those remittances.

Price movements

Headline inflation rate rose to 4.1 percent in December 2013 (Figure 1.5). All commodity groups except communication, recreation, and education posted higher year-on-year increases in December, a continuation of the uptick that started in September. The retail prices of vegetables started going up in September as a result of the devastation caused by Typhoon Maring in Luzon. In the latter part of 2013, inflation in areas outside the National Capital Region (NCR) accelerated faster than inflation in the NCR. Almost all food items in the consumer price index increased, with some items reaching double-digit inflation in typhoon-affected areas. Nevertheless, the annual average of 3 percent is still

Table 1.8. Balance of p	Table 1.8. Balance of payments, 2005–2013 (in USD million)											
	2005	2006	2007	2008	2009	2010	2011	2012	2013 ^p			
Current account	1,990	6,963	8,072	144	8,448	7,179	5,643	6,949	9,423			
Goods and services	-9,998	-6,982	-8,008	-16,675	-8,962	-11,094	-13,866	-12,747	-11,704			
Goods	-12,146	-11,459	-13,966	-18,646	-13,860	-16,859	-20,428	-18,926	-18,525			
Services	2,148	4,477	5,958	1,971	4,898	5,765	6,562	6,179	6,821			
Primary income	354	702	1634	1,100	841	677	942	197	-254			
Secondary income	11,634	13,244	14,446	15,719	16,570	17,596	18,567	19,500	21,381			
Capital account	79	103	36	110	90	88	160	95	115			
Financial account	1,834	1,684	-170	1,370	-896	-11,491	-5,319	-6,748	635			
Direct investment	-870	-1,639	2,454	630	-167	1,642	342	958	-218			
Portfolio investment	-1,298	-3,019	-1,575	1,587	-2,054	-4,890	-3,663	-3,205	-1,325			
Financial derivatives	43	138	288	114	-30	194	-1,005	-14	-88			
Other investment	3,958	6,204	-1,336	-961	1,356	-8,436	-993	-4,487	2,266			
Net unclassified items	2,174	-1,613	277	1,204	-3,013	-3,515	279	-4,556	-3,818			
Overall BOP position	2,410	3,769	8,556	89	6,421	15,243	11,400	9,236	5,085			

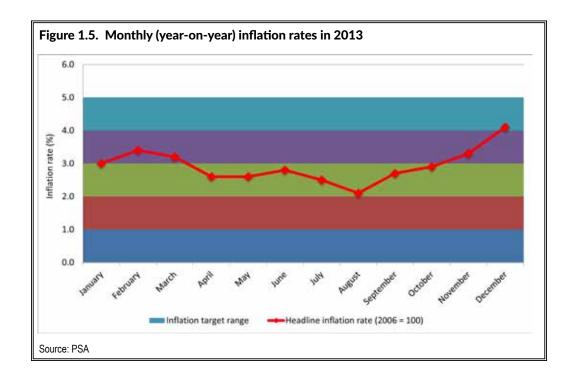
Notes: The data are recalibrated figures following the Balance of Payments and International Investment Position Manual, 6th edition (BPM6) compilation framework that was issued by the IMF and is being adopted by the BSP. Negative financial account means liabilities were incurred, or the rest of the world had net payments to the country (inflow) for the financial assets they acquired; p Preliminary

Source: BSP

Cash Remittances (in USD million) 6,050.5 6,031.3 6,886.2 7,578.5	Growth Rate (in %) 0.5 -0.3 14.2 10.1
6,031.3 6,886.2 7,578.5	-0.3 14.2
6,886.2 7,578.5	14.2
7,578.5	
,	10.1
0.550.4	
8,550.4	12.8
10,689.0	25.0
12,761.3	19.4
14,449.9	13.2
16,426.9	13.7
17,348.1	5.6
18,763.0	8.2
20,117.0	7.2
21,391.3	6.3
22,968.2	7.4
	12,761.3 14,449.9 16,426.9 17,348.1 18,763.0 20,117.0 21,391.3

within the BSP's 3- to 5-percent inflation target range and also lower than the 2012 average of 3.2 percent. Core inflation, which excludes the effects of volatile prices of selected food and energy items, averaged at 2.9 percent in 2013, lower than the 3.7 percent average in 2012.

The global food price index and crude oil price movements in 2013 (Figure 1.6) also show that price shocks in the Philippines are less influenced by external events and emanated from domestic events. World food and oil prices in 2013 were relatively stable and lower compared with prices in previous years. The Food and Agriculture Organization (FAO) of the United Nations reported a large increase in world cereal output in 2013 at 2.52 billion tons, a 9-percent increase from the 2012 level (FAO 2014). The downward pressure on Brent crude oil prices, meanwhile, is partly explained by the lifting of some economic sanctions on Iran after the country reached an interim accord with the United States and some European countries over its nuclear program (Bloomberg 2014).



Peso depreciation prevailed throughout 2013 (Figure 1.7), a reversal of the peso appreciation experiencedsince 2008 (Figure 1.8). Peso depreciation was most rapid in June 2013. Nevertheless, the depreciation did not affect inflation significantly, a confirmation of the declining pass-through effect of exchange rate adjustments to inflation in monetary policy regimes that have adopted inflation targeting while keeping a floating exchange (Mihaljek and Klau 2008). In 2008, it was estimated that in the Philippines, a one-peso depreciation increased the average annual inflation by only 0.043 percentage point (Guinigundo 2008).

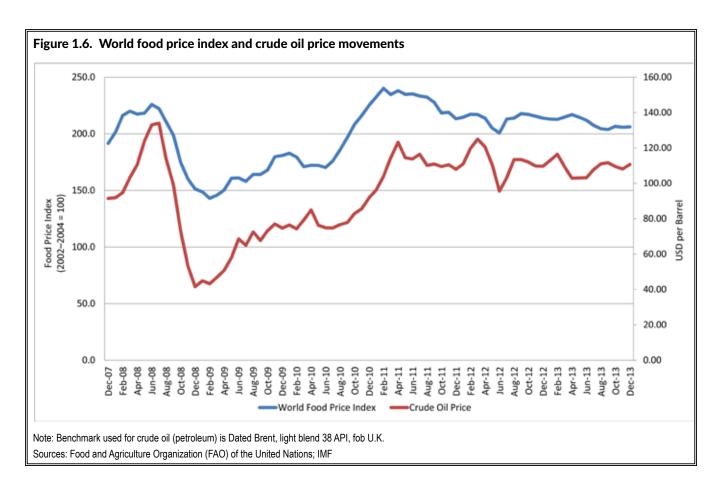
Trading in the Philippine equity market in 2013 was marked by high volatility (Figure 1.8), a reflection of volatility in equity markets worldwide due to speculations on when exactly the start of the

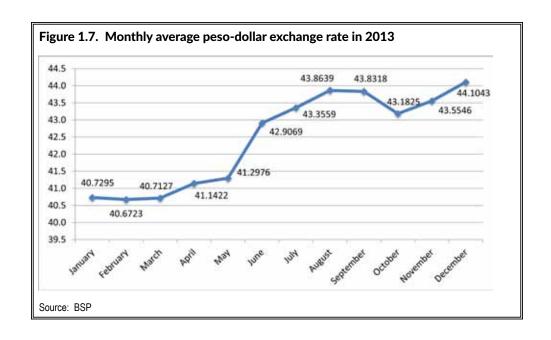
Fed tapering would be, fears of US intervention in the Syrian civil war, and signs of problems with financial regulations in China.

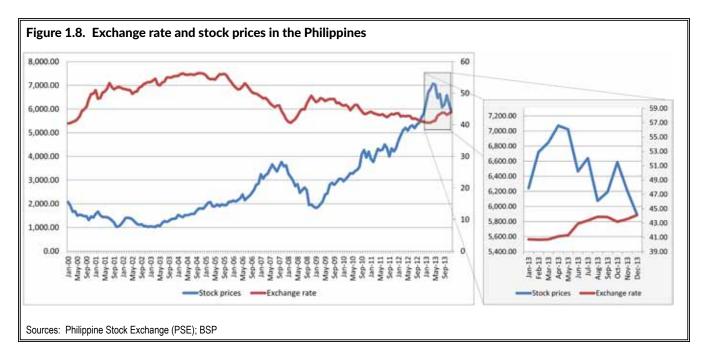
Speculations of a bubble in Philippine asset prices became prominent in the last quarter of 2013. The Philippine Stock Exchange index, however, experienced some correction and ended at 5,889.93 or 0.20 percent higher on the last trading day of 2013.

Rapid credit growth and property price increases are usually the first signs that analysts look at when deciphering tell-tale signs of an asset price bubble. That a credit bubble is forming in the country seems unfounded because as mentioned in the discussion of fiscal performance, the debt-to-GDP ratio has been declining.

Price increases in the property sector are also backed by strong demand, and prices are increasing







due to low supply. A 2012 study (SHDA and CRC 2012) revealed that the housing backlog in the socialized, economic, and low-cost segments was 3.09 million housing units as of 2011. There was a surplus of 474,000 units in the middle-income and high-income segments, but these accounted for only 1 percent and 0.16 percent of demand, respectively. There was also evidence of low vacancy rates in

the central business and industrial areas. In the Philippine property sector, prices usually rise when vacancy rates drop below 10 percent. Colliers International (2013) reported that in the last quarter of 2013, the vacancy rate in the Makati central business district (CBD) declined to 2.3 percent. Moreover, the average industrial vacancy rate in the CALABARZON declined by more than 3 percent,

suggesting a thriving manufacturing industry. Residential vacancy rate in the Makati CBD increased to 11 percent and the residential vacancy rate in Fort Bonifacio decreased to 5 percent. Nevertheless, risk warnings must not be ignored. Stricter regulation of lending to the real estate sector is in place (e.g., bank lending cap of 20% to the real estate sector) and the BSP is planning to create an official real estate price index to monitor any sign of overheating in the sector more closely.

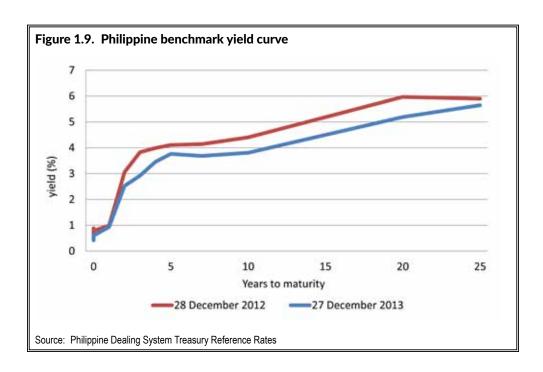
The low cost of capital continued to prevail in 2013. Comparing the yield curves on the last trading day of 2012 and 2013, the interest rates for all maturities were found to have declined further in 2013 (Figure 1.9). This has positive implications for investments, including infrastructure and manufacturing investments, which in turn suggests the potential to create more jobs.

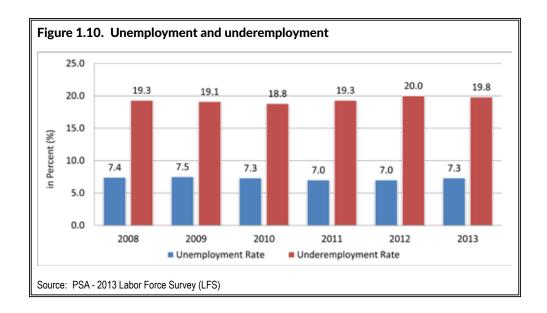
Job creation

The perennial high unemployment rates have raised increasing concerns about the inclusiveness of Philippine economic growth. Unemployment in 2013 stood at 7.3 percent of the labor force (equivalent to 2.99 million Filipinos without jobs), which was higher than the figure recorded in 2012. More worrisome is the underemployment rate at 19.8 percent (equivalent to 7.51 million Filipinos who have jobs but are looking for additional work), which was only slightly lower than the rate in 2012 (Figure 1.10).

Data on the dynamics of labor movement are available only for enterprises in the NCR, but this is where most large enterprises are located and thus could show significant patterns on job creation and job losses. The 2013 labor market data show an overall gain in job creation in the NCR (Table 1.10).

Although job shedding (measured by the separation rate) was higher by 0.02 percentage point than job creation (measured by the accession rate) in the first quarter, the reverse happened in the second quarter: job creation was higher than job shedding (accession or hiring rate was 2.49 percentage points higher than separation rate). In the third quarter, accession rate was 2.38 percentage points higher than separation rate. The fourth quarter data show





a higher net jobs gain given that the accession rate was 3.22 percent higher than the separation rate, but job losses occurred in the education and mining and quarrying sectors.

Table 1.10 shows that there were net gains in NCR employment in 2012 and for the most part of 2013. The high unemployment rate nationwide and the finding that there were net gains in employment in 2013 in the NCR suggest that either job losses occurred mostly outside NCR or job creation was slower in areas outside NCR, or it could be both. This seems to reinforce the non-inclusiveness of economic growth, geographically in this case.

Prospects for 2014

The developments in 2013 suggest a generally positive outlook for 2014. Even with the likely increase in domestic interest rates due to the monetary tightening of the BSP and the end of the US quantitative easing, there is still sufficient slack in investments and wide room for productivity improvements. Thus, we expect that these developments will not significantly dampen investor confidence. Despite the risks ahead, we expect GDP to grow by 6.6 percent in 2014 (Table 1.5).

Capital formation was a significant factor in the economic performance in 2013 and we expect the strong 18.2-percent growth in capital formation to have a lag effect. Investments as a driver of internal growth will thus remain significant. Construction is likely to accelerate due to postdisaster reconstruction efforts, more aggressive infrastructure investments, and the start of some public-private partnership projects.

The damage to agriculture and support infrastructure wrought by Typhoon Yolanda has a considerable effect on the growth potential of the affected region. However, the typhoon's overall (negative) impact on the agricultural sector's performance in 2013 is minimal. The minimal contribution of the agricultural sector to value-added growth in 2013 is projected to persist in 2014 because of low productivity and investments in that sector.

Inflation is likely to be slightly higher this year at 4 percent and will be driven by higher food and electricity prices as low agricultural productivity continues and tight supply margins in the power grid remain. The depreciation of the peso could also push overall inflation up through its impact

	2012											
	1st Quarter		2	nd Quarte	er	3	rd Quarte	r	4	th Quarte)r	
Sector	Accession Rate	Separation Rate	Percent Difference									
All Sectoral Groups	<u>8.10</u>	<u>7.47</u>	0.63	8.93	8.08	0.85	8.43	6.08	2.35	<u>8.14</u>	<u>5.67</u>	2.47
Agriculture, forestry, and fishing	5.59	6.63	(1.04)	5.06	4.21	0.86	5.65	6.09	(0.43)	4.36	5.22	(0.86)
Industry	6.03	4.90	1.13	8.18	7.94	0.24	7.17	6.19	0.98	7.62	5.99	1.63
Mining and quarrying	19.16	9.35	9.81	12.95	9.16	3.79	12.28	9.13	3.15	10.75	18.02	(7.28)
Manufacturing	4.09	4.04	0.04	5.51	8.30	(2.78)	5.86	2.03	3.83	3.40	2.22	1.18
Electricity, gas, steam, and air conditioning	1.32	1.86	(0.54)	1.20	1.75	(0.55)	0.64	1.55	(0.91)	1.35	1.52	(0.17)
Water supply; sewerage, waste management and remediation activities	3.52	2.70	0.82	2.08	2.69	(0.61)	2.24	10.02	(7.78)	4.33	1.29	3.04
Construction	8.55	6.40	2.16	11.93	7.84	4.09	9.14	12.60	(3.46)	14.14	10.91	3.23
Services	8.60	8.06	0.54	9.11	8.12	0.99	8.71	6.06	2.66	8.26	5.60	2.65
Wholesale and retail trade; repair of motor vehicles and motorcycles	7.22	7.96	(0.74)	7.66	7.38	0.29	10.61	6.74	3.87	10.52	6.91	3.60
Transportation and storage	5.29	4.35	0.94	3.56	4.28	(0.72)	4.92	4.24	0.68	4.69	3.94	0.74
Accommodation and food service activities	11.34	8.92	2.41	12.09	8.49	3.60	7.55	9.66	(2.11)	11.74	7.71	4.04
Information and communication	5.94	6.98	(1.04)	7.47	5.39	2.08	7.68	6.02	1.66	5.82	4.16	1.66
Financial and insurance activities	5.88	4.15	1.73	4.83	3.63	1.20	4.07	3.35	0.72	3.91	2.28	1.63
Real estate activities	10.68	10.15	0.53	8.25	5.45	2.80	7.26	5.42	1.83	5.98	3.40	2.58
Professional, scientific, and technical activities	10.67	5.60	5.07	15.13	10.68	4.45	3.94	2.23	1.71	3.78	3.54	0.24
Administrative and support service activities	12.70	10.59	2.11	13.48	13.08	0.40	10.49	6.95	3.54	8.29	5.31	2.99
Education	1.74	4.90	(3.15)	13.86	12.94	0.92	3.26	1.04	2.23	1.60	3.65	(2.05)
Human health and social work activities	5.96	5.71	0.24	5.75	5.23	0.52	5.32	5.81	(0.49)	3.72	7.68	(3.96)
Arts, entertainment, and recreation	6.58	5.02	1.56	13.93	12.40	1.53	14.52	11.84	2.68	6.27	7.05	(0.77)
Other service activities	13.06	31.65	(18.59)	13.88	11.07	2.82	4.49	4.46	0.04	4.90	2.98	1.93

						20	13				,	
Sector	1st Quarter			2	2nd Quarter 3rd C			Brd Quarte	r	4	th Quarte	r
	Accession Rate	Separation Rate	•	Accession Rate	Separation Rate	Percent Difference	Accession Rate	Separation Rate	Percent Difference	Accession Rate	Separation Rate	Percent Difference
All Sectoral Groups	7.49	<u>7.51</u>	(0.02)	8.77	6.28	2.49	8.37	5.99	2.38	8.86	<u>5.64</u>	3.22
Agriculture, forestry, and fishing	4.56	2.72	1.84	2.76	2.75	0.01	3.70	2.53	1.16	6.21	3.92	2.30
Industry	9.41	4.73	4.67	9.26	5.62	3.64	9.00	5.93	3.07	7.97	7.13	0.84
Mining and quarrying	16.36	9.28	7.09	13.04	8.32	4.71	12.59	15.76	(3.17)	5.77	15.04	(9.27)
Manufacturing	6.55	3.85	2.70	8.62	4.10	4.53	8.33	3.62	4.70	9.36	7.15	2.21
Electricity, gas, steam, and air conditioning	2.74	1.29	1.44	1.82	2.08	(0.25)	1.39	1.61	(0.22)	1.83	1.23	0.60
Water supply; sewerage, waste management and remediation activities	6.12	1.44	4.68	2.23	1.95	0.28	1.55	1.69	(0.14)	1.82	1.67	0.15
Construction	13.22	5.76	7.46	10.24	7.64	2.60	9.98	8.01	1.98	6.74	6.69	0.05
Services	7.10	8.10	(1.00)	8.70	6.43	2.27	8.27	6.02	2.25	9.05	5.35	3.70
Wholesale and retail trade; repair of motor vehicles and motorcycles	8.45	10.20	(1.75)	7.72	6.94	0.78	9.92	6.97	2.95	10.15	6.37	3.77
Transportation and storage	5.12	5.30	(0.18)	5.59	4.54	1.05	8.09	4.30	3.79	6.57	5.27	1.30
Accommodation and food service activities	11.45	13.14	(1.69)	17.79	11.50	6.29	11.05	10.09	0.95	10.66	10.21	0.46
Information and communication	5.71	4.85	0.86	4.95	3.26	1.69	5.86	6.14	(0.28)	5.85	4.34	1.52
Financial and insurance activities	3.32	3.23	0.09	3.65	3.60	0.06	3.48	2.82	0.66	4.70	2.36	2.34
Real estate activities	7.09	6.52	0.56	8.36	5.09	3.27	6.00	6.37	(0.37)	4.77	3.74	1.04
Professional, scientific, and technical activities	3.94	4.30	(0.36)	7.48	3.36	4.12	4.40	3.09	1.31	6.72	3.27	3.46
Administrative and support service activities	6.87	8.08	(1.21)	14.18	9.23	4.96	10.22	6.57	3.65	14.70	5.14	9.55
Education	1.76	3.00	(1.23)	12.77	9.65	3.11	6.60	1.66	4.95	2.76	5.50	(2.74)
Human health and social work activities	8.05	4.32	3.73	7.32	5.05	2.27	6.08	4.51	1.57	7.47	4.65	2.82
Arts, entertainment, and recreation	12.84	16.61	(3.77)	15.43	12.58	2.85	10.01	10.75	(0.74)	15.17	12.01	3.16
Other service activities	5.49	6.17	(0.68)	5.70	3.61	2.09	4.33	3.60	0.73	4.27	2.86	1.42

on imported inputs. Nevertheless, the projected inflation rate is still within the government's 3–5 percent target.

The peso-dollar exchange rate will continue to be influenced by the tapering of the US monetary expansion. But its impact is expected to be moderate as investors have likely incorporated this expectation in advance into their investment decisions. The depreciation trend of the peso will likely continue and we expect the exchange rate to average at PHP 45 to USD 1. This increased competitiveness of the peso will have positive impacts on the exports sector. A rebound in exports is expected to take place as a result of higher semiconductor and electronics exports, which is targeted to grow by 5 percent based on projections of the Semiconductor and Electronics Industries in the Philippines, Inc. (PHILEXPORT 2014), and higher exports of other manufactured goods given the boost that the manufacturing industry is getting.

The projected 6.6-percent GDP growth is in line with the government's target of rapid and sustained growth. The challenge of making this growth more inclusive should be addressed urgently. The Philippine Development Plan 2011-2016 identified the following critical development constraints to sustained and inclusive growth: (a) narrow fiscal space, (b) inadequate infrastructure, (c) major gaps in governance, (d) inadequate investments in human capital, and (e) environmental degradation. Various policy and institutional reforms addressing these constraints have resulted in a strong macroeconomic framework that has provided stability and investor confidence and has primed the economy for sustained growth. Increased expenditure in education and health, including such propoor expenditure programs as the conditional cash transfer have started, albeit slowly, to embed the ethos of making growth inclusive in the government's budget, policies, and processes. It seems

that good governance and anticorruption initiatives have permeated government consciousness and have influenced policymaking for good. The recent Philippine development experience attests to the efficacy of reforming policies and institutional frameworks. It is necessary for government to stay the course.

However, much greater effort must be exerted in increasing infrastructure investments, expanding the industrial base, introducing a competition policy framework, reforming regulatory institutions, and addressing labor market issues to attain inclusive growth and bring about a significant reduction in poverty and income inequality.

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Policy Updates: Developments and Implications

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he last chapter described the economy's recent notable growth performance and underscored the lack of inclusiveness of economic growth. The high unemployment rate indicates that around 3 million Filipinos were without jobs in 2013, higher than the figure in 2012. Equally disturbing is the large number of Filipinos who are employed but are looking for additional work as their earnings do not allow them to live a decent life. In 2013, 19.8 percent of those with jobs—equivalent to 7.51 million Filipinos—were underemployed.

There is no doubt that high rates of unemployment and underemployment have induced more poverty. The latest data from the Philippine Statistics Authority (PSA) reveal that there has been slow progress in reducing poverty. While there has been a downward trend in the proportion of the population that was poor from 2006 to 2012, the reduction has been very small. The poverty incidence—the proportion of the population with per capita income less than the poverty threshold¹—declined to just 25.2 percent in 2012 from 26.3 percent in 2009 and 34.4 percent in 1991. With the sluggish job-creating capacity of the economy, amid a population growing annually at 1.7 percent, the magnitude of poor people has further increased. It rose to 23.7 million in 2012 from 22.6 million in 2006 and 21.7 million in 1991. Natural calamities in 2013—Typhoon Yolanda and the earthquake in Bohol—have contributed to the slow reduction in poverty.

¹ The minimum income necessary to meet food and nonfood needs.

Regional disparities have widened despite some improvements over the period 1991-2012. Luzon has remained to be better off than Visayas and Mindanao. Poverty has increased consistently in the Autonomous Region in Muslim Mindanao (ARMM). Half of its population is living in poverty and it is now the poorest region in the country. In 2012, the poverty incidence in ARMM (55.8%) was 14 times that of the NCR (3.9%). Davao has experienced considerable gains, making it the best-performing region in Mindanao. Eastern Visayas, Soccsksargen, Bicol Region, Caraga, and Zamboanga Peninsula have at least 40 percent of their population living below the poverty line. Meanwhile, less than 4 percent of the population in NCR is income poor. In the Visayas, Eastern Visayas used to be the fourth poorest region in 1991 but is now the second poorest region.

The lack of inclusiveness of growth clearly begs for a serious look at the relevance of the laws, regulations, and policies formulated and adopted by government to address critical constraints to inclusive growth. This chapter reviews the policies issued in 2013, explains their rationale, analyzes impacts (whenever available information permits an assessment), and offers recommendations.

Updates on the poverty reduction program

The government is pursuing new poverty reduction strategies to close regional disparities in economic development and bring down poverty incidence to 18 percent by 2016. The government's approach takes provinces as the spatial platform for various interventions designed to address deep poverty and inequality in the country. Recognizing that provinces have different constraints to growth owing to differences in their location and initial endowments, the *Philippine Development Plan 2011–2016 Midterm Update* adopts a spatial focus in addressing poverty

and inequality. The plan's midterm update established a **new poverty reduction roadmap** that groups provinces into three categories, identifies the priority provinces for each category (Table 2.1), and maps out distinct development strategies.

Category 1 provinces

These provinces had the highest number of poor families in 2012 based on the National Household Targeting System (NHTS) of the Department of Social Welfare and Development (DSWD). But they are not necessarily the poorest provinces. As stated in the plan's midterm update (NEDA 2014)

"for a number of the provinces in this category, namely Cebu, Pangasinan, and Iloilo, development opportunities clearly exist. However, pockets of poverty also exist in these provinces to the extent that opportunities may be limited and certain segments of the population are unable to readily participate in the growth process. In-migration may also be a factor to the extent that the provinces tend to attract the poor from other places but opportunities for gainful employment are limited given existing skill sets."

In this context, interventions for these provinces shall aim at increasing investments to create more employment opportunities. To achieve this, the plan recommends the following: (1) focus on improving physical infrastructure to enhance trade and labor mobility; (2) tap the potential of new growth drivers such as agro-industry, food manufacturing, and logistics in some of the provinces; (3) expand current sources of growth such as information technology-business process management and tourism; (4) improve human capital through investments in education and training (e.g., technical vocational education) to

Category 1	Category 2	Category 3
Zamboanga del Sur	Lanao del Sur	Ilocos Norte
Cebu	Maguindanao	Ilocos Sur
Pangasinan	Eastern Samar	Abra
Negros Occidental	Apayao	Benguet
Camarines Sur	Zamboanga del Norte	Cagayan
Leyte	Camiguin	Quirino
lloilo	Saranggani	Isabela
Sulu	North Cotabato	Nueva Vizcaya
Quezon	Masbate	Zambales
Davao del Sur	Northern Samar	Pampanga
		Aurora
		Cavite
		Laguna
		Rizal
		Catanduanes
		Antique
		lloilo
		Bohol
		Eastern Samar
		Leyte
		Northern Samar
		Southern Leyte
		Zamboanga del Su
		Zamboanga Sibuga
		Dinagat Islands
		Agusan del Sur
		Surigao del Norte
		Surigao del Sur

increase the employability of the workforce; and (4) introduce more flexible work arrangements. The plan also emphasizes the need to continuously upgrade social services in the relatively more developed and urbanized areas (e.g., Cebu) to prevent congestion as a result of in-migration from other areas.

Category 2 provinces

The 10 provinces with the highest poverty incidence among their populations are placed in Category 2 (Table 2.1). These provinces are "generally characterized as having limited opportunities for development. They have small populations, are less dense, or are located in remote areas. For the

provinces in this category, weather-related events and armed conflict have been additional factors to contend with" (NEDA 2014).

For these provinces, the thrust shall be the effective and efficient provision of basic social services particularly health services, basic education, water, and sanitation. Job creation shall be pursued simultaneously by linking small agriculture-based enterprises to supply chains of product or service providers in the more developed areas of the region. With human security a critical issue in these provinces, it is necessary to strengthen and earnestly pursue peace-building efforts by addressing the fundamental roots of the conflicts.

Category 3 provinces

Twenty-eight provinces belong to this category of highly vulnerable areas that are prone to multiple hazards, including landslides and flooding (Table 2.1). The marginally nonpoor in these provinces can slide into poverty relatively quickly owing to economic shocks or natural disasters.

The strategies to be implemented in these provinces will focus on disaster risk reduction and mitigation, social insurance and social protection, and income diversification.

Implications

Categorizing provinces and formulating specific strategies for each category will likely lead to more appropriate and consequently more significant reduction in poverty. However, this implies that the bases for the categorization are critical to ensure that the conditions in the province match the strategies. In this respect, the correct categorization of provinces would be critical, particularly since only 43 provinces are considered priority. For instance, using the official poverty statistics for provinces for 2012 with the largest magnitude of the poor would

have ensured that the poorest provinces are included in the priority areas. However, using the data from the NHTS to identify the provinces with the most number of poor families may not necessarily lead to the poorest provinces because the NHTS data do not represent the whole province.

Updates on industrial policies

The 2012 Economic Policy Monitor stressed the importance of reviving the manufacturing sector to boost economic growth and make it more inclusive. The Philippine Manufacturing Industry Roadmap Project led by the Department of Trade and Industry (DTI) is a major initiative of the government to revive the manufacturing sector.

Launched in 2012, the project envisions the private sector to take the lead in the preparation of sectoral roadmaps with the DTI serving as catalyst, facilitator, and "enabler". DTI commissioned the Philippine Institute for Development Studies (PIDS) to provide a conceptual framework for the formulation of the roadmap and to consolidate the sectoral roadmaps into an all-inclusive blueprint for the manufacturing sector. Meanwhile, the DTI developed the guidelines for the preparation of the sectoral roadmaps. These were presented and discussed with the different associations during the industry dialogues that the DTI-Board of Investments (BOI) conducted. DTI-BOI also had discussions with stakeholders to formulate a new industrial policy where government will play a more proactive role by addressing the most difficult challenges affecting the entry of new firms and preventing existing firms from moving up the value chain. These challenges include market failures or coordination failures such as difficulties in accessing raw materials and finance especially for small and medium enterprises (SMEs), and building the necessary infrastructure such as roads, airports, ports, or common facilities.

The Philippine Manufacturing Industry Roadmap is crucial for two reasons. First, it will enable the Philippines to take advantage of the opportunities from the AEC and address the threats and challenges arising from it. Second, it will provide the blueprint for creating a sufficient number of quality jobs to achieve sustainable and inclusive growth. Philippine experience in the last two decades has shown that the country cannot leapfrog industrialization and cannot rely on the services sector alone to achieve sustainable and inclusive growth. Growth, to be inclusive, needs the revitalization of the manufacturing industry so that more and better jobs can be created. A welldeveloped manufacturing sector can offer a wide range of jobs requiring high-skilled, semi-skilled, and low-skilled workers. The upgrading, diversification, and transformation of the manufacturing industry will facilitate the movement of workers from the informal to the formal sector as well as from low value-added activities to high value-added activities where wages and compensation are much higher.

In 2013, the government allocated PHP 2.3 billion to a new program called the "Manufacturing Resurgence Program" to support the implementation of the Roadmap project along with the establishment of the Industry Development Council composed of representatives from various government agencies and private sector groups. The council will monitor the implementation of the roadmap and recommend policies and programs to address binding constraints to manufacturing growth and development.

In close coordination with the DTI-BOI and the industry associations, PIDS consolidated 19 sectoral roadmaps and crafted the Manufacturing Industry Roadmap which will serve as input to the Comprehensive National Industrial Strategy. The latter will link the manufacturing industry with the other major economic sectors such as agriculture,

fishing, forestry, mining, construction, and services. DTI-BOI also created technical working groups (TWGs) for these sectors with completed roadmaps. The TWGs are led by industry champions from both the DTI-BOI and the industry sector. They serve as venues for discussion and formulation of more detailed action plans and programs to implement the roadmaps. A good example is the roadmap to develop the Philippine automotive industry (Box 2.1).

The DTI presented the Manufacturing Industry Roadmap to industry stakeholders on August 13, 2013 and conducted a series of presentations to generate broad-based support for its implementation. Supported by an investment strategy, the roadmap focuses on the role of education, value/supply chain, effective regulation, and industrial clusters/agglomeration to reduce transaction costs.

Implications

The effective implementation of the roadmap is both crucial and timely given the governance reforms that the present government has initiated, which have led to the strong performance of the economy and foreign and local investors' growing interest in the Philippines as an investment destination. With the combined efforts of government and the private sector, these reforms have led to an improvement of the investment climate. In terms of performance, the manufacturing sector registered a growth rate of 12.3 percent in 2013, considerably higher than the 5.5 percent achieved in 2012. The subsectors that led this auspicious growth were chemical and chemical products; basic metal industries, furniture, and fixtures; radio, television, and communication equipment and apparatus; nonmetallic products; and footwear and leather products. Investment in capital formation for durable equipment accelerated to 14.4 percent in 2013 from 8 percent in 2012.

Box 2.1. Developing the Philippine automotive industry

One of the components of the Philippine Industry Manufacturing Roadmap is the Auto Industry Roadmap. It seeks to develop the automotive industry through its integration into the production and distribution systems of global automakers. The automotive industry is a highly global and a high-technology industry. It is capital intensive and requires economies of scale to make its operations profitable. A car has over 30,000 parts and is strongly linked with the metal, chemicals, plastic, textile, rubber, glass, steel, electrical, and other manufacturing subsectors. Hence, in terms of interindustry linkages or supply chain impact, auto manufacturing has one of the highest multipliers¹ based on input-output analysis. Although the country's current domestic production is still limited, there are clear opportunities for greatly increasing scale due to the country's growing middle class and the integration of the member-economies of the ASEAN into a single economic community by 2015, which represents a market of over 600 million people. According to industry experts, the third wave of ASEAN motorization is also expected to take place in the Philippines by 2016 (the first wave took place in Thailand; the second in Indonesia).

The government is crafting the New Auto Program that will serve as the implementation plan of the Auto Industry Roadmap. The program contains the more specific measures to be carried out by the government in achieving the broad goals/vision/direction of the Auto Roadmap such as how to attract FDIs in both assembly and component manufacturing to enable the country to deepen its participation in the global value chains of multinational companies. Suppliers usually follow where assemblers locate their production. This has been shown by the experience of emerging markets like China, Brazil, and Thailand, where massive inflows of FDI into assembly have also attracted many new component companies that are following the FDI of their major customers. Through its industrial policy, Thailand was able to successfully integrate its automotive industry into the global automakers' networks. To achieve the same in the Philippines, a comprehensive mix of policies shall be crafted under the New Auto Program to include demand-stimulating policies, measures to reduce costs, and effective implementation of regulations affecting the industry. With new investments in the industry, the New Auto Program can serve as a catalyst of growth within the industry and drive broad-based manufacturing growth and economic transformation in the country.

Updates on agricultural policies

In 2013, a significant share of the Department of Agriculture's (DA) budget was allocated for expenditure items to meet the rice production targets of the Food Staples Sufficiency Program. As Table 2.2 shows, the most significant increases in the agriculture budget have been directed toward irrigation followed by farm-to-market roads (FMR). The strong financial commitment to agricultural infrastructure continued in 2014; irrigation and FMR together accounted for 41 percent of the

operations and projects budget of the DA-Office of the Secretary.

However, concerns from key stakeholders about the proper use of these resources persisted owing to increasing allegations of fraud, abuse, waste, and mismanagement of public funds in various government departments. To promote transparency, the DA has been required, effective the 2014 budget preparation cycle, to submit an irrigation master plan and an FMR network plan to the DBM as a basis for the release of the agriculture budget.

¹ The industry multiplier measures the economic value of an industry across the entire economy as a share of the direct industry impact.

Table 2	Table 2.2. Public expenditures for agriculture, 2009–2014, in PHP million										
	Farm-to-Market Roads (FMR)¹	Irrigation ¹	Agricultural Expenditures ²	Share of FMR (%)	Share of Irrigation (%)						
2009	3,782	12,610	81,422	4.64	15.49						
2010	6,555	13,599	86,239	7.60	15.77						
2011	2,500	12,791	56,012	4.46	22.84						
2012	5,001	26,515	99,445	5.03	26.66						
2013³	7,000	27,400	-	-	-						
2014	12,150	12,640	-	-	-						
Sources:	Sources: ¹ General Appropriations Act; ² Bureau of Agricultural Statistics; ³ Manasan (2013)										

World Trade Organization (WTO) and food security

The pursuit of rice self-sufficiency is being implemented by the Philippine government consistent with the Agricultural Tariffication Act, which provides for quantitative restrictions (QRs) on rice imports. In keeping with the self-sufficiency target, the National Food Authority (NFA) reduced the volume of imports to a mere 205,700 tons in 2013, down from 2,149,102 tons in 2010 (Table 2.3). Prior to the crop damage of late 2013 caused by Typhoon Yolanda, the expectation was to achieve full rice self-sufficiency by the start of 2014. However, the NFA had authorized imports of 500,000 tons for 2014 to augment the government's buffer stock—a clear indication that the target was not met.

The implementation of the QRs has conflicted with the country's WTO obligations since mid-2012, upon expiration of the special treatment for rice, which is already in its extension period. The government has filed a request to extend the special treatment yet again to 2017. The WTO is currently reviewing this request and may arrive at a decision in early 2014.

The dramatic reduction in imports has contributed to the spike in the price of rice from June to September. Prices tapered off in November

onwards but remained elevated at the PHP 36.00 range, clearly higher than the PHP 32.00 range that prevailed from January 2012 to June 2013. One way the government could have offset the reduction in imports was, at least temporarily, to accelerate releases from the NFA buffer stock. Yet NFA's retail rice distribution over the months of the price spike (June–September) was nearly identical to its releases over the same months in 2011, when imports exceeded 1 million tons. NFA should not have also relied on domestic production alone. Although it was 2.2 percent higher than in 2012 (or 400,000 tons more), the increase was not enough to compensate for the reduction in imports.

The increase in rice prices in 2013 arose from flawed decisionmaking. To avoid a similar scenario in the future, the government is advised to revisit its rice self-sufficiency policy and abandon its unrealistic goal of no imports and reliance on domestic production. It should also resist its proclivity to request for an extension of its rice QR. Instead, the government should accede immediately to its WTO obligation and move to a regime of import tariffs computed at levels consistent with WTO prescriptions and incorporating inputs from key stakeholders such as farmers, millers, traders, and consumer groups.

	2010	2011	2012	2013
January	234,850	-		
February	353,577	-		
March	559,577	-		
April	308,157	51,300		
May	238,580	61,000		91,650
June	200,969	77,300		107,450
July	147,350	36,600	50,091	6,600
August	106,043	25,100	27,076	
September	-	-	4,998	
October	-	-	37,611	
November	-	-		
December	-	-		
Total NFA	2,149,102	251,300	119,777	205,700
TES	199,974	654,995	373,189	
PITC	19,987			
MAV/CSQ	346	157,691	199,255	4,746
Grand total	2,369,409	1,063,985	692,221	210,446

Food safety

The 15th Congress quietly passed a landmark legislation—the Food Safety Act of 2013 (Republic Act or RA 10611). The law codifies sundry rules and regulations into a coherent legal framework. This framework lays down the roles of national line agencies (mainly DA and Department of Health or DOH), as well as local governments. The implementation of this act is also critical to meeting some key competitiveness benchmarks as the country enters the AEC in 2015. The implementing rules and regulations (IRRs) are currently being drafted; hopefully, completion of the IRRs will

be expedited by DA, DOH, and other concerned agencies to bring Philippine food safety systems closer to equivalence with those of leading countries in ASEAN (namely Thailand and Singapore).

Updates on policies related to fisheries, forestry, mining, and natural disasters

Fisheries

Promoting sustainable fisheries also took center stage in the policy priorities of the DA. On September 12, 2013, the DA Secretary signed Fisheries Administrative Order (FAO) No. 246. This order bans the use of Danish seine and modified Danish seine (holbot holbot) in Philippine waters. Danish seine, which was invented in Denmark as the name implies, involves throwing a large rock or tom weight tied to a net into the sea and dragging it underwater. The use of this method can lead to higher fish catch and profits for fishermen. However, environmental destruction is severe because dragging the large rock underwater to catch fish destroys coral reefs that are spawning grounds of marine life. Before FAO 246, the Bureau of Fisheries and Aquatic Resources (BFAR) Administrative Order No. 222, Series of 2003 which provided the regulations, allowed the use of modified Danish seine² in waters beyond 15 kilometers from the municipal coastline provided that tom weights or other methods that destroy coral reefs, seagrass beds, and other marine habitats are not utilized.

With FAO 246, persons, associations, cooperatives, partnerships, or corporations engaged in Danish seine and modified Danish seine will be

² The modified Danish seine is an active fishing gear consisting of "a conical net with a pair of wings, the ends of which are connected to a rope embedded with buri, plastic strips, sinkers or any similar materials to serve as scaring/herding device as hauling ropes passing through a ring permanently attached to a tom weight (lingote) and hauled through a mechanical winch or by manpower" (BFAR Administrative Order No. 222, Series of 2003).

given six months from the effectivity of the order to reconstruct or convert their fishing gear to other legitimate devices. Furthermore, violators will be imposed the penalty of imprisonment from 2 to 10 years and a fine of not less than PHP 100,000 to PHP 500,000, or both fine and imprisonment and confiscation of their boat and gear. Two groups of small-scale fishermen, however, have requested for exemption from FAO 246 so that they can recover from the effects of Typhoon Yolanda (Sologastoa 2014; Yap and Delos Santos 2014). Specifically, they petitioned for the suspension of the order in the provinces of Samar, Leyte, Iloilo, Capiz, and Masbate until April 2017. Thus, while FAO 246 can be lauded as a welcome step in the protection of the marine environment in the country, it is also recommended that the government seriously consider the request for exemption by the smallscale fishermen in the Yolanda-affected areas or, alternatively, provide livelihood and other forms of assistance to them.

Moreover, the president signed Executive Order (EO) 154 on December 6, 2013. EO 154 adopts a national action plan to prevent and eliminate illegal fishing in Philippine waters. It establishes a Philippine Committee against IUU Fishing, composed of duly authorized representatives from the Office of the President (OP), DA, Department of Transportation and Communications (DOTC), Department of the Interior and Local Government (DILG), Department of Finance (DOF), Department of Justice (DOJ), Department of National Defense (DND), and Department of Foreign Affairs (DFA), and their respective offices and attached agencies, including concerned economic zone authorities, as well as representatives from the private sector. The DA Secretary or his duly authorized representative is designated as Chairperson of the Committee. EO 154 should be lauded as a positive development in fisheries as it addresses the "need to address the ecological, biological and socio-economic challenges posed by IUU fishing in a coordinated and integrated manner through a collaborative institutional mechanism involving the concerned departments and agencies of the government".

Forestry

Two memorandum circulars (MCs) were issued to hasten the implementation of the National Greening Program (NGP).

On April 16, 2013, the Department of Environment and Natural Resources (DENR) issued MC 2013-06 that provides guidelines and procedures for plantation development for the NGP. The guidelines aim to accelerate the production of 1.5 billion seedlings and a plantation establishment of not less than 1.5 million hectares by the end of 2016 through the engagement of other government entities, local government units (LGUs), private sector, civil society organizations (CSOs), nongovernment organizations (NGOs), and people's organizations/indigenous peoples.

Furthermore, on May 30, 3013, the DENR and DILG issued Joint MC 2013-03 that provides the guidelines for the establishment and implementation of the Barangay Forest Program (BFP) in support of the NGP. The circular mentioned, among others, that the coverage of BFP includes rural barangays of all fifth- and sixth-class municipalities, barangays covered by the bottom-up planning and budgeting and within the 1,233 focused municipalities identified by the National Anti-Poverty Commission (NAPC), barangays affected by the recent calamities, or barangays within priority critical watershed areas with approved watershed management plans.

Mining

On November 26, 2013, the president signed EO 147, which created the Philippine Extractive Industries Transparency Initiative (PHL-EITI). The EITI is an

international coalition of governments, companies, and CSOs established in 2003 to promote honest and responsible management of revenues from natural resources including oil, gas, metals, and minerals. The formation of PHL-EITI is viewed as necessary for completing the process to make the Philippines compliant with the international undertaking (EITI) to bring about more transparency and accountability in the extractive industries as well as in government.

EO 147 mandates that PHL-EITI be made operational through a multistakeholder group (MSG) and decisionmaking body that will be headed by the finance secretary. The members include five government representatives chosen by the Mining Industry Coordinating Council (MICC), five business group representatives, and five representatives of CSOs. The EO further stipulates the formation of the PH-EITI secretariat and directs other government agencies and governmentowned and -controlled corporations (GOCCs) to assist the MSG in carrying out its functions. Among the tasks of the MSG are to ensure commitment of all stakeholders to the PH-EITI, set and define strategic direction and scope required to effectively implement the EITI in the Philippines, produce regular reports with contextual information about the extractive industries, and ensure that the PH-EITI is effectively integrated in the process outlined under EO 79 intended to institutionalize and implement reforms in the mining sector.

Despite EO 147, some opposing sectors continue to consider the overall mining policy of the government as flawed and inadequate in addressing the destructive effects and miniscule benefits from large-scale mining (e.g., Atienza 2013). Nonetheless, EO 147 can be regarded as an important step in the right direction to promote transparency and accountability in mining.

Natural disasters

On November 11, 2013, the president signed Proclamation No. 682 declaring a state of national calamity to enable the government and local population to respond more effectively to the devastation wrought by Typhoon Yolanda. The president explained that the state of national calamity would hasten the rescue, recovery, relief, and rehabilitation efforts of the government and the private sector, including international humanitarian assistance. He further said that it would effectively control the prices of basic goods and commodities for the affected areas and give government ample latitude to utilize appropriate funds to provide assistance and services to the people.

Relatedly, the president signed Memorandum Order (MO) No. 62 on December 6, 2013. MO 62 created the position of Presidential Assistant for Rehabilitation and Recovery who will oversee and monitor the rehabilitation, recovery, and reconstruction efforts in the areas affected by Typhoon Yolanda. This order also directs all departments, bureaus, offices, agencies, instrumentalities of the government, including GOCCs and government financial institutions, to render full assistance and cooperation to the presidential assistant as may be required to carry out his functions, and urges LGUs, NGOs, and the private sector to do the same. Both Proclamation No. 682 and MO No. 62 are seen as appropriate immediate actions in response to the devastation caused by Typhoon Yolanda.

Updates on housing policies

Since 2011 when the government formulated the National Informal Settlement Upgrading Strategy (NISUS) Program, it has provided around PHP 50 billion housing budget for the informal settler

families (ISFs) living in danger areas in Metro Manila. However, the pace of implementation has been slow. Two major policy reforms were considered in 2013 to facilitate the process.

First, the NHA Enhanced Resettlement Package increased the maximum cost of socialized housing units developed by the National Housing Authority (NHA) for off-city and in-city resettlements. The cost of an off-city housing unit increased from PHP 175,000 to PHP 240,000. The adjustment allows for bigger housing size and disaster-resilient shelter design. For in-city resettlement, the socialized housing unit cost increased from PHP 400,000 to PHP 550,000. In addition, NHA adopted usufruct³ arrangement in lieu of land ownership. These program reforms give premium to in-city development by making in-city housing more affordable to ISFs and giving them better access to livelihood and employment opportunities.

Second, the Socialized Housing Finance Corporation (SHFC), which implements Community Mortgage Program (CMP), expanded its financing program to include high-density housing (HDH). The traditional CMP focused on horizontal housing development and financed mainly purchase of land for security of tenure of organized ISF communities. Member-households can borrow up to PHP 100,000 for land purchase in highly urbanized cities such as Metro Manila. Additional financing for shelter development is conditional on loan repayment of the community. Under HDH, organized communities can borrow up to PHP 450,000 per household for land purchase, site development, and construction of multistory building (two-five stories) on-site, in-city, or near-city.

HDH intends to address the issue of limited land for socialized housing in urban areas by

accommodating more families per unit of land. This scheme also enables the community to build better housing and to improve access to basic facilities and infrastructure. This is in contrast to the traditional CMP, where most housing communities have remained undeveloped and have turned into slums because they were not effectively integrated into the city or municipality's network of roads and other basic infrastructure.

Implications

While the policy changes are necessary, the overarching critical issues in housing the poor are not addressed in a holistic manner. First, the government has no clear policy on housing subsidy. The current programs assume cost recovery of projects despite historical records showing high levels of nonperforming loans. Affordability should be recognized as a major issue; the current schemes of interest subsidy and graduated loan amortization are insufficient to improve repayment capacity of households. Recent profiling of ISFs in danger areas of Metro Manila shows that about 35 percent of families live below the poverty threshold and about 60 percent of ISF households are considered nonbankable under the PAG-IBIG Affordable Housing Loan Program that caters to low-income households. A study in Latin American countries (Chile, Mexico, Peru, Brazil, among others) noted that poorly designed shelter programs can induce poverty by creating a situation where a household, after paying for housing (rent or mortgage plus utilities, property taxes, and house maintenance), cannot afford the minimum poverty basket of nonhousing goods (Ruprah 2010). This shelterinduced indigence and poverty was found substantial in several housing programs in Latin America. Based

³ Usufruct is similar to a lease agreement, except that it may or may not have considerations of rental/lease payment.

on these findings, countries in the region adopted income-based indicators to prioritize applicants for housing programs and increased the size of existing housing vouchers or subsidies particularly for the poor. Brazil, a country similar to the Philippines in terms of widespread informal settlements, has shifted to a policy of huge upfront capital or direct subsidies for the poor while interest subsidy is provided mainly to middle-income households (Magalhaes 2012). Government housing programs in the country would need a similar strategy that will provide equitable subsidy and coverage to the lowest income level. A direct and equitable distribution of housing subsidy would also result in efficient administration of government funds for housing.

Second, land availability is a critical issue. Under the Urban Development and Housing Act (UDHA) of 1990, LGUs are tasked to identify lands for socialized housing in their respective localities but so far, only a few LGUs have provided an inventory of these lands. The NHA also ceased its land banking activities and opted to partner with LGUs or private developers that provide land for socialized housing development. However, this partnership only works for off-city resettlement. In Metro Manila where ISFs are numerous, low-priced lands suitable for socialized housing development are scarce. There are also legal constraints to the disposal of government-owned lands and proclaimed public alienable and disposable lands. Financial institutions including government programs still prefer title-based transactions despite the BSP's approval of the rights-based approach for housing microfinance of up to PHP 300,0000 (BSP Circular 678 of 2009).4 These legal constraints have significantly delayed the disposal and titling process and consequently project development. Moreover,

the search for available land for in-city resettlement entails high transaction cost due to limited access to complete and reliable land records both at the national and local levels, even in highly urbanized cities such as Metro Manila.

As it will take time to fix land administration and management in the country, the government can direct the key national and local land agencies and the private sector to help develop a georeferenced land inventory starting with Metro Manila. Meanwhile, the NHA usufruct scheme for in-city resettlement may provide a temporary solution to the land issue. International experience shows that countries that applied usufruct at a wide scale had adversely affected the mortgage value of property and investments in housing and maintenance (e.g., Hoek-Smith 2014). However, usufruct or lease could be a pragmatic approach for the Philippines given that the provision of land subsidy on top of other capital subsidies for housing would need to be further studied for its political and socioeconomic suitability.

Third, various institutional issues persist. Most LGUs have a weak capacity in urban and shelter planning. The Philippines lacks a national policy on shelter development specifically one that integrates infrastructure, housing, and environmental concerns in shelter plans. The current approach to shelter is primarily on a per project basis instead of a city-wide shelter development. The absence of a city-wide approach creates difficulties for the national government and LGUs to address the housing problem on scale.

Unless these concerns are addressed, the achievements of the ISF program will be limited and results on the ground may not be realized within the target period of 2016.

⁴ Under a rights-based approach, the forms of secure tenure or property rights acceptable as collateral for a housing loan (i.e., for purchase of a lot or house and lot or housing maintenance) are usufruct agreement, lease contract/agreement, or freehold (i.e., title or interim titles such as Contract to Sell or conditional sale).

Updates on health policies

Fiscal space for health has dramatically improved since the launch of the health reform agenda in 2010. The health budget increased twofold between 2010 and 2013 (Table 2.4). This reflects the seriousness of the present administration to expand provision of health services. Two key strategic programs underpinned this increase—the expansion of the Sponsored Program of the Philippine Health Insurance Corporation (PhilHealth) and the DOH's Health Facility Enhancement Program (HFEP). Both programs are crucial pillars of *Kalusugang Pangkalahatan*, the Aquino administration's universal health care program.

Expansion of the PhilHealth coverage and benefits

In the past, PhilHealth suffered from low benefit delivery rate. Enrollment, availment, and financial benefit coverage rates were only 53, 42, and 34 percent, respectively, of the total population (DOH 2010). PhilHealth members also carried the burden of high out-of-pocket costs—approximately 50 percent of their health care expenses. It was estimated that 25 percent of the population (roughly 20 million) are poor and eligible for the Sponsored Program, but only 3 million were covered by PhilHealth until 2008 (Lavado 2010). The low support value can be attributed to the small budget allotted for premium payment and service delivery for PhilHealth members.

To address these gaps, numerous programs were institutionalized to expand PhilHealth enrollment. The coverage was expanded with the passage of RA 10606 or the revised National Health Insurance Act of 2013 that prioritized indigents and the informal sector. Extending the coverage to these groups is a step in the right direction in realizing the vision of universal health care. However, its implementation is a huge challenge for PhilHealth as covering employed workers including overseas workers and the lifetime members is easier than covering indigents and the informal sector. Significant budget was allocated to subsidize the health insurance premiums of these priority groups in the past four years. In 2013, the bulk of the increase in the health budget was for the payment of premium of 5 million poor households. The national government shouldered PHP 12.6 billion worth of premium subsidy in 2013, a sharp increase from the PHP 2 billion subsidy in 2008.

To address the high out-of-pocket health expenditures, PhilHealth expanded the primary care benefit (PCB) package that covers outpatient services and the Z benefits package that covers selected chronic diseases. The no-balance billing (NBB), which ensures that the poor will not have to pay a single cent in a government hospital, and the case-based rates (CBR), where there is a predetermined fixed rate for health care providers,

Table 2.4. Budget allocation for DOH and major health reforms, 2010–2013										
	2010	2011	2012	2013						
DOH budget	24,649,765,000	32,427,444,000	42,769,378,000	50,442,299,000						
NG premium subsidy for indigents (% of DOH budget)		3,500,000,000 (11%)	12,028,000,000 (28%)	12,612,283,000 (25%)						
HFEP (% of DOH budget)	3,251,695,000 (13%)	7,143,909,000 (22%)	5,078,000,000 (22%)	10,772,495,000 (21%)						
Source: Authors' compilation based or	Source: Authors' compilation based on the General Appropriations Act.									

were also strengthened and expanded to further improve the level of support value and promote efficiency and transparency in the delivery of benefits. However, PhilHealth and DOH still face an enormous challenge on how to ensure that these initiatives translate to improved access to quality health services.

Health Facility Enhancement Program

Another crucial pillar in the attainment of universal health care is access to health facilities that provide quality health services. The HFEP has been in place since 2008 but was stepped up only in 2011 and received substantial funding only in 2013. Out of the total DOH budget, PHP 10.7 billion (21% of the DOH budget) was allocated for funding the upgrade, construction, and/or enhancement of rural health units (RHUs) and hospitals all over the country.

The enhanced HFEP was introduced to revive the declining capital investments in health facilities compounded by the burgeoning population. The bed-to-10,000-population ratio has also declined from around 32 in the 1970s to 17 at present. The occupancy rates in most public hospitals have exceeded 100 percent, indicating a severe shortage in infrastructure.

From 2010 to 2013, almost 1,350 barangay health stations, 2,400 RHUs, 761 local government hospitals, and 70 DOH hospitals have been equipped and renovated. Despite these achievements, an initial assessment of the program reveals numerous bottlenecks, including slow processing and approval of enhancement plans due to bureaucratic hurdles; lack of clear, strategic, and equitable allocation of HFEP resources; and absence of a monitoring mechanism to track progress and impact (David 2013; Lavado et al. 2012). In support of the HFEP, the Aquino administration is eyeing public-private partnerships (PPP) to improve hospital infrastructure in the country. Only the

modernization of the Philippine Orthopedic Medical Center under a build-operate-transfer (BOT) scheme has been approved so far.

Updates on policies addressing infrastructure constraints

The inadequate stock and poor quality of physical infrastructure as a binding constraint to growth has been one of the long-standing concerns in the Philippines. The update given in this chapter monitors the progress in relaxing this constraint in transport, energy, water supply and sanitation, and information and communications technology (ICT). A discussion of cross-cutting policies across these sectors such as the guidelines on PPP issued by the Investment Coordination Committee (ICC) of the National Economic and Development Authority (NEDA) Board is also included.

Transport sector

Congress enacted a law exempting international carriers from income taxes on the basis of reciprocity. The president issued an administrative order on the setting up of Metro Manila integrated transport terminals, an executive order on the Metro Rail Transit (MRT)-3 buy-out, and a memorandum order on the Skyway Stage 3 project. The DOTC issued a department order regarding aviation traffic.

RA 10378 recognized the principle of reciprocity as basis for the grant of exemptions to international carriers (i.e., international airlines and shipping lines) from paying common carrier tax on its gross Philippine billings. Reciprocity means that an international carrier may be exempted from paying the common carrier tax—a form of income tax—if its home country also grants income tax exemption to Philippine carriers.

Administrative Order (AO) No. 40 Series of 2013 provided for the establishment of three interim transport terminals in the north, south,

and southwest portions of Metro Manila. The interim terminals are to be set up to prepare for the integrated transport system that EO 67 Series of 2012 directed to be established in Metro Manila through a PPP scheme. When the integrated transport terminals are already in place, buses, jeepneys, and other public utility vehicles plying provincial routes must end at the transport terminals. The Metro Manila Development Authority (MMDA) and DOTC opened the Southwest Interim Transport Terminal (SITT) in Parañaque City on August 6, 2013. But petitioners composed of a group of bus operators and commuters have asked the Supreme Court to issue a temporary restraining order against the implementation of AO 40 Series of 2013 and EO 67 Series of 2012 because these were implemented without due notice and public hearing. It was also reported that commuters are exposed to unsanitary conditions and high air pollution in the SITT (Manila Times 2013).

EO 126 Series of 2013 repealed EO 885 Series of 2010 and authorized the implementation of the equity value buy-out of the Metro Rail Transit Corporation (MRTC), the owner of the MRT-3 facility, and prescribed guidelines for this buy-out. The repealed EO designated the National Development Company as the acquiring vehicle for the MRTC buy-out. In the new EO, the president directed the DOF, DOTC, Development Bank of the Philippines, and Land Bank of the Philippines to acquire MRTC stocks or assets via either equity purchase or asset purchase.

MO No. 66 issued by the president on January 6, 2014 created a project coordinating committee for the Metro Manila Skyway Stage 3 project. The Skyway Stage 3 project is a 14.8-kilometer, six-lane elevated expressway that will connect the South Luzon Expressway and the North Luzon Expressway

via a route traversing Gil Puyat Avenue-Plaza Dilao-Aurora Boulevard-Quezon Avenue-Balintawak. The coordinating committee is tasked to, among others, act as the coordinating body between various government entities and the private sector, as well as identify project implementation bottlenecks and measures to address such bottlenecks. The committee representatives are from the Office of the Executive Secretary (chairperson), DOTC-Toll Regulatory Board, Department of Public Works and Highways, DENR, Department of Energy (DOE), Office of the Solicitor-General, National Power Corporation, National Transmission Corporation, Metropolitan Manila Sewerage System, National Telecommunications Commission, NHA, Housing and Urban Development Coordinating Council, Presidential Commission for the Urban Poor, Commission on Human Rights, and MMDA. The target project completion date is March 2017, or 36 months after full-scale construction beginning April 2014. An accelerated construction plan that will allow completion by June 2016 is being discussed between the government and the private firm (Citra Metro Manila Tollways Corp.) but this will highly depend on timely right-of-way (ROW) acquisition and the cooperation of stakeholders who will be affected by ROW concerns.

The DOTC issued Department Order 2013-08 imposing restrictions on general aviation traffic (i.e., limiting landings and takeoffs at certain hours only and prohibiting food and fish hauls by aircraft) at the Ninoy Aquino International Airport (NAIA). This interim measure is to prepare for the full transfer of general aviation traffic⁵ to Major Danilo Atienza Air Base in Sangley Point, Cavite. The transfer is aimed to alleviate runway congestion at the NAIA. The NAIA's runway capacity is an hourly average of 36 aircraft movements (i.e., takeoffs and landings), but

⁵ The International Civil Aviation Organization defines "general aviation traffic" as those flight activities not involving commercial air transportation or aerial work.

actual aircraft movements went as high as 50 during the summer of 2013. The seriously growing runway congestion at NAIA has been causing flight delays, cancellations, and rerouting to Clark airport.

Energy sector

Policies were issued to strengthen the National Electrification Administration (NEA), address the Mindanao electric power shortage, and implement retail competition and open access.

RA 10531 or the National Electrification Administration Reform Act of 2013 was enacted on May 7, 2013. The law amends certain sections of Presidential Decree No. 269 issued in 1973 that transformed NEA into a corporation and provided its charter. RA 10531 aims, among other objectives, to empower electric cooperatives (ECs) to cope with the changes brought about by a restructured electric power industry. However, some provisions of the law became controversial. In particular, the law specified that any person (or his or her spouse) who holds any public office or has been a candidate in the last preceding local or national elections is barred from being elected or appointed as an officer or board member of an EC and that the "fit and proper rule" must be observed in qualifying and disqualifying directors or officers of ECs. The law also provided that NEA has the right to restructure ailing ECs to make them economically and financially viable and defined the conditions under which the NEA may step in and take over from the board the operation of an ailing EC.

The Philippine Federation of Electric Cooperatives (Philfeco) has petitioned the Supreme Court to stop the implementation of RA 10531 on the claim that it is unconstitutional. The argument of Philfeco is that the NEA step-in right is tantamount to a government takeover of a private utility, which is allowed by the Constitution only in

times of national emergency and upon payment of just compensation.

The president issued EO 137 Series of 2013 on the Mindanao Modular Generator Sets Program to provide additional electricity supply in Mindanao. The program is a PHP 4.5-billion loan facility extended to electric cooperatives in Mindanao for the acquisition of modular generating sets. The NEA is administering the loan facility, which offers an interest rate of 6 percent or less.

The DOE issued Department Circulars (DC) 2013-05-0008, 2013-09-0020, and 2013-09-0023 as rules for the operation of the Interim Mindanao Electricity Market (IMEM), which was launched on September 26, 2013. DC 2013-05-0008 issued IMEM implementing rules, declared that the IMEM shall apply to all electric power industry participants (any entity engaged in generation, transmission, or distribution) in Mindanao, and mandated all generating facilities in Mindanao to be transparent with respect to their capacities. DC 2013-09-0020 amended the IMEM rules and promulgated IMEM manuals. DC 2013-09-0023 declared the launch of IMEM and the terms and conditions for the commencement of its full commercial operations.

The Energy Regulatory Commission (ERC) issued the transitory rules for the implementation of open access and retail competition on December 17, 2012 (ERC Resolution No. 16 s. 2012) and set a six-month transition period from December 26, 2012 to June 25, 2013. Under open access and retail competition, an electricity consumer whose peak demand is at least 1 MW can choose its retail electricity supplier and the supplier is allowed to access transmission and distribution systems subject to the payment of retail wheeling charges. The ERC issued supplemental rules on June 10, 2013 for the initial commercial operations of the competitive retail market on June 26, 2013. As of this writing, the rules on customer switching (i.e., the contestable

customer switching from one supplier to another) are being harmonized.

Water supply and sanitation sector

The DILG issued MC 2013-143 that prescribes policy guidelines in the provision of potable water supply under the *Sagana at Ligtas na Tubig sa Lahat* (Salintubig) Program taking into consideration the grassroots participatory planning and budgeting (GPPB)⁶ process for priority LGUs. MC 2013-143 recognized that the government has recently adopted the GPPB approach in identifying and prioritizing poverty reduction projects for funding. Such poverty reduction projects include water supply and sanitation projects. DILG, as lead agency for the implementation of the Salintubig program, had a 2013 budget appropriation of PHP 1.811 billion for the Salintubig priority projects identified through the GPPB approach.

ICT sector

The key developments are the Supreme Court's ruling on the constitutionality of the anticybercrime law and the president's order to government agencies to migrate to the web hosting service of the Department of Science and Technology-ICT Office (DOST-ICTO).

RA 10175 or the anticybercrime law (An Act Defining Cybercrime, Providing for the Prevention, Investigation, Suppression and the Imposition of Penalties Therefor and for Other Purposes) was enacted on September 12, 2012 but soon after, a petition to declare it unconstitutional was filed at the Supreme Court on various grounds, including restraint to the freedom of speech and freedom of expression. On January 15, 2013, the Supreme Court heard the oral arguments regarding the petition.

On February 18, 2014, it ruled that the provision on online libel is constitutional subject to one condition—it should not cover persons other than the original author of the potentially defamatory online post, that is, it should not cover persons who merely react to the post. The Supreme Court also ruled that three provisions are categorically unconstitutional, namely, unsolicited commercial communications, law enforcement authorities' real-time collection of traffic data, and restricting or blocking access to computer data. The provision requiring online communications service providers to preserve traffic data and subscriber information for at least six months was upheld in the law. This obligation by service providers will entail cost and the telecoms regulator must ensure that utmost transparency is observed when consumers are made to bear this additional cost.

To have greater security and robustness in internet technology utilization by the government, the president issued AO 39 on July 12, 2013. The AO mandates government agencies to migrate to the web hosting service of the DOST-ICTO. The ICTO stated that the spate of government website defacements in 2013 is proof of the need for AO 39 and warned that activist groups that have hacked into government websites and have been proven to have violated RA 8792 or the e-Commerce Act will be liable to criminal charges (DOST-ICTO 2013). The ICTO is conducting a series of trainings for government agencies and facilitating website migration via case-specific arrangements.

Cross-cutting policies

On PPPs, EO 136 Series of 2013 was issued to amend certain sections of EO 8 Series of 2010, such as an additional section establishing a PPP

⁶ The DBM defines the GPPB as an approach to preparing the budget proposal of government agencies that takes into consideration the needs of cities/municipalities as identified in their respective local poverty reduction plans.

governing board and another section specifying that the executive director of the PPP Center shall be included as a member of the NEDA Infrastructure Committee-Technical Board and the NEDA ICC-Technical Board. The BSP also issued Circular 2013-799 amending the regulations on the single borrower's loan limit with respect to PPP projects. The BSP allowed an additional single borrower's loan limit of 25 percent of the net worth of the lending bank or quasi-bank if the purpose is for undertaking PPP projects.

Through a memorandum dated April 29, 2013, the ICC raised the "cost floor" of major capital projects that will need to be cleared by the ICC. Previously, capital projects worth at least PHP 500 million require ICC clearance; the cost floor is now PHP 1 billion. For projects worth below PHP 1 billion, the head of the implementing agency or the governing board of the implementing government financial institution or corporation shall be the approving authority. Exempted from this ICC guideline are projects covered by RA 7718 (the BOT law), which have a cost floor for ICC clearance of PHP 300 million, and projects that will need national government borrowing or guarantee, which are covered by separate rules under RA 4860 (Foreign Borrowings Act) and RA 8182 as amended (ODA Act).

Implications

The implications of these policies on the stock and quality of Philippine infrastructure are positive. The policy issuances are numerous and this shows that the government is on an accelerated mode in relaxing a critical binding constraint to economic growth—the weak state of the country's physical infrastructure. For example, the newly issued transport policies aim to address the serious congestion problems in Metro Manila roads and

at the NAIA, and the NEA reform law intends to bolster the weak links in the restructured electric power industry.

But many lingering problems have yet to be addressed. These include the lack of modern navigation facilities and night-landing capabilities in major domestic airports and the slow progress in developing an alternative gateway that will co-exist with NAIA. The issue of port congestion in Manila's seaports vis-à-vis underutilization of Subic and Batangas ports is another long-standing concern. With respect to the Philippine PPP program, although there are new amendments to the IRR7 for the BOT law, the clamor for amendments to the law itself has not yet been addressed. Proposed amendments that have been raised since 2006 include the clarification of the scope of PPP contractual arrangement, confirmation of the principle of publication of contract terms and notification to Congress, and aligning the investment incentives provision with the Omnibus Investment Code (Canlas et al. 2006).

There are also infrastructure sectors that do not seem to be getting enough attention from policymakers, such as the water supply and sanitation sector and the ICT sector. There is slow movement in policymaking and in coming up with investment programs for the water supply and sanitation sector. For example, bills proposing the creation of an independent economic regulator for the water and sanitation sector and the restructuring of the water supply industry are still pending in both houses of Congress. Meanwhile, access gaps remain huge-17.2 percent of Filipino families have no access to safe water supply and 7.5 percent of Filipino families do not have a sanitary toilet facility in 2010, according to the Millennium Development Goals (MDG) Watch statistics (PSA

⁷ The latest (IRR) amendments took effect on October 22, 2012.

2014). Past programs fell short in reducing access gaps due to insufficient public sector financing relative to investment needs and weak attention given to sanitation. Aside from continuing the water supply and sanitation programs started by the previous administration, there may be a need for an expanded and better program that will make a larger impact on reducing the access gaps.

Meanwhile, the ICT sector is not benefiting as much as it should from the target infrastructure spending of 5 percent of the GDP. Based on the Philippine Public Investment Program 2011–2016 (May 31, 2012 update), the ICT sector will get only 1.06 percent of the target investments for infrastructure while the other infrastructure sectors will get a total of 98.94 percent (i.e., transport, 57.93%; social infrastructure, 19.02%; water resources, 13.03%; energy, 8.93%; investments that cut across sectors, 0.03%). The pace of modernizing the ICT systems of the bureaucracy also leaves much to be desired. As a result, some government entities are still slow in facilitating the public's interactions with government, less transparent in their actions and decisions, and experience coordination failures among themselves.

The current efforts are not enough given that many of the newly issued infrastructure policies are actually long overdue. For example, the decision to connect the north and south expressways of Metro Manila was in the drawing board for more than two decades before the Skyway 3 was finally approved during this administration's term. The government is being criticized for the inconveniences that the flurry of activities in the infrastructure sector is causing the public. Political hurdles are also getting in the way. The government must stay the course despite all these. But a greater sense of urgency in policymaking and investing on physical infrastructure, especially to address airport congestion, sea port capacity modernizing government optimization,

systems, and expanding water supply and sanitation access, should also prevail.

Updates on the trade policy environment

There has been growing pessimism about the future of the WTO because of its repeated failure to conclude the Doha Development Agenda that was launched way back in 2001. Finally, a trade deal was reached during the 9th WTO Ministerial Conference (MC9) held in Bali, Indonesia last December 2013.

Breakthroughs were made on the substance and content of two areas of the Bali package—trade facilitation and agriculture. In terms of trade, the major outcome is the long-awaited Trade Facilitation Agreement (TFA). Its chief provisions include, among others:

- Publication and availability of information (including availability through the Internet, notification requirement, etc.)
- Advance rulings (in a reasonable, time-bound manner to an applicant that has submitted a written request containing all necessary information)
- Appeal or review process and other measures to enhance impartiality, nondiscrimination, and transparency
- Disciplines on fees and charges imposed on or in connection with importation and exportation
- Release and clearance of goods (including electronic payment, separation of release from final determination of duties and other charges, risk management, postclearance audit, trade facilitation measures for authorized operators)
- Border agency cooperation
- Formalities connected with importation and exportation and transit, which cover:
 - Use of international standards

- Single window
- Preshipment inspection
- Common border procedures and uniform documentation requirements

• Customs cooperation

Trade facilitation is a clear area where everybody wins, developed and developing countries alike, although some technical assistance and capacity building for developing countries may be needed to ensure that benefits are realized, and in a more equitable manner.

The Asia-Pacific Economic Cooperation (APEC) estimates that trade transaction costs (TTC) could be as much as 18.9 percent on all APEC imports and 18.7 percent on all APEC exports (APEC Policy Support Unit 2012). These represent huge economic costs, highlighting the urgent need for trade facilitation. The gains from bringing down TTC through trade facilitation could be significant, possibly much higher than the benefits from further tariff reduction. APEC estimates that its membereconomies' combined GDP could gain by around 0.9 percent each year from reducing the costs of international trade transactions by just 5 percent (APEC Economic Committee 2002). The benefits could be even more significant for SMEs. Research indicates that reducing the number of days to clear exports by half could increase the probability of SMEs to export by 7.5–12 percent (Li and Wilson 2009). Hence, the implications of the TFA on the Philippines are bound to be positive.

Trade facilitation is also one area in the Philippines where substantial reforms in line with the TFA have already been done. Most of the trade and customs reforms were implemented as national objectives. At the same time, it helped that the Philippines is part of APEC and ASEAN. For example, the development of a national single window has been given much effort by the government as part of the country's trade facilitation commitments to ASEAN. The Philippines is also active in the trade facilitation efforts of APEC. APEC economies have made huge improvements in trade facilitation, but more should be done, especially in completing the long-delayed second phase of the implementation of the national single window.

The second major achievement of the WTO MC9 consists of two significant outcomes in agriculture. The first concerns the so-called "peace clause" on domestic support already in place for "traditional staple food crops in pursuance of public stockholding programmes for food security purposes".8 Such domestic support could be considered under WTO rules as trade distorting and could be subject to sanctions. The "peace clause" protection would allow the countries to continue with its domestic support without reprisal of legal sanctions under WTO until a more permanent solution is reached.9 The second is the expansion of "general services" in Annex 2 of the Agreement on Agriculture under the "green box" (allowable domestic support) to include "land rehabilitation, soil conservation and resource management, drought management and flood control, rural employment programmes, issuing land ownership titles and settlement programmes."10 These deals could arguably be interpreted as a reversal of the trade liberalization objectives of the WTO because they expand the list of "legitimized" trade distortion.

⁸ World Trade Organization (WTO). Public Stockholding for Food Security Purposes - Ministerial Decision WT/MIN(13)/38 - WT/L/913, December 11, 2013. https://docs.wto.org/dol2fe/Pages/SS/directdoc.aspx?filename=q:/WT/MIN13/38.pdf.

⁹ The "peace clause" protection was left open ended in WTO MC9.

¹⁰ WTO. General Services - Ministerial Decision - WT/MIN(13)/37 - WT/L/912, December 11, 2013. http://www.puntofocal.gov.ar/doc/min13-37.pdf.

However, they can also be viewed as a way of leveling the playing field between developed and developing member-countries of the WTO. For the Philippines and other developing countries, the additional items provide the needed policy space. Nevertheless, they could also give room for politicizing trade policy.

There are other areas covered in the MC9 such as export subsidies and cotton, but they are on a "best endeavor" basis.¹¹

Implications

What was accomplished at MC9 should not be underestimated. In and by itself, the MC9 resolution is very significant. That decisions can be made under the auspices of the WTO, such as the trade deal delivered in Bali, signaled to the world that the WTO is still relevant. The Bali package brings promise for the future of the multilateral trading system. However, more work needs to be done to realize the potential benefits arising from the trade deal. Even in trade facilitation, the agreement would need to be further deepened (e.g., in the use of ICT and supply chain connectivity) in addition to capacitating many developing countries that are lagging behind. Member-countries should not stop to seek ways to build on what has been accomplished.

For the Philippines, the trade deal reached in Bali would hopefully add further stimulus to implement its trade facilitation reforms more quickly, especially those already committed to ASEAN. In the area of agriculture, caution should be made that the policy space provided by the "peace clause" and the expansion of general services under the "green box" do not impede the needed reforms to liberalize the sector.

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3 Labor Policy Analysis for Jobs Expansion and Development

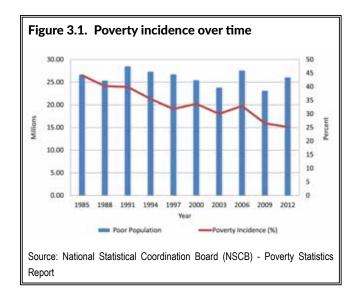
Vicente B. Paqueo, Aniceto C. Orbeta, Jr., Leonardo A. Lanzona, Jr. and Dean Gerard C. Dulay

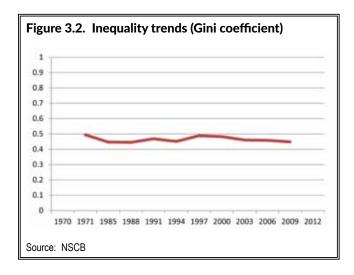
mid the uncertain and slow recovery of the global economy from the Great Recession of 2008, the Philippines achieved rapid GDP growth of 5.1 percent between 2008 and 2013. This achievement came as a result of improved macroeconomic fundamentals and better financial management. The country's investment rating has been upgraded, lowering its cost of borrowing and boosting business confidence. These achievements have led to optimistic views of the Philippines as the next tiger or as an economy poised for sustained takeoff.

But whether its takeoff will reach escape velocity or burst like a bubble is an open question. There are early signs that the economy could be headed for sustained rapid growth, but there are also notable risks. In any case, it is obvious that at this juncture of its history, the Philippines has another opportunity to choose two different paths. One can lead to sustained and rapid growth with massive expansion of poverty-reducing jobs. The other will almost surely keep the Philippines in the same familiar road of continued high inequality and poverty incidence. The answer relies on the wisdom and political calculations of the country's politicians and its influential citizens.

Regardless of how fast growth will turn out to be, it should be accompanied by transformative structural policy changes and programs that would enable the poor to escape the vicious cycle of poverty. The concern is that despite rapid economic growth, income inequality and poverty incidence have remained high and stable in the last two decades after significantly declining previously (Figures 3.1 and 3.2).

¹ See Raul Fabella's "Green shoots" in Introspective, BusinessWorld, February 9, 2014.





It is widely believed that this failure to attain greater inclusiveness is due to widespread joblessness among the poor and the country's inability to rapidly expandjob opportunities. The issue of joblessness and "jobless growth" has resonated strongly with critics and supporters alike of the Aquino administration, as well as with the country's development partners like the World Bank, Asian Development Bank (ADB), and International Labour Organization

(ILO). Not surprisingly, the resonance of the issue has led to a chorus calling for rapid and massive creation of jobs. As a result, the government quickly obliged and pivoted rhetorically, making the jobs issue a central feature of its development strategy for inclusive growth.²

Two questions arise at this point. Firstly, what does the data say about the nature of the jobs issue? Secondly, how does one address the issue, given the political configuration and historical experience of the Philippines? This article seeks to clarify the jobs issue and articulate a program to address it.

The paper is organized as follows. The next section defines the jobs issue, its importance, and its dimensions. The third section presents data on aggregate outputs, employment, productivity, wages, and relative input prices. It highlights certain macroeconomic trends that are relevant to the jobs and poverty challenge. The fourth section describes the labor policy and regulatory environment. The fifth section presents evidence on the effects of a labor regulation like minimum wages on enterprises and individuals from disadvantaged groups. The penultimate section examines the impact of minimum wages on household welfare. The final section outlines a strategy and action program to support poverty-reducing employment.

Defining the jobs issue

The simple definition of the jobs issue is lack of job opportunities. A more nuanced view is the inability of the common person to earn a decent living through productive employment or self-employment. The jobs issue has many dimensions. For the nonpoor, unemployment for many of them is about investing time and money in job search. It is looking or waiting for a job that best fits their

² See Philippine Development Plan 2011–2016.

ambitions, skills, and temperament. Viewed this way, the job challenge is a middle-class issue (De Dios and Dinglasan 2014).

For the poor, however, jobs are about survival. Unlike the middle class, the poor cannot afford to be unemployed for long periods.³ That is why the poor and those with low levels of education have relatively low rates of unemployment. What matters for them is how to earn more from time spent on work.⁴ This observation has led some economists, e.g., De Dios and Dinglasan (2014), to question the claim that solving the unemployment problem would resolve the issue of poverty and inequality.

In fairness to employment advocates, however, what they are proposing is not mere reduction in the open unemployment rate. Rather, they mostly want the government to focus on a strategy that creates massive opportunities for more gainful jobs for the jobless. These are jobs that will give the poor and jobless workers opportunities to increase their work time and a chance to learn and raise their productivity. In this regard, a more nuanced articulation of the strategy by government is perhaps needed.

Magnitude of the jobs challenge

Figure 3.3a reveals that in terms of full-time equivalent⁵ persons, there are about 20 million workers in the "reserve army" of the openly unemployed, underemployed, and the low productivity workers (known also as disguised unemployment). This army,

referred to in this study as the pool of "underproductive workers", constitutes over half of the working-age population (Table 3.1). They are unproductive in that as of the time of the survey, each of those workers is either openly unemployed or earns less than the official per capita food poverty threshold. In other words, the worker is not productive enough to survive on his or her own earnings, let alone feed others.

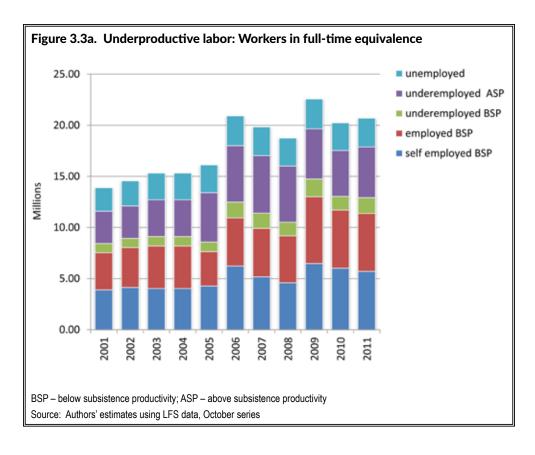
There are several conclusions that one can draw from the data. First, the total number of underproductive labor grew to 20.7 million from 13.9 million in full-time equivalent persons between 2001 and 2011 (Figure 3.3a). The number increased in all categories in absolute terms. As a percentage of the labor force, the number increased to 50 percent or over in 2006-2011 from about 40 percent in 2001-2005 (Figure 3.3b). Second, open unemployment accounts for only 13-15 percent of the total underproductive workers in 2006-2011, down from 17 percent in 2001–2005. Third, the vast majority of workers have jobs but their productivity is too low to support their own survival, or they want to earn more, presumably to meet needs beyond food for subsistence. These workers constitute about 84 percent of the total number of unproductive workers (Figure 3.3c). Therefore, fourth, the issue of poverty is not primarily about idleness; the core of the issue is more accurately described as a combination of joblessness (open unemployment and underemployment) and lack of opportunities for productive and rewarding work.6

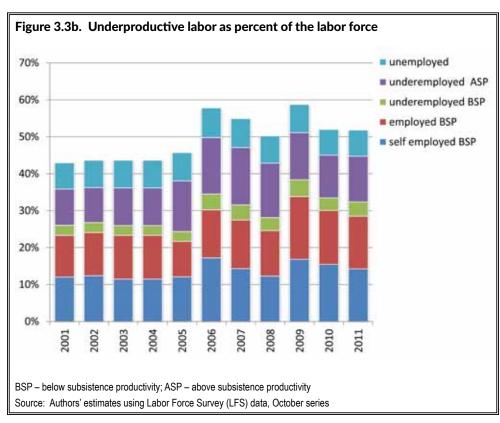
³ Unemployment is largely accounted for by the young, the highly educated, and the well-off (WB 2013b).

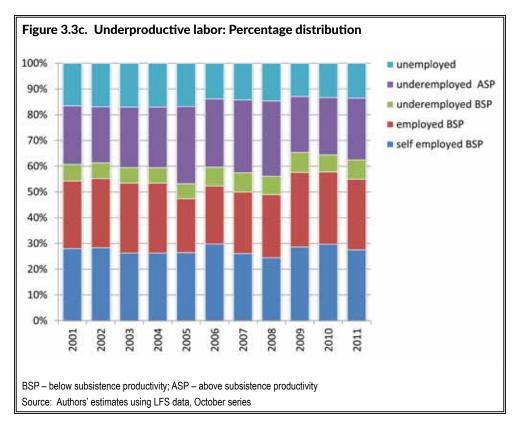
⁴ The above point is worth making to belie a common view that the poor consist mainly of idle men. It has long been recognized that the poor are actually maximizing given their circumstances (Schultz 1964). A more informed view of the poor would recognize that job creation should not just be about giving the poor jobs (or any job) to keep them busy. For example, beneficiaries of the *Pantawid Pamilyang Pilipino Program* (4Ps), the government's conditional cash transfer program, should not be made to build the proverbial roads that go to nowhere, plant trees that fail to grow, and dig holes and fill them back for lack of bureaucratic imagination. The failure to appreciate this nuanced view of the jobs challenge can and has led to inappropriately designed public jobs programs and policies. On this score, since most of the heads of poor households spend the day working to eke out a living that barely keeps their body and soul together, indiscriminately requiring all heads of the 4Ps' beneficiary households to get involved in public work projects with little or no pay would be inefficient and cruel.

⁵ Employed persons working equivalent to 40 hours per week.

⁶ Broadly, the Social Weather Stations (SWS) data convey similar messages about the job challenges highlighted above, although there are differences in definitions and methodologies between the LFS and SWS employment survey data (see Mangahas 2013 and Albert 2014).







The point here is not to minimize the problem of open unemployment; rather, it is to emphasize the need for a multidimensional solution to the issue of jobs and poverty.

Economic growth without commensurate job creation

The jobs issue is an old concern. In fact, it was the central issue for the ILO mission led by Professor Ranis of Yale University in the 1960s (Sicat 2004). What has provoked renewed concern about the issue is the observation that the recent acceleration of GDP has not led to reduction in joblessness. The phrase "jobless growth" has become a popular term to denote economic growth without expanding employment opportunities or without reduction in joblessness.

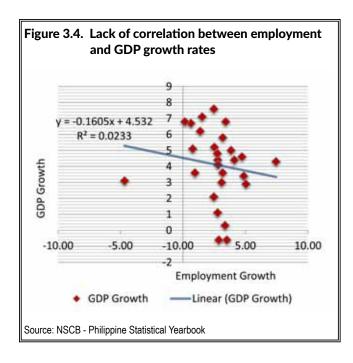
The usual expectation, based on Okun's Law,⁷ is that a faster rise in GDP leads to a lower unemployment rate. Contrary to expectations, however, the recent achievement of higher economic growth was accompanied by neither a decline in the unemployment rate nor a rise in employment growth. This finding was used to denigrate the recent performance of the economy under the current administration. The finding is true, but interestingly it applies as well to past decades (Figure 3.4).

There are a couple of reasons to think that Figure 3.4 probably gives a distorted view of reality. The Philippine Labor Force Surveys (LFS) are known to suffer from lack of consistency in their definitions of terms and from other measurement errors.⁸ Moreover, it takes only an hour of work

⁷ For a brief discussion of the Okun's Law, see Fuhrmann (2012).

⁸ Felipe Medalla, professor of the University of the Philippines School of Economics and member of the Monetary Board of the BSP, has cautioned commentators against over-interpreting short-term changes in unemployment in the LFS due to data problems.

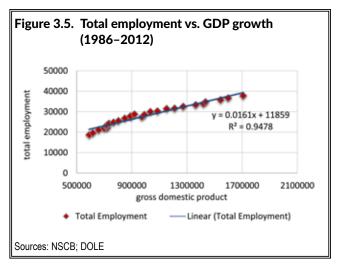
Table 3.1. Underproductive workers: Full-time equivalent number and percentage distribution	productive	workers: Full	l-time equiv	alent numbe	er and perce	ntage distril	oution				
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Self-employed BSP	3,890,698	4,127,307	4,023,044	4,023,044	4,263,744	6,228,139	5,169,633	4,589,502	6,469,077	6,015,578	5,691,216
	78%	28%	79%	79%	79%	30%	76%	24%	78%	30%	27%
Employed BSP	3,644,059	3,912,876	4,165,107	4,165,107	3,377,376	4,707,340	4,742,810	4,587,141	6,533,794	5,680,476	5,680,476
	79%	27%	27%	27%	21%	23%	24%	24%	78%	28%	27%
Underemployed BSP	895,103	894,776	922,900	922,900	936,195	1,536,790	1,494,992	1,332,987	1,737,889	1,342,905	1,554,306
	%9	%9	%9	%9	%9	%2	%8	%2	%8	%2	%8
Underemployed ASP	3,159,904	3,165,389	3,593,108	3,593,108	4,822,733	5,533,158	5,612,256	5,492,184	4,909,975	4,498,836	4,947,637
	23%	22%	23%	23%	30%	79%	28%	78%	22%	22%	24%
Unemployed	2,303,203	2,470,476	2,616,499	2,616,499	2,714,792	2,905,775	2,824,112	2,749,490	2,922,808	2,709,487	2,821,867
	17%	17%	17%	17%	17%	14%	14%	15%	13%	13%	14%
Total	13,892,967	14,570,825	15,320,658	15,320,658	16,114,840	20,911,201	19,843,803	18,751,304	22,573,543	20,247,282	20,695,502
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
ASP - above subsistence productivity; BSP - below subsistence productivity	e productivity; BSF	- below subsiste	ince productivity								
Source: Authors' estimates from LFS 2001–2011, July series	tes from LFS 2001	–2011, July serie	(A								



within a narrow timeframe to be considered employed. Those deficiencies make "rates of change variables" look more volatile or scattered than what might really be happening.

In contrast, we observe that there is a high correlation (Figure 3.5) between the level of employment and output. This relationship is probably more realistic. The graph uses "level variables" that are likely to average out statistical errors and minimize exaggerated swings in employment data from one year to the next.

The statistical caveat above notwithstanding, the relationship depicted by Figure 3.5 appears consistent with the observation of international studies. They find that despite the volatility of employment growth in the short run, the number of employed workers tend to converge with population trends in the long run (WB 2013a). This tendency suggests that there are mechanisms that move labor markets toward equilibrium over time (perhaps, not actually reaching it).



The conclusion then is that the characterization of economic growth in the Philippines as "jobless" needs clarification. To make sense, "jobless growth" cannot mean no jobs have been added as the economy produces more output. Rather, it should mean that the number of additional jobs or amount of time worked associated with growth of GDP or sector outputs are too little to make a substantial dent on the unemployment and underemployment rates over a year or a quarter. It is this definition of jobless growth that we shall use in the rest of the paper.

Elasticity, labor intensiveness, productivity, and wages: The broad view

This section broadly discusses why the economy is not able to generate substantial employment despite substantial growth. One hypothesis is that perverse incentives (discussed below) are promoting the growth of sectors that are not utilizing the country's abundant labor and discourages the development of enterprises that employ lower-skilled workers (e.g., labor-intensive manufacturing). Another hypothesis is that we are not producing competencies demanded by the fast-growing modern sectors, preventing the economy from achieving its potential.⁹

⁹ This is observed in the current needs of the service sector which is currently the country's main employment generator. It is indicated by many studies that the service sector actually requires highly skilled and educated workers to remain competitive with the rest of the world.

Table 3.2. Grow	th-employmer	nt elasticity b	y period (19	56-2010)				
	Sect	or Employmer	nt Elasticity to	GDP	Sector Empl	oyment Elasti	city to Sector	Value-added
	1956– 1969	1970– 1985	1986– 1996	1997– 2010	1956– 1969	1970– 1985	1986– 1996	1997– 2010
Economy wide	0.59	0.64	0.82	0.54				
Agriculture	0.46	0.65	0.43	0.30	0.52	0.97	0.81	0.42
Industry	0.55	0.63	1.26	0.29	0.50	0.48	1.16	0.34
Service	0.97	0.95	1.19	0.80	0.97	1.01	1.00	0.66
Source: World Bank (W Note: All estimates are s	,	ŭ						

These points can be supported by looking at employment elasticity in relation to output, productivity, input prices, and labor intensiveness. These broad views provide the context to the microeconomic view that is presented later.

Employment elasticity

The above conclusion about the relationship between aggregate employment and output begs the question: How many additional jobs are usually generated by increases in outputs in the medium to long run? A standard practice to answer this question is to measure the elasticity of employment with respect to output. This elasticity parameter is defined as the percentage change in employment with respect to a percentage change in output. Table 3.2 shows employment-output elasticity estimates for the Philippines and other countries for the economy as a whole and for agriculture, industry, and services.

On the whole, Philippine employment appears to be inelastic with respect to GDP. It means that the economy-wide response of employment to a percentage increase in GDP is estimated to be less than 1 percent. Although inelastic, it is nevertheless large compared with that of successful neighbors, based on estimates reported by the World Bank (2013b) and Felipe and Hasan (2006).

In the WorldBank's 2013 Philippine Development Report (PDR), the country's elasticity of employment with respect to GDP was reported to be around 0.54 in 1997–2010 (Table 3.2). This means that a 10-percent increase in GDP was associated with a 5.4-percent rise in employment. This estimate is the lowest for the period 1956–2010. The employment-GDP elasticities were 0.59 in 1956–1969, to 0.64 in 1970–1985, 0.82 in 1986–1996, and to 0.54 in 1997–2010. Had the elasticity remained at its peak of 0.82, a 10-percent rise in GDP would have had generated an 8.2-percent expansion of employment instead of only 5.4 percent.

In the ADB study "Labor markets in Asia", Kapsos (2006) presents estimates of the employment-GDP elasticity of around 0.42 (Southeast Asia), 0.36 (South Asia), and 0.18 (East Asia) in 1999–2003. The corresponding figure for the Philippines ranges from 0.54 to 0.82, as mentioned.

High elasticity indicates that expanding output by 1 percentage point would require a much greater percentage increase in labor inputs. That the Philippines has had a relatively high employment-output elasticity is, thus, an indication that it is less productive than its neighbors. The high elasticity can be explained by two reasons. First, the country's labor productivity is low. Second, the economy is not able to attract as much capital as the other

countries.¹⁰ This is a matter of concern, but it is old news, as the Philippines has started to move toward near convergence with its neighbors. Its employment elasticity fell in 1997, after rising between 1956 and 1996.

Labor intensity of output and the relative cost of inputs

The extent to which demand for labor rises with output depends on the mix of labor and capital inputs. On this point, it is generally recognized that a country's GDP and sectorial outputs can be produced through a wide range of capital/labor combinations. Which combinations prevail depends on several factors. First, they depend on the composition of aggregate outputs and, therefore, on market demand. Some commodities are more labor intensive than others. Second, for a given commodity, producers have a choice of labor or capital-intensive processes. Among other factors, the choice will depend on relative factor prices, defined broadly to include not only the explicit price tag of inputs (e.g., wages and rentals) but also other costs incidental to the actual use of a factor of production, such as the difficulties and uncertainties associated with certain labor practices. On the whole, markets tend to choose more capital-intensive processes and commodities in the long run, when labor becomes expensive relative to capital inputs.

The ability of labor-intensive industries to compete, particularly in manufacturing, has been seriously hampered by the elevated cost of labor relative to capital. In the context of China's and Viet Nam's cheap and disciplined labor, this handicap has been identified as one of the key causes of the remarkable shedding of labor-intensive manufacturing activities in the Philippines in the

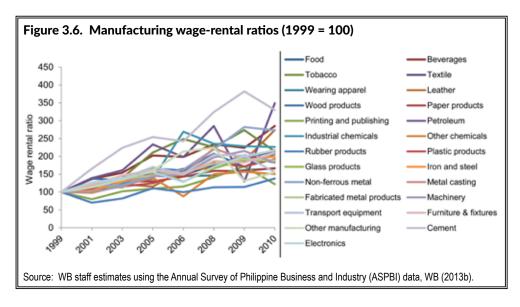
past and its failure to hire more workers. This shedding is premature at this stage of the country's development, given its superabundant labor supply.

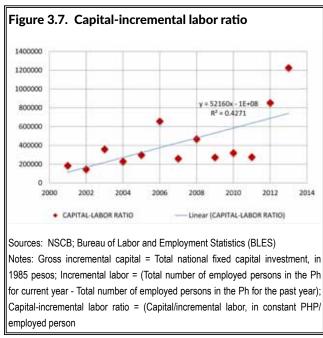
The cause of the shedding has been attributed, at least in part, to distortions in the cost of labor inputs relative to capital. Part of these distortions were brought about by capital-biased subsidies, work disruptions, mandates on minimum wages and other labor remuneration, as well as other regulations and practices that make it difficult and costly to deal with labor issues.

Looking forward, the concern is that similar policies and practices will continue to make labor relatively more expensive and difficult to manage, and thus will be a drag on the country's ability to compete and grow its labor-intensive industries. There is reason for this concern. As can be observed in Figure 3.6, the ratios of manufacturing wages (for different subsectors) relative to the rental price of capital exhibit an upward trend. Concomitantly, there is a tendency for the incremental capital-labor ratio to rise (Figure 3.7).

From the standpoint of international competitiveness, Philippine labor cost (in terms of minimum wage) remains high compared with competitors' cost. Table 3.3 shows that Philippine minimum wage is higher than that of China, Thailand, Indonesia, and Viet Nam, and the East Asian average. Without productivity adjustment, Philippine labor cost is three times more expensive than Viet Nam's (Table 3.3). Except for Viet Nam, Philippine labor cost remains higher than that of competitor countries, even when differences in workers' productivity are taken into account. Interestingly, the Philippines looks competitive against Viet Nam, when minimum wage relative to average labor productivity is used as the measure of competitiveness (Figure 3.8) although

¹⁰ Given the high unemployment, there is a need to increase labor productivity and to attract more investments. Other countries have done this, resulting in growth and employment at the same time.





Country	USD (2005 prices)
Philippines	1,860
China	1,728
Papua New Guinea	1,296
Indonesia	1,140
Thailand	852
Lao PDR	684
Cambodia	444
Viet Nam	408
Kiribati	0
Malaysia	0
Timor-Leste	0
East Asia and Pacific (developing)	888
Source: WB (2013a), 2010 or latest ava	ilable data; WB (2013b)

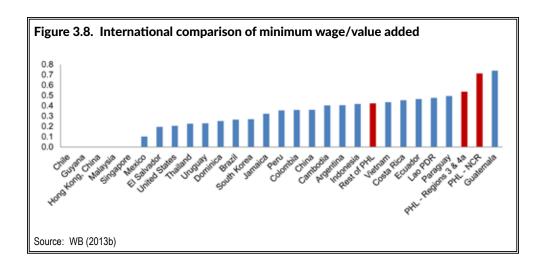
this is only true for the rest of the Philippines and not so for the NCR.

These convey two key messages. On the one hand, they show that increased labor productivity can attenuate a country's high labor cost disadvantage against some competitors. On the other hand, they highlight the disconcerting fact that increased productivity alone is not enough to be competitive with the rest. For the Philippines, efforts to increase

labor productivity should be taken as a complement and not as a substitute for moderation in minimum wage rises and other cost increases arising from burdensome labor regulations.

Productivity, wages, and employment

Aggregate data reveal that Philippine labor productivity has been rising over time on average, while the daily wage rate seems to be declining. These



two variables seem to be negatively correlated. Figures 3.9, 3.9a, 3.9b, and 3.9c present these observations for the economy as a whole as well as for the industrial, agricultural, and services sectors.¹¹

The wage decline is surprising in the face of rising labor productivity. Standard neoclassical economic theory predicts that a rise in labor productivity should lead to wage increases. Competition is supposed to induce employers to pay workers the value of their contribution to total output. Why the wage rate is declining is a puzzle that needs further research, beginning with an analysis of data quality. One issue here is that the wage data might not capture accurately nonwage benefits.

In analyzing the employment issue vis-à-vis labor productivity and wage policy, a model of an economy with unlimited or superabundant labor surplus can be a useful guide. The underlying view of this study is that the Philippines can be characterized as an economy with "unlimited" supply of labor. In such an economy, the real wage of a predominantly unskilled labor force would tend to settle at around

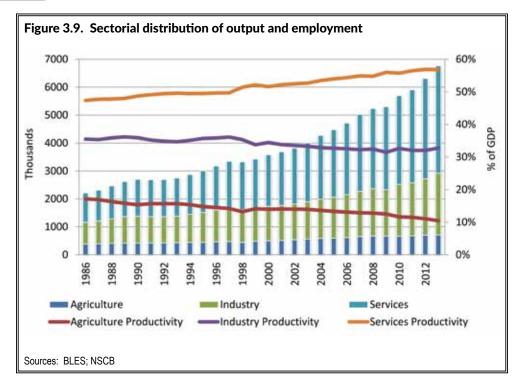
some natural minimum wage (NMW) equilibrium.¹² The presumption is that there is a wage level below which employers will find it disadvantageous to bid wages further down. One reason is that below that wage level, the productivity of workers would become so low due to ill health and malnutrition effects that it does not pay to hire them at wages lower than NMW. Conversely, if for some reason such as increased minimum wage, the real wage of unskilled workers goes beyond the NMW, competition among surplus laborers would push the real wage back to NMW (probably with a time lag).

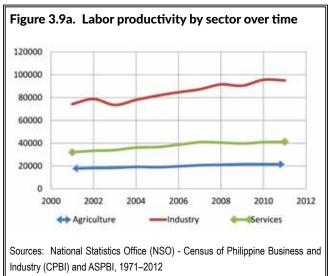
The labor surplus model predicts that *ceteris* paribus, labor productivity would be uncorrelated with the wage rate of unskilled workers. Similarly, a minimum wage higher than the equilibrium wage rate will render increases in labor productivity uncorrelated with increases in wage rate. The demand for unskilled labor, however, is expected to rise with increased productivity and, therefore, reduce joblessness.

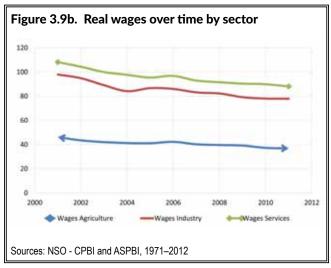
An exploratory analysis of panel data, using fixed effects models and frequency of typhoons as

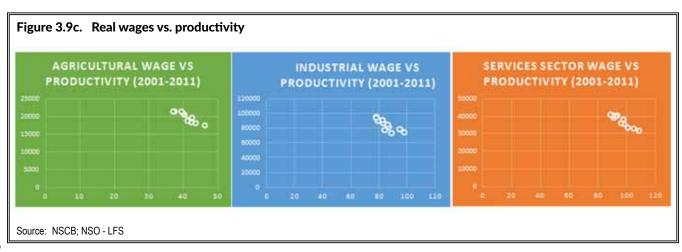
¹¹ Lanzona (2014) also finds declining real wages.

¹² We call the wage rate at that level a natural minimum wage (NMW). Unlike the traditional idea of subsistence wage, NMW does not presume that the income from work at that rate will be enough to cover all expenses needed to survive in the long run.









instrumental variable (IV) for labor productivity, was undertaken to test those two hypotheses. Table 3.4 presents estimates of the elasticity of the regional employment and underemployment rates with respect to regional labor productivity. As expected, productivity is positively and negatively related with employment and underemployment, respectively. These results are consistent with the aforementioned hypotheses. Incidentally, the elasticities say that a 10-percent rise in overall regional labor productivity increases the employment rate by 3 percent and reduces the underemployment rate by about 3 percent. We also find that wage rate (not shown in the table) is uncorrelated with productivity. These results indicate that the Philippines can be reasonably described as if it were an economy with unlimited supply of labor.

The impact of a minimum wage mandate will be estimated and discussed in detail in later sections. The hypothesis is that in an economy with labor surplus, a rapid rate of increase in the legal minimum wage (above the NMW or the equilibrium wage rate) would reduce the income of the average households, especially the poor, because of increased joblessness among household members even if this may mean higher wages for those who gets employed.

It should be emphasized at this point that a world with unlimited supply of unskilled labor can coexist with shortages of workers with skills and character traits highly valued by the market. In this regard, investment in education and other forms of human capital will command a wage premium. As demand for this type of workers increases and shortages develop, the wage premium is expected to rise. Remarkably, Di Gropello et al. (2010) have noted an upward trend in the wage premium for

Table 3.4. Effect of aggregate labor productivity on employment and underemployment, IV estimates, years

-		
	Employment Rate	Underemployment Rate
Constant	71.4406	23.42156
Regional aggregate labor productivity (output per worker)	.5372195*** (.0149954)	0976515*** (.023024)
R-squared	0.3060	0.0685
Elasticity	.2994079	3107145

Notes:

- 1/ Productivity data taken from the BLES website and employment and unemployment rate for Labor Force Surveys.
- 2/ Fixed effects model, using frequency of regional typhoons as instrumental variable for labor productivity.
- 3/ Authors' estimate using IV and frequency of typhoons as IV to productivity

skilled and educated workers in recent years in the Philippines, implying the emergence of shortages in this type of workers.

Broadening the discussion on productivity, we now look at the country's total factor productivity (TFP) growth. TFP is the residual change in output after deducting the contributions of labor and capital inputs to total output. It is well known that Philippine TFP growth had historically been consistently negative. This means that for the most part of the postwar years, the economy was becoming less efficient in the use of its resources, unlike the experience of its more successful neighbors¹³ (Table 3.5).

It is remarkable, therefore, that TFP growth appears to have turned positive in recent years (Figure 3.10). This implies that, if sustained, the country's GDP and labor productivity could grow at a faster rate than

^{***} Significant at 1-percent level

¹³ Sustained TFP increases, which imply reduced labor and capital cost per unit of output, have generally been the historical experience of economically successful countries. The effect of labor saving here, it should be noted, is different from that induced by government mandates. These mandates make the price of labor artificially more expensive relative to capital, while TFP growth increases output and demand for labor.

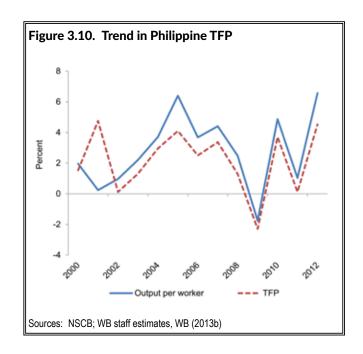
	Growth in	Co	ontribution to Growth o	of
	Output per Worker	Physical Capital	Human Capital	TFP
Philippines	1.0	0.9	0.4	-0.3
East Asia	4.4	2.4	0.5	1.4
China	4.8	1.7	0.4	2.6
Indonesia	3.0	1.8	0.5	0.6
Korea	4.8	2.8	0.7	1.2
Malaysia	3.6	2.2	0.6	0.8
Singapore	5.0	3.0	0.5	1.5
Taiwan	5.8	3.0	0.6	2.1
Thailand	4.1	2.5	0.4	1.2

its historical experience. The question is: Will the recent TFP experience of the Philippines be sustained? There is little doubt that efficiency increases can be sustained. These will, however, require government actions on certain critical issues beyond the scope of this study. These issues, however, are discussed in detail by Llanto and Navarro (Chapter 1, this volume), World Bank (2013b), and Usui (2011).

Shifting the center of gravity

Further on employment and productivity, a key lesson of development experience is that moving labor resources from low- to high-productivity sectors and activities has historically been a key driver of TFP growth. Development strategies based on these dynamics has been shown to work in various developing countries that have achieved sustained economic takeoff and poverty reduction (e.g., China, Singapore, Thailand, Malaysia, and Indonesia).

On this issue, there is wide agreement that the Philippines should pursue a more robust shift of its economic center of gravity from low- to high-



productivity activities. Historically, this means increasing the share of the non-agricultural sector (manufacturing, particularly) in total employment. The assumption is that the manufacturing and other industrial sectors are more productive and have more potential room for expansion¹⁴ than agriculture or

¹⁴ Demand for agricultural product is inelastic with respect to income growth compared with that of manufacturing and other non-agricultural outputs.

some services subsectors for that matter. Despite wide agreement on the goal of industrialization, there are serious disagreements on how to achieve it.

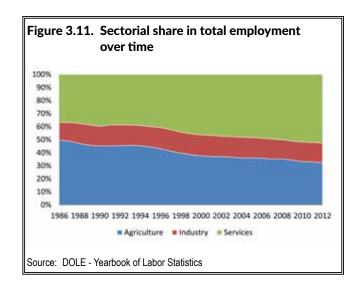
What has been the extent and pace of the country's evolution toward industrial development? The share of agriculture, which exhibits lower labor productivity compared to other sectors, has been reduced, while the share of the non-agricultural sector has increased on the whole (Figure 3.11). The issue, however, is that the share of the manufacturing industry remains small and it has been stagnating, until recently. Instead of manufacturing, the center of economic activity in the Philippines has moved toward the service sector, prematurely in the view of some economists (Fabella 2013). We emphasize, however, that agricultural productivity growth is critical to sustainable transformation of the economy.¹⁵

The evolution of the share of manufacturing in the economy is unsurprising. As mentioned, businesses left labor-intensive manufacturing years ago because labor and other business costs in the Philippines were higher than those of its neighbors like China and Viet Nam, making it difficult for Philippine businesses to compete.

Propitiously, there is a new opening for the Philippines to reenter the competition today. With China now starting to shed labor-intensive manufactures in a big way, there are plenty of opportunities for revitalizing and expanding laborintensive manufacturing in the Philippines. Success in this regard will, however, depend on the timely institution of a business environment that is more supportive of labor-intensive manufacturing.

Section summary

The foregoing discussion highlights the need to focus on the rapid expansion of labor demand for low-



skilled labor and the promotion of labor productivity growth. These twin strategic priorities can be achieved by: (i) more realistic pricing of Philippine labor and capital inputs to expand employment in labor-intensive sectors and the demand for existing skilled and semiskilled workers; and (ii) increasing human capital through greater and more efficient investments in education, training, and other forms of human development activities. Although the latter may require substantial investments, the rate of return has been shown to be high (as discussed in the next section), making it a sound investment. Realistic pricing means that the Philippines needs to maintain an economic policy that closely aligns factor prices with the scarcity value of the country's labor and capital endowments.

To be clear, the idea is to have an appropriately priced labor to achieve full employment. The real prize to keep in mind in the long run should be the eventual achievement of sustained rises in real wages and incomes of the household, particularly of the poor, with as little government dictation as possible. It should also be stressed that increased wage-capital

¹⁵ A well-recognized impact of the stagnant agricultural productivity is increased food prices that fuels demand for higher minimum wage. Habito (2014), however, has pointed out that so many resources have already been spent on agriculture with little results. We need new strategies here.

rental ratios should not in themselves be a concern. But the issue is that those ratios have been distorted by policies that have tended to artificially raise the cost of labor and lower the price of capital, creating an environment that is unfavorable to investment in labor-intensive industries and the creation of good job opportunities.

Labor policy, regulations, and rationale

This section reviews the regulatory and policy environment governing the labor market. It lays the foundation for the next sections, which present and discuss estimates of the effects of legal minimum wages (LMWs) on outputs, employment, incomes, wages, and poverty in the Philippines. Although the study focuses on the LMW issue, the intention is to use it to illustrate the need to do an evidence-based analysis of the other labor laws, regulations, policies, and practices. Our motivation in this regard is to ensure that labor regulations like LMWs do indeed benefit the poor and disadvantaged population and that complementary and alternative ways to improve their incomes are systematically explored. On this point, it would be wrong to ignore strong suspicion that the current labor regulatory environment supposedly intended to protect workers might not in reality be as helpful as they are thought to be. Worse, it might even be detrimental to the welfare of the poor.

This section accordingly is structured as follows. It first discusses the minimum wage law and, more generally, the country's labor policy and regulatory environment. It then highlights the main arguments for and against the minimum wage law and other labor market interventions. The following discussion draws heavily from Lanzona (2014).

Mandatory minimum wages

The primary objective of the law when minimum wages were instituted in the 1950s was to set a decent

wage level for workers. Sicat (1986), however, noted that the timing of the institution of minimum wages coincided with import substitution policies and the state's bias against export-oriented laborintensive industries. In time, these policies, by Sicat's reckoning, led to a greater application of mechanized operations at the expense of labor (a development favorable to monopolies during the time).

When first set up, there was only one minimum wage set by Congress for the entire country regardless of regional and industrial differences. In the beginning, during the early years of tripartite meetings (organized by the government, labor, and employers), the agreement was to aim for some form of indexed minimum-wage package that would include benefits. In the end, the result was a "bilateral monopoly bargaining process" on the wage package. The consequence was that, as Lanzona (2014) writes:

"Monopolists were able to keep their rents, with organized labor receiving a portion of such rents. In the process, a number of workers who were not part of the bargaining process were left unemployed or employed in marginal occupations."

In July 1989, to appease other employers, protect workers, and spur regional development, Congress enacted RA 6727, which delegates Congress power to set minimum wages to the newly created Regional Tripartite Wages and Productivity Boards (RTWPBs). The RTWPBs are mandated to prescribe minimum wage rates for their respective regions while taking into account their regional conditions.

Decentralized wage setting was thought to be a more efficient approach for several reasons. In general, a decentralized system allows for minimum wages to be better aligned with local preferences and labor market conditions, which differ by region. Citing Moretti (2010), Lanzona (2014) argues: ".... For example, an underdeveloped region can set lower minimum wages to attract new investments and thus move the region from a bad equilibrium (i.e., low density of economic activity and low employment) to a good equilibrium (i.e., high density of economic activity and high employment). In this case, the short-run efficiency costs of setting minimum wages could be small compared to the potential long-run benefits of moving to a better equilibrium" (Moretti 2010).

The labor policy and legal framework in general

The rules of the game covering the labor market is embodied in the Philippine Constitution, the 1974 Labor Code, and other executive policy instruments. The 1974 Philippine Labor Code prescribes rules governing the relationships of workers and employers, including regulations on hiring and termination of private employees; the conditions of work including maximum work hours and overtime; employee benefits such as holiday pay, 13th month pay, and retirement pay; and the guidelines on the organization and membership in labor unions as well as in collective bargaining. Specifically, the following are the salient features of the labor policy and legal framework:

- (i) Promotion of *tripartism*, a policy that seeks to resolve labor issues through consultation and conflict resolution processes that involve the government, employers, and workers;
- (ii) A sustained government policy prioritizing the establishment of a negotiation environment that respects the rights of both labor and

- management to bargain for their respective interests, guided only by the condition that these negotiations must not hinder government programs and development goals;
- (iii) Recognition of the right to form trade unions and the right of a union to insist on a closed shop;
- (iv) Authorization of strikes for as long as they comply with the strict requirements under the Labor Code, and workers who organize or participate in illegal strikes may be subject to dismissal;
- (v) Management recognition of the importance of labor unions and labor organizations, which are in turn expected to assume a similar degree of responsibility for the firm (in terms of meeting any demands and challenges from competition, both domestic and global);
- (vi) Employment laws governing individual contracts and determining the compensation, the length of trial periods, and the conditions of part-time work;
- (vii) Restrictions on the range of feasible contracts and the cost of laying off workers and increasing hours of work (regulations on this score tend to favor full-time indefinite contracts, over short-term, fixed-term, or temporary contracts);
- (viii) Provisions in the Labor Code mandating a minimum advanced notice period prior to termination, specifying justifiable dismissal, and establishing compensation to be awarded to laid-off workers based on the reasons of their job terminations; 16
- (ix) Provisions relating to collective or industrial relations laws that regulate bargaining,

¹⁶ Termination of short-term contracts at no cost to the firm is allowed, provided the duration of the contract has expired. To prevent firms from exclusively hiring workers on temporary contracts, the use of such arrangements is severely limited. The Labor Code also allows a limit of six months to test and dismiss a worker at no cost if his or her performance is considered unsatisfactory.

adoption, and enforcement of collective agreements, the organization of trade unions, and the industrial action by workers and employers;¹⁷ and

(x) Jurisprudence that tends to resolve cases in favor of labor in case of doubt about the interpretation and application of labor laws and regulations.¹⁸

The overall intent and significance of the abovementioned provisions of the labor code and jurisprudence is to change the balance of bargaining power between workers and employers by empowering labor unions to represent workers collectively and protect particular union approaches in negotiations with the employers.

With the current labor regulatory and policy environment, therefore, employers face three binding constraints. These are, to quote, Lanzona (2014):

- (i) "Labor relations and the protection of permanent and unionized workers (Article 234,253A,260,and 264) whose services cannot be terminated except for just and authorized cause and subject to the requirement of due process (Article 278).
- (ii) The restrictions to subcontracting arrangements (Article 106) and ... probationary period of six months (Article 281) after which the employer should offer permanent employment (Article 279).
- (iii) ... [M]inimum wage law that prohibits wages from going below a certain level and which does not allow the diminution of benefits once awarded (Article 127)."

Worker protection is commonly assumed to be desirable not only for its social value but also for its ability to form skills. Ensuring workers of their respective jobs creates incentives for them to learn more firm-specific skills and in the process be more productive. Protectionism, however, can be overdone and can cause deleterious effects on the industry, and hence can increase unemployment and eventually reduce skill formation. Just like medicine, when abused, it can be worse than the disease. The welfare of workers, particularly the poor, the less educated, the young, and women can be seriously hurt by government mandates and regulations intended to curb presumed employers' abuses, monopsony power, and unfair bargaining advantage over individual workers. For example, it can be argued that high minimum wages in conjunction with other laws that prevent firms from recouping their investments in training the young and inexperienced (the six-month regularization rule) can result in firms not investing enough in on-the-job training, resulting in inadequate skills formation and high unemployment rate among the aforementioned disadvantaged groups.

To summarize, Philippine laws, regulations, and policies seek to advance the welfare of workers by strengthening their bargaining position against employers, protecting them against abuses, and mandating minimum wages for them to earn a decent living. Some of these government measures can enhance the welfare of the workers; others can be detrimental despite good intentions, particularly when overdone. The question is: What have been their effects on the welfare of households and enterprises?

Labor laws effectively allow workers to participate in the contract negotiation process, especially in the area of compensation through participation in collective bargaining agreements (CBAs) and the arbitration process.

Lanzona (2014) has noted that "Philippine jurisprudence has long applied a rule that any doubts in the interpretation of law, especially the Labor Code, will be resolved in favor of labor and against management."

The effects of minimum wages on enterprises and disadvantaged workers

This section presents empirical evidence on the above question. The evidence presented is based on modern impact evaluation methods. There are two parts to this section. The first relates to the response of enterprises to minimum wage; the other is about its impact on the economic welfare of the individuals belonging to selected disadvantaged population groups.

Impact on enterprises

Using various econometric methods and applying them on the combined sample of small and large enterprises, Lanzona (2014) found a statistically significant negative relationship between minimum wages and employment (Tables 3.6a, 3.6b, 3.7, 3.8, 3.9a, 3.9b). The relationship implies that, on the whole, the minimum wage policy reduces employment. This finding holds, even when the regression analysis is limited to small-scale enterprises, which incidentally constitute the vast majority of the enterprise sample. In contrast, when the regression analysis is limited to large firms, the results tend to show that they hire more workers with higher minimum wages. The latter findings are consistent with the monopsony theory of labor markets, although there are other possible explanations (see below). With monopsony power, firms can easily adjust their employment patterns given the regulated wages and retain most of their profits. In conclusion, it should be emphasized that despite this seemingly positive impact of minimum wages on employment among large enterprises, their net effect is negative, when all enterprises are combined.

Lanzona's study also finds that minimum wages cause firms to reduce their production

workers. This impact is, at least, due to scale effect. Normally, because the marginal cost of output rises with scale of production, firms will reduce their output to restore profitability. This means that with increased wage rates, firms will cut employment of production workers. Microeconomic theory further predicts an additional impact. With higher labor cost, firms are expected to substitute capital for labor inputs. In the process, the demand for production workers declines. A related finding of the study is that while some production and nonproduction workers are laid off simultaneously as a result of hikes in minimum wages, relatively more production workers are generally laid off than nonproduction workers.

Interestingly, the study was unable to find compelling evidence of significant substitution effects. One possible explanation, according to Lanzona, is that capital expenditures may be complementary to labor and may also be constrained by higher labor costs. Incidentally, firms with larger capital are also those that maintained their workers despite the increases in minimum wages. In fact, larger firms were able to increase their employment of production workers as workers who may have lost their jobs in the smaller enterprises could have been absorbed by the larger firms. Smaller firms may have closed since even nonproduction workers were reduced because of the policy. The reason is that while increasing the scale of production allowed the larger firms to limit their average costs, including their labor costs, smaller and more laborintensive firms were unable to reduce their costs. Finally, Lanzona observes that the Kaitz index19 is higher for more labor-intensive industries. In effect, the labor-intensive firms and those with relatively higher labor costs are those affected by the minimum

¹⁹ The Kaitz index is the ratio of the minimum wage to the average adult wage multiplied by the percent of persons covered by the minimum wage.

Table 3.6a. Minimum wage elasticities on	vage elasticities on lak	oor employment	labor employment by type of enterprise and worker	ise and worker			
Data	1,000	All Ente	All Enterprises	Small E	Small Enterprises	Large E	Large Enterprises
Indicator of Minimum Wage	Methodology	Production	Nonproduction	Production	Nonproduction	Production	Nonproduction
evel with regional	Difference-in-difference	-0.513**	-0.386**	-0.702**	-0.385**	1.113**	0.102
controls - Kaitz index	Fixed Effects	-0.295**	-0.607**	-0.284*	-0.600**	-0.031	-0.821**
	Fixed Effects	-0.927**	-0.782**	-1.107**	-0.915**	0.991*	-0.859
(panel data) - minimum wage	Random Effects	-0.926**	-0.783**	-1.131**	-0.858**	*086.0	-0.936
Note: ** indicates significance at 1-percent level, and * indicates significance at 5-percent level. Source: Authors' estimates	:1-percent level, and * indicates	significance at 5-percen	t level.				

Table 3.6b. Minimum wage elasticities	ge elasticities on la	abor market partic	on labor market participation (employment probability)	nt probability)			
	All Workers	No Schooling	Primary School	Teenage	Young	Middle Age	Male
Panel logit				(15-19 Yrs)	(20-34 Yrs)	(35-49 Yrs)	
Fixed effects	-0.636**	-0.236**	0.022	-0.597**	-0.364**	-0.459**	1.983**
Random effects	-0.689**	-0.295**	-0.446**	-0.298**	-0.091	-0.306**	0.283

Note: Probabilities are relative to college education for schooling variables, and relative to old working age (50 and above) for age variables. For specific workers, these probabilities are based on interactions of minimum wages and specific worker qualities.

^{**} indicates significance at 1-percent level.

Source: Authors' estimates

Data/Tests	Minimum Wage Indicator	Pooled Cross- Section, Difference in Difference	Fixed Effects	Random Effects-GLS	First Differencing
A. National data (industry level)	Kaitz index	-34,025.47	117,271.60**	138,307.30**	-141.90
Hausman test			7.07		•
Serial correlation			37.66		•
R-squared		0.69	0.45	0.45	0.11
B. Regional data (industry level)	Kaitz index	-12,427.29**	-9,217.39**	24,031.89**	n.a.
Hausman test	•		224.56		•
R-squared		0.48	0.52	0.57	•
C. Panel data (firm level)	Real minimum wage	n.a.	-6.60**	-6.59**	3.01
Hausman test			3.33		-
Serial correlation	•		0.745		•
R-squared			0.02	0.02	0.001

Notes: Within R-squared is used for fixed and random effects. The standard error for the first differencing is based on the Huber-White estimator (robust standard error) to control for serial correlation. ** indicates significance at 1-percent level.

Source: Authors' estimates

Table 3.8. Employment effects of mand large firms	inimum wage	es, small
	Small	Large
A. Regional data (industry level): Kaitz index		
Difference-in-difference	-14,653.81**	38,491.47**
Fixed effects	-8,101.19**	-8,028.526
B. Firm panel (firm level): Real minimum wage		
Fixed effects	-6.40**	6.81
Random effects	-6.48**	6.68
Hausman tests	45.22	1.26**
Note: ** indicates significance at 1-percent level. Source: Authors' estimates		

wage.²⁰ This finding suggests that the minimum wage policy may have failed to account for the labor requirements of these small industries. This is not surprising as the policy focus has mainly been on protecting workers at the regional level.

The conclusion then from these findings is that there may be serious consequences in the way the Labor Code affects production efficiency and social protection. And as Lanzona points out, "There is thus a need to coordinate these policy areas in a way that they reinforce one another."

²⁰ Contrary to the criticism by a labor movement spokesperson, this study has noted the effect of the share of labor cost on the size of the employment impact of minimum wage. On this score, the movement needs to clarify the policy implications of its argument for a hefty daily minimum wage increase of PHP 125. Noting that the share of labor in production cost is small, it argues that a large rise in minimum wage will not hurt demand for labor. This is a highly simplistic argument. First, the share of labor cost in many industries is not negligible. Second, in the long run, firms tend to shift to technologies and industries that are less labor intensive, lowering further the share of labor cost in production expenses. Decades ago, the Philippines witnessed such a shift to the detriment of the poor unskilled workers in garment and other labor-intensive industries. By its logic, the said movement would, therefore, appear to welcome a further reduction in the share of labor cost. To workers that are lucky enough to have stable full-time jobs, this reduction would not be highly concerning. However, for the growing number of jobless poor as well as the young and inexperienced, such a development would mean greater exclusion and impoverishment.

Table 3.9a. Effects of minimum wage	s on production	workers	
	All	Small	Large
A. Regional data (industry level): Kaitz index			
Difference-in-difference	-10,360.86**	-12,770.32**	37,625.22**
Fixed effects	-5,964.95**	-5,160.63*	-1,053.41
B. Firm panel (firm level): Real minimum wage			
Fixed effects	-5.21**	-5.10**	9.52*
Random effects	-5.20**	-5.21**	9.41*
Hausman tests	1.52**	29.14	1.27**
Note: ** indicates significance at 1 percent-level; * ind Soource: Authors' estimates	dicates significance at 5	-percent level.	

Table 3.9b. Effects of minimum wage	s on nonproduct	tion workers	
	All	Small	Large
A. Regional data (industry level): Kaitz index			
Difference-in-difference	-2,066.42**	-1,883.49**	866.25
Fixed effects	-3,252.44**	-2,940.56**	-6,975.11**
B. Firm panel (firm level): Real minimum wage			
Fixed effects	-1.385**	-1.299**	-2.711
Random effects	-1.387**	-1.217**	-2.954
Hausman tests	15.25**	118.22	2.22**
Note: ** indicates significance at 1-percent level. Source: Authors' estimates			

Minimum wage impact on disadvantaged workers

It is well known in the international literature that minimum wages tend to be disadvantageous to the less educated, inexperienced, and young workers. The reason simply is that in cutting back workers, it will be profitable for them to start with those whose productivity (in value terms) is less than their increased wage cost. Arguably, these pertain to the aforementioned workers.

Lanzona (2014) in the same study discussed above analyzed the impact of minimum wages on the employment of the less educated, inexperienced, and young workers, using the LFS panel data. As predicted and shown in Table 3.10, the study finds, using fixed

effects models, that the impact of minimum wages on employment is negative. The estimated impact indicates that higher minimum wages lead to a significant decrease in the likelihood of employment. With the introduction of the interaction terms in the second specification, the direct effect of minimum wages is no longer significant. However, the impact of minimum wages on unemployment is now reflected in the different population subgroupings. In general, minimum wages appear to create significant employment effects unfavorable to the least educated, the teenagers, the young, and women. The common factor of these demographic groups is their low levels of accumulated human capital and productivity compared with other workers.

	Without Minimum Wage Interactions	With Minimum Wage Interactions
	Fixed Effects	Fixed Effects
Real minimum wage	-0.012**	-0.009
	(2.26)	(0.74)
No schooling	0.0004	3.77**
	(0.00)	(3.48)
Primary school	-0.13	-0.20
	(1.32)	(0.37)
High school	-0.17**	-0.52
	(2.29)	(1.09)
Middle age	0.48**	2.14**
	(6.87)	(4.90)
Teen age	-1.08**	3.19**
	(8.45)	(4.30)
Young working age	0.27**	2.18**
	(2.80)	(4.27)
Male	-	-
No schooling * minimum wage	-	-0.08**
		(3.60)
Primary school * minimum wage		0.001
		(0.12)
High school * minimum wage		0.01
		(0.72)
Teen age * minimum wage		-0.08**
		(5.84)
oung working age * minimum wage		-0.04**
		(3.79)
Middle age * minimum wage		-0.03**
		(3.84)
Male * minimum wage	•	0.07**
		(6.94)
Constant	•	
Year and regional effects	Yes	Yes
Worker effects	Yes	No
Hausman test	506.17	630.5
Likelihood ratio test	614.96	716.33
Wald test		
Number of observations	31850	31850
Number of individuals	3178	3178

Household perspectives: Impediments and enabling factors

This section now focuses on the households. It lays out the challenges that households face and highlights strategic factors that raise their chances of getting out of poverty or lowering their risk of becoming poor. There are three parts to this section. First, it profiles households and their challenges. Second, it discusses the impact of minimum wages on household income and poverty to empirically verify and illustrate the damage wrought by burdensome regulatory mandates. The question being addressed in this regard is: How helpful (or detrimental) is a faster rise in minimum wages to household income and the goal of poverty reduction? Third, the discussion in this section raises the issue about the translation of productivity improvements into increased household income and reduced poverty incidence. Do they benefit the common man and the poor?

Profiling the poor versus other households

The conventional view is that the poverty rate has not changed much since the beginning of this century. The reality, however, is more complex, as pointed out by Reyes et al. (2011). Using panel data from the Annual Poverty Indicators Survey (APIS) 2004–2010, they find that there is, in fact, a lot of economic mobility.

Figures 3.12a, 3.12b, and 3.12c show the distribution of households by economic status in 2004 in comparison with the distribution of the same in 2010. As can be seen from the graph, a good proportion (34%) of the moderate poor in 2004 became nonpoor by 2010. A smaller but significant proportion, however, of the nonpoor in 2004 became poor in 2010. Relatively more of the poor who had moved upwards came from agricultural households.

Table 3.11 presents in more detail household profiles according to economic mobility status. The

APIS panel data of 2004, 2007, 2008, and 2010 were used to construct the table. A household is classified as persistently poor if in all the survey years they were poor (conversely, a household is classified as persistently nonpoor if in all the survey years they were nonpoor). However, if the households were found poor at least once during any of the survey years, they were classified as transient or near-poor households. These households mostly cycle back and forth between being poor and nonpoor. They are highly vulnerable to idiosyncratic and covariant shocks. They are likely to be at a tipping point of becoming poor, as opposed to the hard core or persistently poor households.

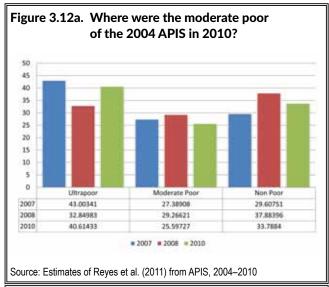
The total households in the panel are distributed as follows: 8.9 percent are persistently poor, 38.65 percent are near poor, and 52.45 percent are persistently nonpoor. The differences between the persistently poor and the persistently nonpoor are very telling. As expected, the gaps between them are huge in terms of total income and expenditures. These huge gaps are also reflected in specific expenditures like education and health spending. Not surprisingly, the characteristics of the nearpoor are between those of the persistently poor and the nonpoor. Remarkably, the average characteristics of the transient households are closer to those of the persistently poor (hence, the alternative label of near-poor).

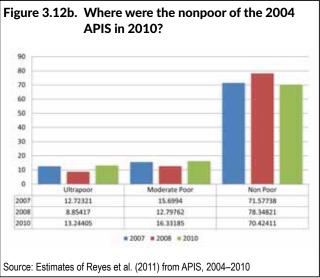
The persistently nonpoor are much better educated and predominantly live in urban areas. While only 19 percent of the persistently poor are in urban locations, 65 percent of the persistently nonpoor live in them. In regard to education, moreover, only about 20 percent of the heads of the latter households did not graduate from high school. The corresponding figure for the persistently poor is 66 percent. Education is clearly a key factor in economic mobility, reflecting the importance of human capital investments in poverty reduction.

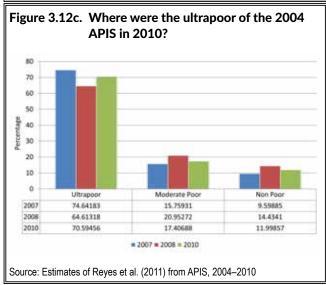
The employment rate of heads of households differs in a way that had surprised many commentators. The rate of employment of the persistently poor (92%) is much lower than that of the nonpoor (74%). As mentioned at the beginning, the core issue for the poor is not idleness, as pointed out by de Dios and Dinglasan (2014). Clearly, for the educated and well-off, it is not the issue either. Being unemployed for them is largely voluntary. Their issue relates more to the cost effectiveness of unemployment as a way of finding better jobs. Investing in job search and looking and waiting for the right job to come along could arguably yield better-paying jobs that are at the same time more suited to the workers' skills and temperament. This explanation based on search theory is plausible, although it has yet to be validated empirically in the Philippines. It would be useful in this regard to look at the return from being temporarily unemployed to search for more gainful and suitable job offers.

The households' sources of livelihood also differ. Self-employment and employment in private business establishments account for a higher share of employment among the persistently poor than among the nonpoor. In comparison, the relative share of employment in government work (20.2%) and in own family-operated farm or business (12.7%) appears to be remarkably greater for the persistently nonpoor. The corresponding figures for the persistently poor are only 3.8 percent and 0.2 percent, respectively.

Finally, the share of entrepreneurial activity in total income is highest for the persistently poor at 38.3 percent (versus 21.5% for the nonpoor). This activity is dominated by low-productivity work such as fishing and operating *sari-sari* stores. Furthermore, the share of wages and salaries to total income dominates among the persistently nonpoor at 40.3 percent, followed closely by other income at 38.3 percent. The latter consists of income







All HHs	Persistently Poor	Near Poor	Persistently Nonpoor	Profiles	
100	8.9	38.65	52.45	Distribution	
38.82	19.36	43.13	65.19	% Urban household	
47.87	66.23	45.57	19.80	% Did not graduate high school	
				Household mean:	
88352.32	46038.36	78284.69	180500.5	Total income	
35628.04	17465.67	29354.37	78672.28	Wages and salaries	
24318.58	17424.86	24720.21	35679.59	Entrepreneurial income	
28405.71	11147.83	24210.11	66148.66	Other income	
78274.48	45313.55	69912.2	150984.3	Total expenditures	
3915.794	1392.178	3069.368	9851.464	Education expenditures	
2541.679	655.2633	2128.184	6586.586	Medical expenditures	
2727.969	1477.232	2363.472	5571.398	Loans from other families	
2754.213	127.6611	1361.787	9846.716	Amount deposited in banks and investments	
83.16	92.33	79.47	73.72	% Employed	
				% Class of worker:	
2.33	2.49	2.59	1.48	Worked for private HH	
33.42	38.02	32.08	25.93	Worked for private establishments	
8.08	3.84	6.63	20.19	Worked for government	
47.38	50.46	48.75	37.96	Self-employed without any employee	
7.59	4.47	8.50	12.69	Employed in own family-operated farm or business	
0.16	0.17	0.10	0.28	Worked with pay on own family-operated business	
1.03	0.55	1.34	1.48	Worked without pay on own family-operated business	
35.58	34.44	34.10	40.25	% Wages of total income	
32.16	38.30	32.10	21.46	% Entrepreneurial activity of total income	
32.26	27.23	33.81	38.29	% Other income of total income	
77.73	57.38	86.21	98.48	% with own electricity	
28.37	11.99	29.48	55.38	% with own water	
73.25	55.31	78.53	95.51	% Houses made of strong/predominantly strong materia	

Note: All variables except household means are in percentages. Household means are in pesos. Persistently nonpoor households are households that are not poor in all four survey periods. Persistently poor households are households that are poor in all four survey periods. Transient poor is defined as either those households that were not poor in 2004 and became poor in at least one of the three subsequent survey periods or were poor in 2004 and achieved nonpoor status at least once in the subsequent survey periods.

83.35

% Own lot

75.47

Source: Authors' estimates, Annual Poverty Indicators Survey (APIS) 2004–2010

63.88

72.71

from assets and transfers from relatives and other domestic and foreign sources.

Household impact of minimum wages

Poverty incidence is usually reckoned in terms of households or families. Yet, at present, there are no causal models that estimate the impact of minimum wages in the Philippines on household income, poverty incidence, employment, and other welfare indicators. The usual practice has been to estimate the impact of minimum wage on the national employment aggregate (Brooks 2002) or individual worker's employment, unemployment, and underemployment. The following discussion presents estimates of the effects of minimum wage on household income and poverty status. It also teases out the policy implications of the findings. The analysis uses a Difference-in-Difference (DID) methodology²¹ that requires observing treatment and comparison groups over two periods of time-baseline and post-intervention period. The regions with higher rates of minimum wage increase between 2004 and 2007 were considered the treatment group and those with lower rates of minimum wage increase were used as the comparison group. The year 2007 was then considered as baseline year and 2010 as the postintervention year. Details of the estimation are provided in Orbeta et al. (forthcoming).

Tables 3.12a and 3.12b present estimates of the impact of a rapid minimum wage rise from 2004 to 2007 versus a slow minimum wage rise on household poverty status and per capita household

income in 2007-2010. The DID framework identifies the coefficient of the interaction term between the treatment dummy and post-intervention dummy as the measure of impact. Tables 3.12a and 3.12b²² show the estimation results for non-agricultural and agricultural minimum wages, respectively. The results reveal that a rapid increase in either agricultural minimum wage or industrial minimum wage induces a large negative impact on per capita household income. As shown in Table 3.13, the per capita household income of the treatment group would have been about PHP 1,689-PHP 1,71723 greater (2000 prices) or about 20 percent higher, if it had followed the same non-agricultural minimum wage increase as that of the control group. The incidence of poverty would have also fallen by about 3–4 percentage points (Table 3.12a). Interestingly, the employment probability of household heads is not significantly affected. The reason is simply that they have little choice but to eke out a living for the family. The impact of higher changes in agricultural minimum wage generated similar impact, albeit of smaller magnitude. It reduces per capita income by PHP 1,455-PHP 1,501²⁴ and the poverty incidence increase by 1.7-2.6 percentage points (Table $3.12b)^{25}$

The implications of the findings are thought provoking. Hefty increases in minimum wages do result in huge potential income losses, contrary to current views that regard the welfare effects of minimum wage to be modest (WB 2013b). They create more poor people, undermining the assumption and rhetoric about the effectiveness of

²¹ This analysis is inspired by Duflo (2001).

Treatment = 1, if the household is located in regions with rapidly rising minimum wages (0 if not) and Post = 1, if the year of the observation is post-treatment after 2007 or 2010. The Treatment*Post coefficient is the DID estimator of the effect of the faster increase of minimum wage in the treatment group over that of the control group.

²³ With control variables, not shown.

²⁴ Ibid.

²⁵ Invalidation test using higher-income groups that are not expected to be subject to minimum wage expectedly show insignificant results. Parallel trend analysis prior to treatment is verified in the case of non-agricultural minimum wage but not for the agricultural minimum wage case.

Constant 19510.74 -505.6215 .5478261 1.088117 Treatment 8535.064*** (879.7499) 7655.683***1455301***1256576*** (0118464) 1256576*** (0118464) Post 2679.683*** (585.9493) 1674.175*** (.0555766*** (.0913905*** (.0097833)) .0913905*** (.0097833) Treatment * post -1689.498** (754.9644) (757.6506) (.0121391) (.0124011) .0124011) Age 800.8779*** (.0021197) 0178653*** (.0021197) Age-squared 4.92714*** (1.451096) (.000201) .0001182*** (.000201) Sex -6055.816*** (.9925.5632) (.0129439) .0865541*** (.0000009) Clementary graduate -4301.706*** (.723.0703) (.0103519) 0157131 (.0103519) High school graduate 3676.901 (.0113577) 1995226*** (.0113577)	Variables	(1a) Full Sample per Capita Incomes w/o Additional Controls	(1b) Full Sample per Capita Incomes w/ Additional Controls	(2a) Full Sample Poverty Rate w/o Additional Controls	(2b) Full Sample Poverty Rate w/ Additional Controls
Treatment (879.7499) (865.7232) (.0123897) (.0118464) Post (585.9493) (592.7001) (.0094215) (.0097833) Treatment * post (754.9644) (757.6506) (.0121391) (.0124011) Age (153.2097) (.0021197) Age-squared (1.451096) (.0000201) Sex (925.5632) (.0129439) Cher incomes (925.5632) (.0120009)** Elementary graduate (3676.901) (.012391) (.0103519) High school graduate (.0123676) (.012397) (.0103519)	Constant	19510.74	-505.6215	.5478261	1.088117
Ref	T	8535.064***	7655.683***	1455301***	1256576***
Post (585.9493) (592.7001) (.0094215) (.0097833) Treatment * post (754.9644) (757.6506) (.0121391) (.0124011) Age (153.2097) (.0021197) Age-squared (1.451096) (.0129439) Other incomes (.0000009) Elementary graduate (723.0703) (.0103519) High school graduate	rreatment	(879.7499)	(865.7232)	(.0123897)	(.0118464)
(585.9493) (592.7001) (.0094215) (.0097833) Treatment * post	D	2679.683***	1674.175***	.0555766***	.0913905***
Treatment * post (754.9644) (757.6506) (.0121391) (.0124011) Age 800.8779*** 0178653**** (153.2097) (.0021197) Age-squared -4.92714**** .0001182**** Sex -6055.816**** .0865541**** (925.5632) (.0129439) Other incomes 0000009**** (.0000009) Elementary graduate -4301.706*** 0157131 (723.0703) (.0103519) High school graduate 3676.901 1995226****	Post	(585.9493)	(592.7001)	(.0094215)	(.0097833)
Age 800.8779***0178653*** Age-squared (153.2097) (.0021197) Age-squared -4.92714*** .0001182*** (1.451096) (.0000201) Sex (925.5632) (.0129439) Other incomes -0000009*** Elementary graduate (723.0703) (.0103519) High school graduate	-	-1689.498**	-1717.252**	.0302732**	.0403149***
Age (153.2097) (.0021197) Age-squared -4.92714*** .0001182*** Age-squared (1.451096) (.0000201) Sex -6055.816*** .0865541*** (925.5632) (.0129439) Other incomes0000009*** Elementary graduate -4301.706***0157131 (723.0703) (.0103519) High school graduate	reatment * post	(754.9644)	(757.6506)	(.0121391)	(.0124011)
(153.2097) (.0021197) Age-squared 4.92714*** .0001182*** (1.451096) (.0000201) Sex -6055.816*** .0865541**** (925.5632) (.0129439) Other incomes 0000009*** Elementary graduate -4301.706*** 0157131 (723.0703) (.0103519) High school graduate 3676.901 1995226***	A		800.8779***		0178653***
Age-squared (1.451096) (.0000201) Sex -6055.816*** .0865541***	Age		(153.2097)		(.0021197)
(1.451096) (.0000201) Sex (925.5632) (.0129439) Other incomes0000009*** (.00000009) Elementary graduate (723.0703) (.0103519) High school graduate	A		-4.92714***		.0001182***
Sex (925.5632) (.0129439) Other incomes 0000009****	Age-squared		(1.451096)		(.0000201)
(925.5632) (.0129439) Other incomes 0000009*** (.00000009) Elementary graduate -4301.706*** (.723.0703) (.0103519) High school graduate 3676.901 1995226***			-6055.816***	-	.0865541***
Other incomes (.00000009) Elementary graduate -4301.706*** 0157131 (723.0703) (.0103519) High school graduate 3676.901 1995226***	Sex		(925.5632)		(.0129439)
(.0000009) Elementary graduate -4301.706***0157131 (723.0703) (.0103519) High school graduate 3676.9011995226***	0#		•		000009***
Elementary graduate (723.0703) (.0103519) High school graduate 3676.9011995226***	Other incomes				(.00000009)
(723.0703) (.0103519) High school graduate 3676.9011995226***	Elt		-4301.706***		0157131
High school graduate	Elementary graduate		(723.0703)		(.0103519)
High school graduate (812.6434) (.0113577)	High cabaal anadust-		3676.901	•	1995226***
	High school graduate		(812.6434)		(.0113577)

Source: Authors' difference-in-difference estimates based on APIS panel data 2004, 2007, 2008, and 2010. The following variables are defined as follows:

Notes: Per capita income is yearly; ** significant at 5-percent level; *** significant at 1-percent level

the current tripartite system. It fails to represent the interest of the poor and the workers effectively.

At this point, one might ask: Why is household income lower with a more rapid increase in legal minimum wages, if the employment of the household heads is not affected. The answer must be that the affected households must have fewer members with jobs—either they have difficulty landing a job or they have been laid-off. This explanation is consistent with the findings of Canales (2013) who studied the impact of minimum wage increase using

the July 2007–July 2008 panel of the LFS and regression discontinuity design. This particular study concluded that the increase in minimum wages implemented in 2007 reduced the weekly work hours by 2.7 hours. In addition, it also decreased the probability of retaining or gaining employment by 8 percent to 22 percent. Finally, this is also consistent with the findings of Lanzona (2014) that minimum wages significantly reduce the probability of employment of teenagers, the young, the women, and the less educated. Another explanation is that workers had to shift

⁽i) Treatment = 1 if the household's regional LMW was made to rise rapidly in 2004–2007; 0 if increased only slowly during the said period

⁽ii) P = 1 if year is post-treatment, 0 if not

Variables	(1a) Full Sample per Capita Incomes w/o Additional Controls	(1b) Full Sample per Capita Incomes w/ Additional Controls	(2a) Full Sample Poverty Rate w/o Additional Controls	(2b) Full Sample Poverty Rate w/ Additional Controls
Constant	19510.74	-505.6215	.5478261	1.088117
Treatment	8535.064***	2807.637***	0043395	0046716
reatment	(879.7499)	(854.7371)	(.0123144)	(.0117116)
D	2303.664***	1278.059**	.0661646***	.1048574***
Post	(494.2616)	(501.7343)	(.007949)	(.0083946)
	-1454.853*	-1501.061**	.0173391	.0261553**
Treatment * post	(744.2228)	(747.2403)	(.011969)	(.012225)
		794.7559***		01754***
Age		(153.7734)		(.0021322)
		-4.816266***	-	.0001144***
Age-squared		(1.456226)		(.0000202)
•		-6444.177***	•	.0937671***
Sex		(927.3206)		(.0129963)
-				000001***
Other incomes				(.00000009)
		-4204.521***		015387
Elementary graduate		(725.4464)		(.0104105)
		4128.82***		2068838***
High school graduate		(814.0158)		(.0113989)
R-squared	0.0017	0.0442	0.0055	0.1041

Source: Authors' difference-in-difference estimates based on APIS panel data 2004, 2007, 2008, and 2010. The following variables are defined as follows:

Notes: Per capita income is yearly; ** significant at 5-percent level; *** significant at 1-percent level

from formal to informal employment, which yields lower income.

In summary, the household evidence presented above points to the need to moderate rises in minimum wages. The findings about the size of the effects of minimum wages illustrate the need to evaluate the impact of other aspects of labor regulations, policies, and practices such as the six-month regularization requirement, severance payments, subcontracting, and the hiring and firing rules.

Productivity improvement efforts and household benefits

Do productivity improvements both at the level of the household and at higher levels of aggregation translate into income benefits for the common person, especially the poor? This question is highly topical, given the administration's concerns and the critics' complaints about the failure of rapid GDP and productivity growth to create more jobs, raise real wages, improve income distribution, and reduce poverty incidence.

⁽i) Treatment = 1 if the household's regional LMW was made to rise rapidly in 2004–2007; 0 if increased only slowly during the said period

⁽ii) P = 1 if year is post-treatment, 0 if not

Regional Minimum Wage of Household Location	Rapid Minimum Wage Rise (Treatment)		Slow Minimum Wage Rise	Difference	Difference-in-Difference	
or nousehold Location			(Comparison)		Total	Per Peso Change
NAMW level (2004) ^a	209.99		193.09	16.9		
Rate of increase in NAMW ^a (non-agricultural minimum wage) in 2004–2007	53	.82	23.78	36.04		
AMW level (2004)	177.83		186.40	-8.57		
Rate of increase in AMWa (agricultural minimum wage) in 2004–2007	55.85		24.54	31.31		
Household income per capita by	2010	29036	22190	6846	-1689 ^b	40.0
change in NAMW ^a	2007	28046	19511	8335		-46.9
Household income per capita by	2010	27170	25639	1531	4 455b	40.5
change in AMW	2007	26321	23335	2986	-1,455 ^b	-46.5
Increased probability of poverty	2010	.4881	.4023	.0858	0.0000	00004
due to faster rise in NAMW vs. the counterfactual	2007	.6034	.5478	.0556	0.0302 ^b	.00084
ncreased probability of poverty	2010	.5412	.4577	.0835	0.0470h	.00055
due to faster rise in AMW vs the counterfactual	2007	.5282	.4620	.0662	···· 0.0173b	.00055

Notes:

Source: Authors' estimates

A review of evidence suggests that the answer to the question is: It depends. Improvements in education, nutrition, skills formation, and the character traits of individuals appear to be rewarded by the labor market with higher wages and better economic future. On this score, international and local studies have shown that the impact of education on workers' earnings and poverty incidence can be substantial. In the Philippines, education appears to have a high rate

of return. Paqueo et al. (2013), for example, estimated that the rate of return to high school education is over 20 percent. Combining the gains in the daily wage rate and increased hours worked, the average earnings during the year of a high school graduate is more than double that of an elementary school graduate. Moreover, the study finds that the additional income from high school education is large relative to the country's official poverty threshold.

^a NAMW = Non-agricultural daily minimum wage rate; AMW = agricultural daily minimum wage rate

b In constant 2000 prices without controls. The estimate with controls is not too different at 1,717 for non-agriculture and 1,501 for agriculture wages. In the case of probability of falling into poverty, it is 0.04 for non-agriculture and 0.026 for agriculture wages.

[&]quot;Difference", is the simple difference computed from subtracting treatment-comparison. This is to not confuse the reader from other values which is actually a "Difference in-Difference".

The Philippine experience is consistent with international studies. They also show that improvements in human capital lead to increased income. In addition to showing that the rate of return to years of education is high, available international studies further indicate that cognitive learning ability and technical skills lead to more gainful jobs. Moreover, individuals with desirable character traits like grit, curiosity, discipline, resilience, honesty, and other traits valued by the market tend to be more successful in life. These traits account for about two-thirds of the future success of children, according to 2006 Nobel Laureate in Economics James Heckman and his colleagues working on this issue (Tough 2012).

Other examples of human capital investments are improvements in nutrition status. International studies have documented evidence on the impact of nutrition on productivity. In the Philippines, a careful study on the issue has shown that better nutrition, as measured by anthropometric indicators, resulted in improved agricultural productivity, which is reflected in increased wages (Haddad and Bouis 1991).

It must be emphasized, though, that greater inputs do not automatically mean more human capital. This is illustrated by international experience with training programs. Training is often the first intervention that comes to mind when thinking of ways to help low-income households get more gainful jobs. A review of country experiences, however, reveals that some programs are effective, but most public training programs are not. In general, the effectiveness of training programs is mixed, depending on program design and implementation (Betcherman et al. 2004; J-PAL 2013; WB 2013a).

Little has been done to evaluate the impact of training in the Philippines. Available evidence, though, suggests that the results in the Philippines are also mixed. This gap in knowledge about the effectiveness of Philippine training programs and other interventions to improve skills needs to be addressed systematically. The so-called "creative destruction" of jobs and enterprises arising from accelerating technological progress and greater global competition necessitates constant training and retraining of workers. The challenge is to find efficient ways by which the Philippines and its workers can make timely and effective adaptation to the rapidly changing environment.

On this score, there are several fundamental issues that need to be addressed (Paqueo et al. 2011). One of these issues is that only 3 percent of the labor force had obtained technical and vocational education and training (TVET) based on the 2008 APIS. Another (related) issue is lack of opportunities for enterprise-based training. This type of training, which is the most effective in terms of employment, needs expansion. In 2010, only 4 percent of TVET graduates came from enterprise-based training (Orbeta and Abrigo 2013). A large part of the explanation of the lack of enterprise-based training opportunities is that labor regulations create unintended disincentives against firms investing in job-based human capital accumulation.

Conclusions

To summarize, we draw the following strategic conclusions from the above discussion. First, the Philippines remains a country with a huge and growing labor surplus; consequently, wages will be under great pressure to settle down at some low-level equilibrium so that firms, particularly small-scale enterprises, will have the capacity to absorb this labor surplus. Until enough of the labor surplus has disappeared (signaled by sustained increases in the wages of unskilled labor), a rising wage rate is going to be an unlikely engine of poverty reduction for workers without substantial human capital.

Second, for poverty reduction and lower inequality, the core issue is not about open unemployment and idleness; rather, it is about raising household incomes by raising the productivity of the general economy and moving workers from low- to high-productivity sectors. It is also about increasing their employability in jobs that give premium wages for workers with character traits and competencies that are in short supply.

Third, contrary to the perceptions of many critics, the level of employment does rise with increased output over time. On this point, it would make sense to facilitate the expansion of laborintensive industrial production, especially the manufacturing of tradable commodities. Facilitation means not just moderating minimum wage mandates and other restrictive labor regulations, but also pushing reforms that go beyond the responsibility of the DOLE. These include reforms that will effectively deal with critical binding constraints and counterproductive policies (discussed in Chapter 2, this volume). Examples include inter alia infrastructure underdevelopment, elevated cost of subsistence²⁶ due to rice import policy, high cost of doing business, high energy cost, weak enforcement of contracts and protection of property rights, and confusing laws.

Fourth, minimum wages do have substantial negative impacts on household economic welfare. These are reflected in the income and poverty status of households. These are also indicated by the lower employment of individuals with low human capital (e.g., the young, the inexperienced, the less educated, and women). Support for these findings is further strengthened by statistical results showing significant damaging effects of minimum wages

on demand for workers by SMEs. The foregoing observations are perhaps only the tip of the iceberg as the above estimates do not include yet the effects of minimum wages on human capital formation and the impact of other regulations like the six-month worker regularization law and separation pay. The effects of these other labor regulations and the high cost and uncertainty of conflict resolution processes could be as substantial (if not more so) as the impact of minimum wages. Therefore, they need to be empirically evaluated.²⁷

Fourth, under a superabundant labor surplus situation, increased average labor productivity does not automatically lead to a rise in the wage rate of unskilled workers, but it is likely to increase demand for their services. Many poor families with underemployed and underproductive workers can benefit from this increased labor demand through off-farm work and/or by moving from traditional farming to jobs generated by manufacturing revitalization and expansion.

Fifth, investments in education, training, and other forms of human capital like improved health and nutrition do lead to higher wages, provided that those investments are effective in building up human capital. Labor markets do reward effective human capital investments and raise the wage rates of the poor without having to wait first for the disappearance of the huge and growing labor surplus.

Reflections and recommendations

Alternative strategy

The Philippines is at a crossroads. It can choose to continue to follow current unrealistic policies

²⁶ Relative food price is one of the key drivers of minimum wages. This could be reduced by reforming regulations on the importation of rice.

²⁷ Surveys of business enterprises show that other labor regulation concerns rank higher than minimum wage (WB 2013a).

that despite good intentions have been actually detrimental to the poor. Alternatively, with China's massive shedding of labor-intensive manufacturing jobs, it can opt to try another development path to get a better chance at reducing poverty. That mass poverty can be dramatically reduced within a few decades is a proven fact. But for this to be achieved, it is necessary to adopt a policy and regulatory environment that enables and motivates (i) the reallocation of the country's superabundant labor from low- to high-productivity activities, specifically labor-intensive manufacturing; and (ii) the development of the human capital of its workers, especially the unskilled labor.

This strategic view is based on lessons learned from the experience of successful neighbors like China, Singapore, Indonesia, Malaysia, and Thailand. It builds on earlier studies.²⁸ It also draws inspiration from the new structural development economics (Lin 2011).

At the heart of the proposed alternative strategy is the idea that "following its comparative advantage to build up its industries is the best way for any developing country to sustain industrial upgrading and economic growth" (Lin 2011). The challenge is how to find those industries in which the Philippines has comparative advantage. The challenge looks easy. Past decades, however, have seen plenty of well-intentioned industrial plans in developing countries that had failed because they were unrealistic.²⁹

To overcome knowledge constraints and ensure realism, Filipino policymakers and the public will benefit from looking at those industries that China is becoming less competitive in. As mentioned, these are labor-intensive industries that employ millions of workers. The Philippines can choose those industries that are suitable to its superabundant labor endowments and in which China and other more advanced countries do not have a leg up over the Philippines.

In implementing its comparative advantage, reliance on market mechanisms is a must. But the government must also play its central role of solving market failures. A key thesis of the new structural development approach is that there are massive externalities and public goods that require government action to support more efficient use of resources (e.g., labor) and achieve poverty reduction. In this view, the government will have to guide, target, facilitate, and coordinate policies and public expenditures that will correct the aforementioned market failures (Lin 2011). For example, the location of public infrastructure investments on roads, bridges, and ports needs good coordination to maximize the country's ability to attract good investors and facilitate implementation of their projects.

A 12-point job program

In support of the general recommendation above, a concrete 12-point jobs and human capital development program is proposed below, conveniently referred to as the **Jobs Expansion** and **Development Initiative (JEDI)** for poverty reduction. JEDI has two main objectives. One is to expand gainful jobs through the acceleration of labor-intensive production, particularly the manufacturing of tradable commodities. The other objective is to improve investments in education

²⁸ Strictly, most of the elements of the proposed strategy are not completely new. A few or more of them have already been discussed by Sicat (2010), ILO (1974), World Bank (2013b), and Usui (2011) and various studies at the University of the Philippines School of Economics. Similar ideas have been floating around for years, if not for decades, waiting to be seriously adopted and implemented.

²⁹ Ambitious policymakers and politicians adopted them for various reasons. Some did not know any better. Others were misled by ideologues or were captured by vested interests. Moreover, it was politically smart to spouse industrialization and social development short-cuts that were popular but economically naive.

and other human capital development activities and sustain TFP gains. To achieve these objectives, JEDI calls for:

- (i) Simplifying labor dispute resolution processes to cut the time, cost, inconvenience, and uncertainty involved;
- (ii) Making the rules on hiring and firing decisions more flexible, leaving the firms and workers to negotiate and work out agreements that are mutually beneficial;
- (iii) Instituting measures that will minimize the imposition of labor regulations and practices detrimental to and discriminatory against the poor and other disadvantaged populations;
- (iv) Allowing firms to hire low-skilled and poor workers who want to voluntarily opt out of the mandatory minimum wage norm, recognizing that it hurts rather than helps them;³⁰
- (v) Experimenting with a Singaporean style policy (Box 3.1), providing limited grants to targeted ultrapoor workers whose market-determined wages fall far too short of a predetermined social norm on decent wages (should the government find conformity to this norm of public good);³¹
- (vi) Transforming the consultation process from a tripartite into a quadripartite system that would give the poor, unemployed, underemployed, and self-employed direct representation in the determination of labor regulations and policies;
- (vii) Encouraging labor unions to focus on raising the competencies and productivity of workers as a means to achieving decent wages;

- (viii) Lengthening to two years from six months the compulsory regularization of young workers to expand their learning experience and build their skills on the job;
- (ix) Ensuring quality implementation of the K-12 reform; undertaking institutional reform of the Technical Education and Skills Development Authority as articulated in the 2011 Economic Policy Monitor of PIDS; and pursuing ongoing Commission on Higher Education initiatives like the Unified Student Financial Assistance System for Higher and Technical Education (UNIFAST)³² aimed at improving access to quality higher education and the production of good research;
- (x) Implementing the extension of demandside education assistance of the 4Ps to high school students and complementing it with policies and programs that facilitate onthe-job training and employment in private enterprises;
- (xi) Promoting research and development activities in support of this proposed 12-point program, including piloting and testing of innovative approaches; and
- (xii) Facilitating the emergence of a well-organized coalition of stakeholders devoted to finding and promoting approaches that effectively advance the interest of poor workers now being excluded from gainful job opportunities.

Though the 12-point program above does not cover all relevant issues, we believe that substantial progress can be achieved in expanding sustainable,

³⁰ The government must ensure, though, that workers' acceptance of the offers is voluntary and well-informed.

³¹ It is best to finance public goods through general tax revenues rather than raise the cost to firms using more labor inputs.

A UNIFAST bill was recently passed by the House of Representatives Committee on Education and is now being discussed in the Senate Committee on Education. The bill seeks to rationalize and expand student financial assistance, providing grant-in-aid for poor but deserving students, scholarships for the gifted and talented regardless of poverty status, and loans for students with better-off parents with liquidity issues.

Box 3.1. Singapore's support for low-wage workers

Singapore does not have a minimum wage policy but supports its low-wage earners through several programs. First is the Workfare Income Supplement (WIS) scheme. Second is the reduction in the employer's contribution to the Central Provident Fund (CPF), the country's mandated individual pension fund, to improve their employability. Similarly, to increase their take-home pay, their personal CPF contribution rate was also reduced. Third is the Workfare Training Support (WTS).

The WIS scheme was introduced in 2007 as a key pillar of Singapore's social security system. The WIS encourages its older, low-wage workers to continue working and enhance their skills. Since 2010, the government has made changes toward expanding the coverage by increasing the ceiling wage for their qualified beneficiaries. They have also included younger people with disability. Grants have also increased in payout frequency and amount. These are now given four times a year. Under this program, a worker receives as much as SGD 3,500 per year (as of 2013). Box Table 3.1 shows the benefit table by age as of 2013. The employees receive 40 percent in cash (deposited directly into their bank accounts or given in check in the absence of a bank account) and 60 percent in CPF contribution.

Box Table 3.1. Maximum WIS payout per year by age groups (SGD)					
Age Group Maximum WIS Payout Maximum for Employees					
35-44	1,400	933			
45-54	2,100	1,400			
55-59	2,800	1,867			
60 and above	3,500	2,333			

Basic qualifications for the WIS include: (i) Singaporean citizenship; (ii) age of at least 35 years old; (iii) work of at least two months in a three-month period; (iv) an average gross monthly income of not greater than SGD 1,900 for the period worked; and (iv) residence in a property with annual value of SGD 13,000.

In addition, the WIS comes hand in hand with the WTS scheme. Under this program, employees attend training to gain certifiable skills accredited by the Singapore Workforce Development Agency. For those who are not enrolled by their employers, 95 percent of the course fee is funded. Added allowance is also given provided that they (1) were not enrolled by their employers; (2) complete 75 percent of attendance; (3) pass the course; and (4) are employed in a job related to the course.

Sources: www.mycpf.cpf.gov.sg/Members/Gen-Info/WIS/WIS_Scheme.htm; http://www.workfare.sg/ (accessed March 2014)

poverty-reducing jobs. For this, it is necessary that *inter alia* minimum wage is reformed. The reform should be undertaken immediately, while investors are looking for new locations for labor-intensive production and while the Philippine economy is getting another look as a potential destination.

JEDI emphasizes minimum wage reform because there is now clear and preponderant evidence of its deleterious impact on the employment, income, and poverty status of households, especially those belonging to disadvantaged population groups. Undoubtedly, though, other complementary labor

reforms and measures are necessary (as discussed in Chapter 2, this volume).

It should be emphasized that the proposal recognizes the aspirations of Filipinos for secure jobs with decent wages. But it challenges the idea that imposing minimum wages and other current labor regulations should be the weapons of choice. They do not work; worse, they have detrimental consequences, as mentioned. Alternatives should, therefore, be considered, such as better education, increased labor-intensive manufacturing, and greater opportunities for on-the-job training. Arguably, alternatives like these might take time.

Consequently, bridging social protection programs needs strengthening to help the poor directly with their subsistence needs. For this, instead of imposing mandatory minimum wages, it would be better to use direct and temporary income subsidy, carefully targeted to extremely poor households to meet suitable norms that society considers a public good. Such an approach will be both efficient and equitable, conforming to the general principle of public economics that a public good should be financed by general tax revenues. On that score, the Singaporean experience is worth studying: it subsidizes the difference between the wage of a poor worker as determined by the market and the wage level it considers suitable to the achievement of the public good. The advantage of this approach (subject to implementation design details) is that it spreads the cost of such a policy over the general population, who benefits from it, instead of concentrating on and penalizing those enterprises that should be encouraged to employ more workers.

The study, therefore, concludes that the time has come for the country to leave the beaten path and try new approaches that will rebalance current labor laws and practices to expand gainful jobs and minimize unintended consequences detrimental to the poor, the young, the women, the less educated, and the unorganized workers. For too long now, policies and regulations have been advocated on their behalf but have turned out to be detrimental to them and their families.

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This fourth issue of the *PIDS Economic Policy Monitor (EPM)* focuses on the need to pursue inclusive growth through the expansion of quality job opportunities. It revisits the jobs issue and provides recommendations on how to address it, taking into consideration the socioeconomic and political landscape and historical experience of the Philippines.

Consistent with past EPM issues, Chapter 1 analyzes the macroeconomic scenario of the past year and provides an outlook of the economy in the coming year. The 7.2-growth rate in 2013 is examined along with global and regional developments, the productive capacity of the economy to sustain this high-level growth, and the inclusiveness of economic growth. The Philippines is now in the cusp of major international and regional developments. The formation of an ASEAN Economic Community (AEC) in 2015 would benefit the Philippines as it drives market expansion, economic transformation and modernization, and creates more job opportunities. These, along with the country's investment grade rating, bode well for sustaining a high-growth path. Chapter 2 reviews the laws, regulations, and policies formulated and adopted by the government in 2013 in support of the goal to sustain economic growth and achieve social equity. These policies include, among others, the updated poverty reduction program, comprehensive industry roadmap, food safety act, the ban against destructive and illegal forms of fishing, policies related to disaster risk reduction and management, revised national health insurance bill, housing policies, various infrastructure-related policy developments, and breakthroughs reached in the 9th Ministerial Meeting of the World Trade Organization held in Bali, Indonesia. Chapter 3, the theme chapter, looks into the causes of the economy's failure to generate substantial and quality job opportunities by examining the effectiveness of minimum wage and other labor regulations to determine if they are growth and welfare enhancing. The study finds that raising the minimum wage reduces employment in smaller firms, lowers household income, and increases the probability of falling into poverty. Along with recommendations for a minimum wage reform, expansion of gainful job opportunities from the labor-intensive manufacturing sector, and greater investments in education and other human development aspects, the study proposes a 12-point agenda called "Job Expansion and Development Initiatives" or JEDI.



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