



Manufacturing

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Manufacturing: Creating Millions of Better Jobs

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Manufacturing: Creating Millions of Better Jobs

I. Summary and Introduction

Creating more and better jobs is the biggest challenge facing the Philippine economy. For the Philippines to achieve inclusive growth—as President Aquino has declared to be his principal goal for the remainder of his term—strengthening the manufacturing sector is imperative. No country has become a high-income economy without developing a strong industrial sector. Indonesia, Malaysia, Thailand, and Vietnam—economies exporting 2 to 4 times more than the Philippines¹—have each developed its industrial sector to over 40% of the economy, making industry and manufacturing a development backbone.² But in the Philippines, the services sector holds a disproportionate share of GDP. Recent high Philippine economic growth³ has been led by consumption, construction, and public sector spending, supported by yet-increasing remittances from Filipinos abroad, the purchasing power of a growing middle class at home,⁴ and rising exports of business processing and tourism services.⁵ An encouraging trend is that manufacturing growth in 2013 has doubled.⁶

Fortunately, the Philippine economy has high potential to build on proven strengths in both high value-added and low-cost, labor-intensive manufacturing. As its population grows to be the 10th largest in the world⁷ and with a labor force projected to reach 52 million by 2030,⁸ the country must convert high population growth from a potential to an actual demographic dividend.⁹ Vocational school and college graduates can acquire skills to work in high-value manufacturing. **And with bold, innovative policies, labor-intensive manufacturing in the country can be revitalized, absorbing large numbers of urban underemployed and surplus agricultural workers.**

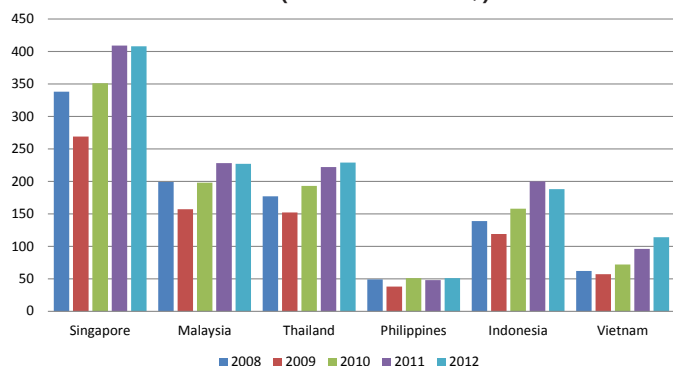
The *Arangkada* Philippines Project organized two roundtables¹⁰ of industry participants to identify broad classes of manufactured products with the highest growth potential for both export and domestic markets and key impediments to their fast growth. This Manufacturing policy brief reflects the valuable inputs of participants and provides policy recommendations for consideration by both the public and private sectors. The document's goal is to present a persuasive case for policies that can create 4 million new jobs in the next decade through achieving a significant increase in the contribution of manufacturing to GDP from 21% to 24% by 2016 and almost 30% by 2022, catching up with Indonesia, Malaysia, Thailand, and Vietnam. The policy brief ends with Conclusions and Recommendations.

"The strategy: Maximize opportunities for all, especially for those most in need. We are not content to wait for the trickle-down effect; we cannot leave their fate—their receiving the benefits of progress—to chance. What we call inclusive growth—this all-encompassing progress—is the principle that drives every initiative, every action, and every decision of your government."

President Benigno S. Aquino III, State of the Nation Address, July 22, 2013

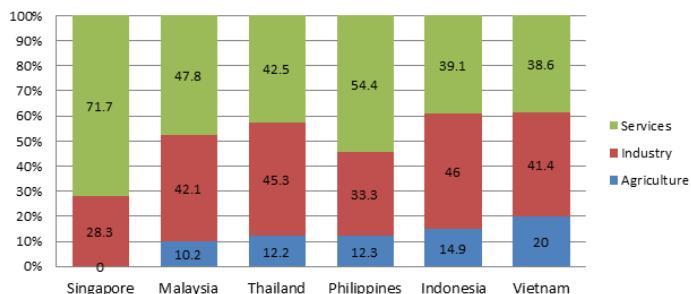
- ¹ See Figure 1 for comparison of ASEAN-6 exports 2008-12.
- ² See Figure 2 Philippines (33.3%), Vietnam (41.4%), Malaysia (42.1%), Thailand (45.3), and Indonesia (46%). Singapore (71.7%) is an outlier given that its high-value services is characteristic of such countries. World Bank.
- ³ GDP growth in the first half of 2013 was 7.6%, the highest of the ASEAN-6 economies, with industry growing 10.3%, services 7.4%, and agriculture -0.3%.
- ⁴ In June 2013 DBS estimated an additional 15 million Filipinos will join the middle class by 2020.
- ⁵ Industry association IBPAP predicts total revenue will reach US\$25 billion by 2016 with total employment of 1.3 million. Foreign visitor arrivals for H1 2013 reached 2.4 million, vs. 2.1 million in the comparable period in 2012.
- ⁶ Manufacturing grew 10.5% in the first three quarters of 2013, by an annual 7.5% average 2010-12 compared to 3.5% average 2004-09.
- ⁷ See pp. 386-387 in *Arangkada Philippines 2010* at www.investphilippines.info.
- ⁸ ADB principal economist Dr. Jesus Felipe, as quoted in *Arangkada Philippines 2010*, p. 19.
- ⁹ An added advantage is that much of the workforce is competent in English, the largest such workforce in Asia excluding South Asia.
- ¹⁰ The first roundtable on April 24 was moderated by Mr. Henry Schumacher, EVP, ECCP, and the second on May 14 by Mr. Roberto Batungbacal, the chairman of the Manufacturing and Logistics Committee of the American Chamber of Commerce of the Philippines. He has more than 20 years in the chemical industry. He is also the President of SPIK, Samahan sa Pilipinas ng mga Industriyang Kimika (Chemical Industry Association) and author of the website "Philippine Manufacturing Revisited."

Figure 1: Merchandise exports of ASEAN-6, 2008-2012 (current Bn US\$)



Source: World Bank, Databank

Figure 2: GDP composition by sector (% share of GDP), ASEAN-6, 2012



Source: World Bank, Databank

II. Background

The objective of this paper is to provide policy makers with recommendations that can contribute to reduced unemployment, more inclusiveness, and accelerated growth of the economy by significantly increasing the contribution of manufacturing to the national economic output. Both unemployment and underemployment are extremely high at 7.3% and 15.2%, and the number of Filipinos without jobs is steadily rising.¹¹

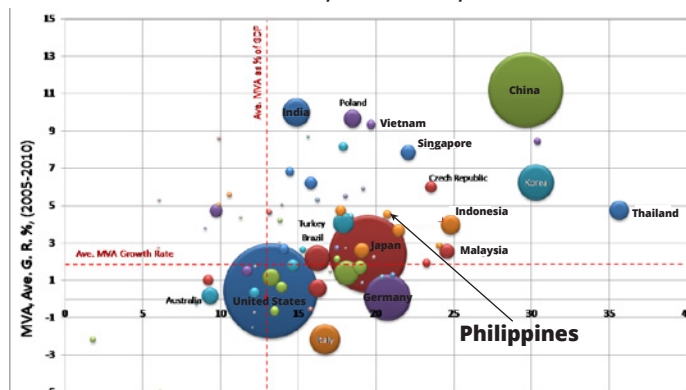
In 2010, the contribution of manufacturing in the Philippines to the economy, defined as the manufacturing value added (MVA) share of GDP, was 21%, versus the ASEAN-6 average of 25%.¹² Philippine MVA grew an average of 3.5% in the period 2005-2010, versus the global average rate of 2.3%. Figure 3 illustrates the Philippine position vis-à-vis other leading manufacturing countries. The same data shows that Philippine manufacturing was the 24th largest in the world in 2010.¹³

In terms of distribution of employment, in 2012 agriculture accounted for 12 million workers or 32% of total employment. Industry accounted for 6 million or 15%, of which 3 million or 8% were in manufacturing. The remaining sectors—largely services—accounted for 20 million workers or 52%.¹⁴

The Philippine manufacturing sector in 2013 (Figure 4) had the highest labor productivity (US\$18,000), higher than agriculture (\$3,000) and services (\$7,000). To increase total national productivity, labor should move from low productivity to higher productivity sectors.¹⁵

This policy brief proposes a two-pronged approach that targets (1) a significant shift of rural workers—particularly the rural unemployed—to the labor-intensive manufacturing subsector and (2) unemployed and underemployed skilled workers to gain full-time employment in high value-added manufacturing sectors, particularly underemployed skilled Filipinos currently working in low-value subsectors of services.

Figure 3: Manufacturing value added (MVA) of countries, % of GDP, 2010



Source: Batungbacal, Roberto based on World Bank, Databank

¹¹ Q3 2013, *Labor and Employment Statistics*, NSO; Chapter 2 - Employment, *Creating More and Better Jobs*, pp. 38-54, World Bank, 2013.

¹² World Bank Databank, 2010.

¹³ Calculated from figures of the World Bank Databank.

¹⁴ DOLE *Labor Force Survey (LFS)*, 2012.

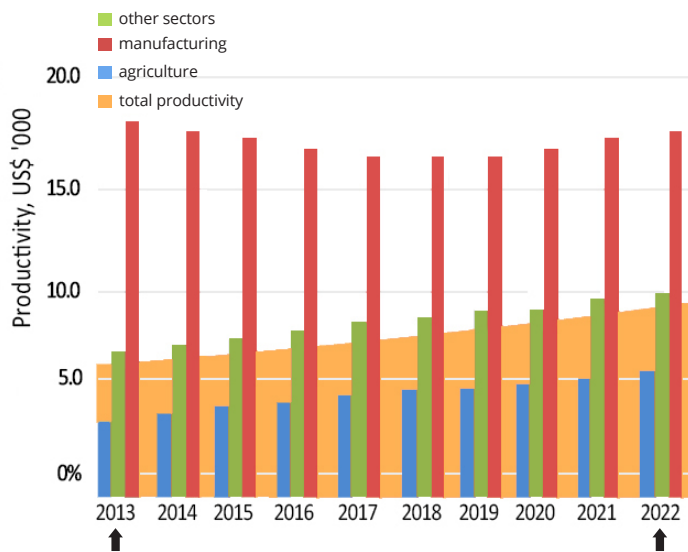
¹⁵ Calculated from sectors value added/number of workers.

III. Vision – main objective

Given its large demographic dividend,¹⁶ improved macro-economic conditions, better governance, political stability, potential new FTA markets,¹⁷ and higher investor confidence, the Philippines is positioned to reduce unemployment and underemployment by **targeting a very significant increase in manufacturing’s contribution to GDP from 21% in 2012 to 24% by 2016 and almost 30% by 2022** (Figure 5), and **generating as many as 4 million jobs from 2015 to 2022** for (a) rural workers in low-cost, labor-intensive manufacturing sectors and (b) urban unemployed and underemployed better-educated workers in high value-added manufacturing sectors. This would more than double the manufacturing labor force from **3 million to 7.5 million by 2022** (Figure 6) and increase the manufacturing labor force share from **8% in 2013 to 17% in 2022** (Figure 7). As a result, manufacturing sector productivity should increase by an average of **10% per annum** while total labor productivity in the Philippines also increases (Figure 4). This should propel the Philippine economy to a higher, sustainable, and inclusive growth trajectory. Figure 8 shows projected growth of the manufacturing sector relative to agriculture and other sectors.

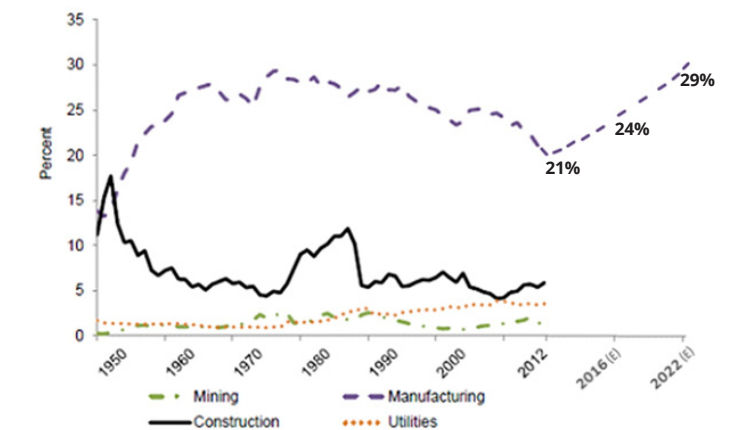
Based on the 2012 Labor Force Survey,¹⁸ total employment in manufacturing was 3.1 million, a total little changed for over a decade. Food manufacturing accounted for 760,000; wearing apparel and textiles was 591,000; wood products and furniture was 454,000; and computer electronics and optical products was 318,000. Table 1: Employed Persons in Manufacturing, 2012 shows a breakdown of manufacturing workers.

Figure 4: Labor productivity and projections, 2013-2030



Source: Databank; DOLE-BLES, World Bank
 Note: projections based on author’s calculations of historical data

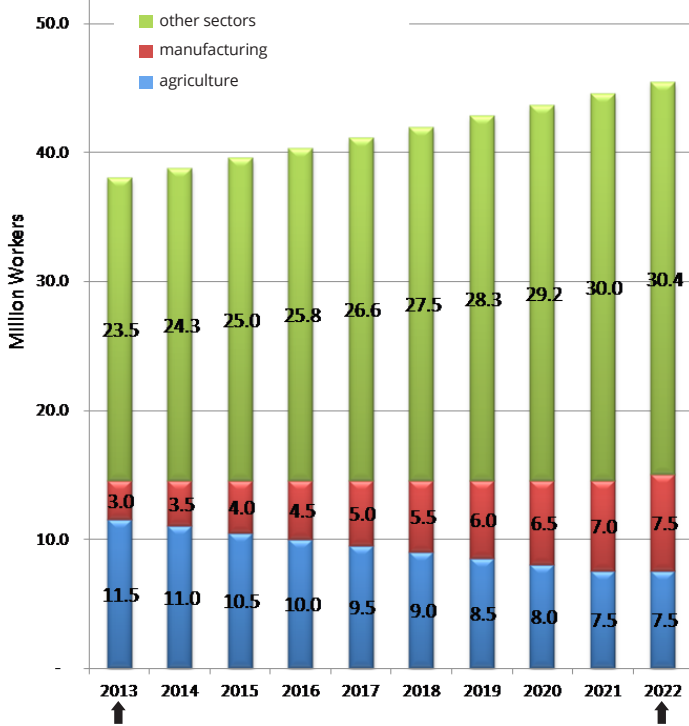
Figure 5: Revival of Philippine manufacturing as % of GDP, 2012-2022 (E)



Source: NSCB

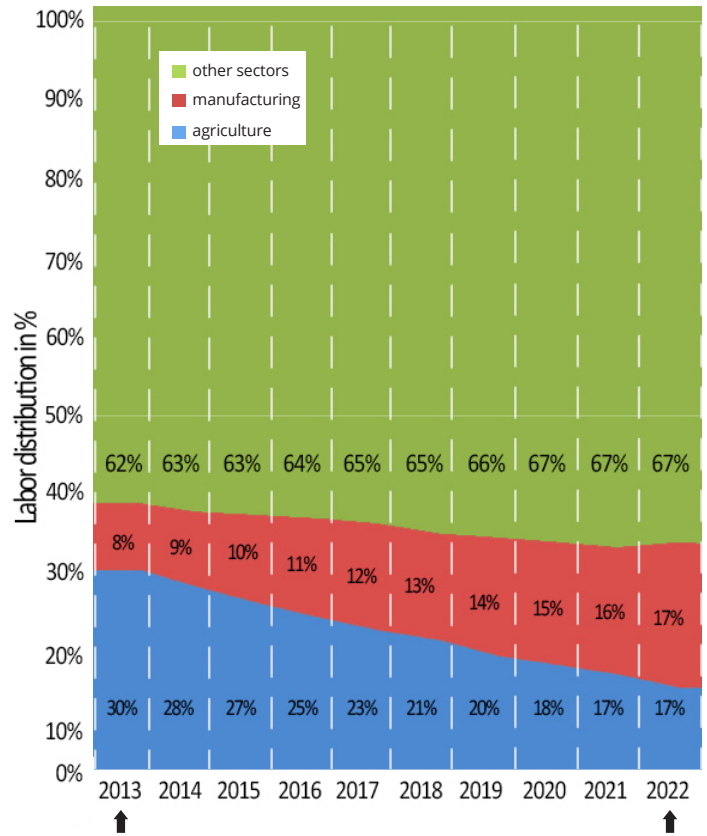
¹⁶ According to the Population Reference Bureau, demographic dividend is the accelerated economic growth resulting from a decline in birth and death rates and the subsequent change in the population’s age structure.
¹⁷ Aside from the ASEAN FTAs with Australia, China, India, Japan, Korea, and New Zealand, the prospect of concluding an EU-PH FTA as well as joining the 12-nation Trans-Pacific Partnership would add huge new market opportunities for Philippine goods.
¹⁸ Average of 2012 quarterly labor force survey, NSO.

Figure 6: Philippine labor force, millions, actual and projections, 2013-2022



Source: World Bank, Databank
 Note: projections based on author's calculations of historical data

Figure 7: Philippine labor force distribution and projections, 2013-2022



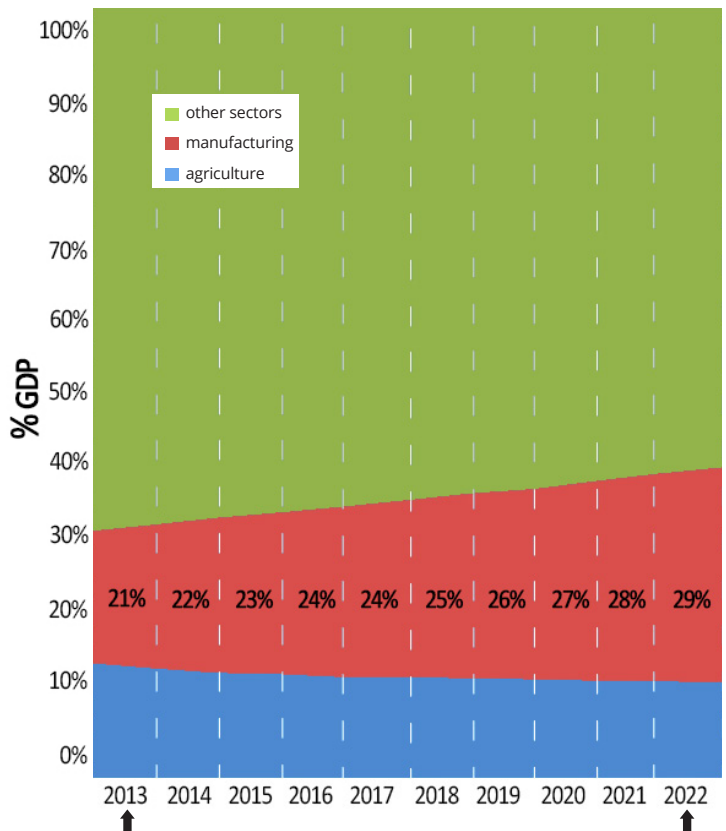
Source: World Bank, Databank
 Note: projections based on author's calculations of historical data

Table 1: Employed persons in manufacturing, 2012

Employed in Manufacturing	Average of Quarterly LFS (in thousands)
Food products	760
Apparel	450
Wood and products of wood and cork except furniture	319
Computer electronics and optical products	318
Fabricated metal products except machinery and equipment	154
Textiles	141
Furniture	135
Others	837
Total	3,113

Source: National Statistics Office, 2012 Labor Force Survey

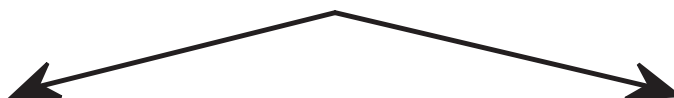
Figure 8: Sectoral % of GDP and projections, 2013-2022



Source: World Bank, Databank
 Note: projections based on author's calculations of historical data

IV. Two-pronged approach

Manufacturing is a broad and diverse sector requiring a large variety of success factors. Broad horizontal policies do not always serve a wide range of its subsectors due to their diverse specific needs. Such specific needs are being elaborated during 2012–14 in more than two dozen roadmaps developed by industry associations with the Department of Trade and Industry and are not included in this paper.¹⁹ Rather, this paper sets forth two broad approaches for growing the manufacturing sector: revive low-cost, labor-intensive manufacturing and expand high value-added manufacturing.



A. Revive low-cost, labor-intensive manufacturing

The Philippines has evolved from predominantly low-cost, labor-intensive manufacturing in the 1960s and 1970s, in products such as garments, footwear, and furniture, towards high value-added, more complex manufacturing since the 1990s, such as automotive, assembled electronics, and semiconductors. Unfortunately, this increase in manufacturing complexity has not lifted most industrial workers to higher productivity and higher value employment with better wages. In fact, a significant number of low-skilled workers lost their jobs when low-cost manufacturing left the country in pursuit of even lower costs in Bangladesh, Cambodia, China, Indonesia, and Vietnam.^{20, 21} This has swelled the ranks of unemployed and underemployed Filipinos and shifted former manufacturing workers to the services sector. Given the country's large young population and labor force, it is critical to regain and expand labor-intensive manufacturing subsectors in order to enhance inclusive growth.

B. Expand high value-added manufacturing

In contrast to the loss of low-labor cost manufacturing, some high value-added manufacturing, such as the semiconductor and electronics sectors, has flourished, as highly skilled workers available at moderate labor cost enabled the Philippines to find a significant niche in this rapidly growing global sector. However, other high-value sectors did not flourish, one notable example being the automotive sector.²²

To appreciate the differences of the manufacturing subsectors in terms of complexity, Table 2 (p. 17) ranks the complexity of these subsectors. Understanding their complexity helps identify sectors where the Philippines could grow given the country's set of endowments (labor, demographics, raw materials, geographic location, and the like).

¹⁹ Roadmaps for overall manufacturing and the cement, chemical, copper, electronics, housing, iron and steel, IT-BPM, paper, and rubber sectors have been released as of October of 2013. Other roadmaps being prepared include: air logistics, auto parts, coconut and coconut products, coffee, engineered bamboo and biodiesel, fine jewelry, flat glass, furniture, garments and textiles, handicrafts, hogs, hotels, medical travel/ medical tourism, metal casting, motorcycle and motorcycle parts, paints and coatings, petrochemicals, poultry, plastics, printing, retirement industry, and tool and die. Those released can be found at www.arangkadaphilippines.com. Source: DTI.

²⁰ The garments industry estimates that its overall employment has decreased 50% since the early '90s, as cited in p. 139 *Create More and Better Jobs*, WB, September 2013.

²¹ A PIDS study by L. J. Lanzona has shown that raising real minimum wages reduces employment, especially among wage-earners, workers with only a HS degree or who did not finish college, and workers age 25-34. p. 138 WB, op cit.

²² After 30 years, the automotive sector has failed to advance beyond basic assembly operations and has been challenged by lower cost imports under AFTA and JPEPA and illegal imports of used cars. By contrast, Indonesia, Malaysia, Thailand, and Vietnam have been more successful in building larger domestic automotive industries than the Philippines. The Philippine auto sector was dependent on a growing domestic market, which was undermined by illegal used car imports, while electronics and semi-conductors faced no similar competition.



Photo source: <http://shipbuildingtribune.com/2012/08/10/the-philippine-government-explores-future-shipbuilding-projects/>

V. Binding constraints

Binding constraints on Philippine growth have often been identified.²³ Poor infrastructure and poor governance are two top constraints. It is important to consider how easing these positively impacts on the two targeted broad types of manufacturing—low-cost and high-value—as well as secondary constraints relevant to manufacturing. Among constraints relevant to manufacturing in the Philippines are labor cost,²⁴ low labor productivity, improperly matched labor skills, land issues, market access/advanced FTAs, power cost and reliability, lack of effective promotion activities, regulation/red tape, lack of industry planning roadmaps, high cost of domestic shipping, smuggling, and tax issues (TCC, VAT, high CIT, and withholding).

Philippine law places very few constraints on foreign ownership of manufacturing, which is with a few exceptions allowed up to 100%.²⁵ However, land on which manufacturing factories may be located has a foreign ownership limit of a maximum of 40%. Manufacturing is a long-term investment where stable access to land is extremely important. While actual land

ownership ensures control and security of an investment, access to land through a long-term lease of 50 to 75 years as allowed in the Philippines can provide similar security and stability as long as contracts are consistently enforced. Most countries in ASEAN also prohibit direct foreign ownership of land for industrial uses, but Thailand allows land ownership for foreign-owned factories.

Other foreign ownership limits indirectly impact the manufacturing sector in areas such as domestic shipping and public utilities, financing, and utilization of natural resources, where a more competitive and liberalized environment would result in lower costs for manufacturers. Forceful proposals to ease these restrictions have been made recently by leading business groups and political leaders.²⁶ The Executive Branch has stated its intention to support legislation in the 16th Congress to liberalize maritime cabotage and unspecified restrictions in the Foreign Investment Negative List but not the economic restrictions in the Constitution, as widely supported by others.

²³ See studies by the ADB and the WB and the source documents of the US-Philippine Partnership for Growth as well as *Arangkada Philippines 2010*, which has sections on Manufacturing, Logistics, and also on Business Costs.

²⁴ Labor costs include minimum wage, 13th month pay, non-working holidays, annual and sick leave benefits, and termination costs.

²⁵ Restrictions are listed in the Foreign Investment Negative List issued every two years and cover advertising, dangerous drugs, education, firecrackers, media, military and police products, professional services, recruitment and security agencies, rice and corn trading, spas, and various financial businesses, among others.

²⁶ A group of 13 domestic and foreign business groups have urged President Aquino to agree with the removal of the economic restrictions in the 1987 Constitution and support a resolution that proposes this reform filed in the 16th Congress by House Speaker Belmonte.



Photo credits: Ted Aljbe/AFP/Getty Images

VI. Four million new jobs in manufacturing

A. Low-cost, labor-intensive manufacturing

The Philippines should aggressively recover and expand low-cost, labor-intensive manufacturing through a paradigm shift approach to job creation, particularly in:

- (1) Food and beverages (especially products using domestic ingredients),
- (2) Garments, footwear, leather goods, and textiles, and
- (3) Furniture, toys, and household items.

This can be accomplished by harnessing the country's large pool of workers through introducing special zones enabled with a combination of supportive government policies to make the zones attractive and competitive sites for both domestic and foreign manufacturing investors. The menu of supportive and flexible policies needed could include: (1) low-rent standard factory buildings, (2) low-cost long-term land leases, (3) programs to increase labor productivity, (4) relaxed policies on hiring and firing, (5) targeted government training programs, (6) special or low electricity rates, and the like, in addition to existing PEZA incentives. Domestic/Export Enterprise Zones (D/EEZs) for targeted sectors should be located outside major urban areas²⁷ to provide employment in rural areas as well as attract urban unemployed to new productive labor zones.

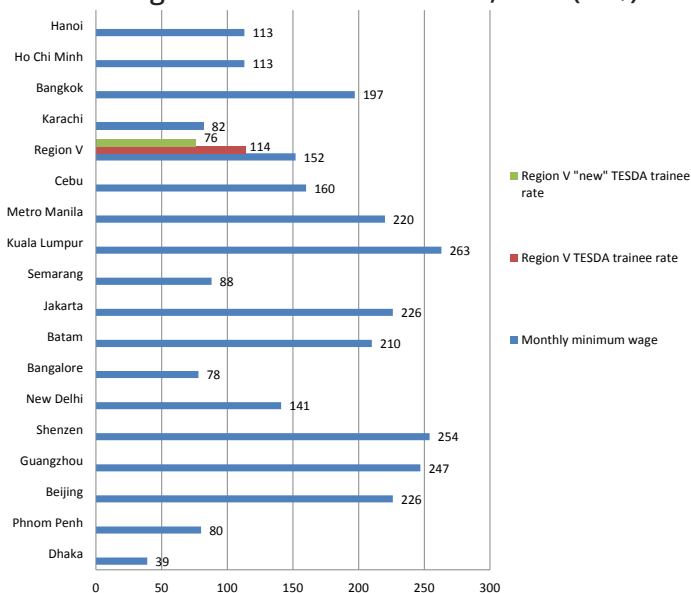
Affordable land and marine transportation access to international ports is essential. These zones could also incentivize existing manufacturers to relocate and potentially reduce industrial pollution and congestion in urban areas, particularly Metro Manila.

A large pool of trained new workers can be generated through a proposed TESDA Industrial Scholarship Program that prepares new high school graduates, 18 years old and above, for internships or apprenticeships of 18 to 24 months in low-cost, labor-intensive manufacturing firms.²⁸ These scholars should be guided by industry-specific curricula, trained by employers, and monitored and assessed by TESDA. The program can provide sufficient time for young workers to gain appropriate knowledge and skills while providing companies time to provide the right training and assessment of individual worker skills. At the end of the internship/apprenticeship, employers should select a targeted quota of workers that best fits their needs. Those not selected have the benefit of hands-on experience in a manufacturing company with knowledge and skills that increase their chances to find employment in another company or industry more suited to them—or even to begin an entrepreneurial career.

²⁷ Metro Manila and Cebu.

²⁸ RA 7796 or the Technical Education and Skills Development Act of 1994 establishes an apprenticeship program (Enterprise-based Training-Apprenticeship Program) that allows for 4-6 months of working as an apprentice with compensation at 75% of minimum wage. Over 25,000 graduates have completed the program as of early 2013. *Status of Project/Program Implementation*, TESDA, 2013.

Figure 9: Minimum monthly wages in Asian cities and Region V TESDA trainee rates, 2013 (US\$)



Sources: JETRO, The 23rd Survey of Investment Related Costs in Asia and Oceania (FY 2012 survey); DOLE-BLES

The **TESDA Industrial Scholarship Program** should seek government funds to support a portion of the wages of the manufacturing scholars throughout their internship/apprenticeship (Figure 9), while manufacturing companies provide free valuable hands-on training and education.²⁹ If a company utilizes significant number of scholars it reduces its labor budget, which includes the costs of hiring, training and development, and firing. Unemployment among new graduates can be significantly reduced depending on the size of the TESDA Industrial Scholarship Program and its adoption by companies in low-cost, labor-intensive manufacturing industries.³⁰ An alternative funding source under the CCT program could be considered.

Special labor-intensive manufacturing zones tentatively called Domestic/Export Enterprise Zones (D/EEZs)³¹ can enable industry clustering, provide supply chain efficiencies, and reduce cost of inputs by providing scale to locators. As with the experience of PEZA, D/EEZs should be insulated from the challenge of dealing with multiple government agencies and local government units.

²⁹ If TESDA could subsidize 25% of minimum wage, the firm would pay only 50%. For example a trainee in Region V where the minimum wage in 2013 is P252 would be paid P126 or \$2.86 daily by the manufacturer or \$57 a month, compared to US\$39 in Dhaka, US\$78 in Bangalore, US\$80 in Phnom Penh, US\$88 in Semarang, US\$113 in Ho Chi Minh, US\$160 in Cebu, US\$197 in Bangkok, US\$209 in Batam, US\$220 in Manila, and US\$254 in Shenzhen. The 23rd Survey of Investment Related Costs in Asia and Oceania (FY 2012 survey), JETRO May 2013 and *Jakarta Post*.

³⁰ The TESDA program to improve language and other skills of potential contact center workers has successfully placed some 100,000 Filipinos in industry jobs since 2005 and is currently funded at around Php500 million a year.

³¹ Dr. Gerardo P. Sicat has spoken and written about such zones in "Reform of Philippine Labor Policies" (July 2012) and "To Raise Labor Income and Employment Faster" (July 2012). Dr. Sicat recommends suspension of minimum wages to attract investment and create jobs in such zones.

³² The National Development Company website states the following criteria for investments: (1) has critical and pioneering impact on national socio-economic development, (2) lack of or absence of willing investors to pursue project, (3) commercially viable, and (4) with exit mechanism.

A PPP project sponsored by the government should be considered to attract real estate industrial zone development companies to invest in D/EEZs and provide factory space at low rent for several years to target low-cost, labor-intensive manufacturing firms. Some large industrial estate firms operating in the Philippines have foreign partners who market their projects to manufacturing investors in their nations and can be asked to assist with marketing. Retail commercial and residential real estate development should be explored as a second income flow to private developers after the commercial success of the estate is established. Alternatively, a public sector agency can undertake the project in its initial years.³² Use of government land might further reduce costs.

Trade access is critical to supply reliable foreign markets for the D/EEZs. Good quality roads to an international port or a port with Ro-Ro access will be needed for efficient movement of goods to export as well as to domestic markets. Country branding and promotion should emphasize the **Philippine image as a sustainable, safe, and ethical manufacturer**.

The example of the GPH interagency "convergence" process that supports improvement of infrastructure in targeted priority regions for increased tourism can be followed for development of low-cost, labor-intensive zones. Convergence for tourism infrastructure means DBM, DOT, and DPWH collaborate to identify, fund, and implement solutions to communication, power, sanitation, transportation, and other infrastructure and public service needs in areas where high international visitor volume is planned. The process started with a single region, expanded for 6 regions, and is now nationwide. A similar process can be started by DOLE, DPWH, DTI, PEZA, and TESDA to identify several initial areas to assess their potential and requirements to establish successful low-cost labor-intensive zones. Possible locations to study could include Albay, Bacolod, Dagupan, Davao, General Santos, Maguindanao, PHIVIDEC, and Tacloban. The NCC regional competitiveness councils might be helpful local partners.

B. High-value manufacturing

The number one driver for global manufacturing competitiveness is talent-driven innovation.³³ The Philippines can expand its high-value manufacturing sector by harnessing its existing large pool of talent and strategically deploying them into several high-value sectors where it has proven and potential competitive advantages.

The Philippines already has a sizeable hi-tech sector in semiconductor and electronics contributing over half of total exports by value for many years. However, lacking backwards integration, the sector is isolated from the rest of the economy and dependent on global trade flows. Weakened global demand for electronics has been dragging on the local industrial sector in the last few years. Domestic economic growth creates limited demand for the sector's products, which are largely intermediate parts finally assembled elsewhere in Asia.

The two TAPP roundtables of industry leaders identified three high-value manufacturing subsectors with high potential for growth, the further development of which would diversify the country's manufacturing base and could duplicate the success of the semiconductor and electronics sector:

- (1) **Semiconductors, computers, phones, electrical and home appliances,**
- (2) **Transportation equipment and parts (aircraft, motor vehicle, ship), and**
- (3) **Chemical, plastic, and rubber products.**

Industry planning, which includes identification of new products for diversification and upgrading, is critical in expanding into high-value manufacturing. Since these are the same industries that compete in Southeast Asia, the future Philippine product portfolio should complement, and not compete, with other ASEAN countries given the upcoming ASEAN Economic Community. Industry roadmapping at the sectoral and even

sub-sectoral level is needed so that specific vertical strategies and interventions can be deployed, instead of broad horizontal fiscal incentives that can be wasteful and ineffective. The Product Space approach currently being promoted by the Asian Development Bank and the Philippine Institute of Development Studies is an important approach for identifying new products and should be part of any sectoral roadmap.³⁴

Coordination of the different industry roadmaps should strengthen linkages between different industries enabling synergy and industry scale. This type of coordination can be orchestrated through the **Philippine Manufacturing Roadmap** and implemented by the **Industry Development Council** that the government has announced it will revive. The Philippine Manufacturing Roadmap should focus on horizontal strategies and interventions that benefit most of the established industries, while sectoral roadmaps should focus on vertical strategies and interventions that are highly specific to a particular sector and to new emerging industries. This framework will require strong coordination between private and public sectors, between agencies and industries, as well as other stakeholders including consumers, labor, and NGOs.

For high-value manufacturing, the following inputs are critical: (1) low-cost capital, (2) access to technology, (3) higher education, (4) research and development, and (5) industry integration. Country branding of the Philippines as a talented, innovative, and creative manufacturer of high-quality products should also be undertaken.

Horizontal challenges include (1) future of fiscal and other incentives, (2) high-cost and reliability of electricity, (3) inefficient and expensive transportation, (4) labor market lack of flexibility, (5) red tape and over-regulation (outside PEZA zones), and (6) skills development.

³³ For example, the competition of Apple and Samsung to develop a smart watch and Google bringing to market various high-tech inventions.

³⁴ Usui, Norio. *Taking the Right Road to Inclusive Growth: Industrial Upgrading and Diversification in the Philippines*. Asian Development Bank Philippine Country Office, 2013.

VII. Competition for FDI amid changing regional dynamics

The manufacturing landscape in ASEAN and the rest of Asia is undergoing very significant changes, creating an unprecedented window of opportunity for the Philippines—as well as its competitors. Millions of new jobs are being created in short periods in Bangladesh, Cambodia, Indonesia, and Vietnam as low-cost, labor-intensive manufacturers move production out of China (see Box 1).³⁵ A recent study estimates China will lose half its 85-100 million manufacturing jobs as labor-intensive industries contract as a result of rapid wage inflation.³⁶ But this giant job creation effect for the region's low-income producers is not yet spilling into the Philippines, as foreign investors and foreign buyers go elsewhere where costs are lower. This strongly argues for greater efforts in the Philippines to reduce business costs.

Box 1: Southern Chinese manufacturing hub loses competitiveness

The factory town Yantian, once a model of China's massive export boom, is now a symbol of China's struggle to maintain foreign manufacturers. From 400 foreign firms in 1998, only 150 remain. Rising labor costs, land shortages, and fading Western consumer demand drove some out of business and others to cheaper locations like Bangladesh and Vietnam. Remaining factories have shifted to specialized, capital-intensive production, but concerns for vulnerability to competitors in Southeast Asia remain (Figure 10). (Based on Asian Wall Street Journal, *How China Lost Its Mojo: One Town's Story*, September 18, 2013).

Figure 10: China, rising wages and appreciating currency, 2006-13



³⁵ Bangladesh has 5,000 garment factories, Indonesia 2,500, and Vietnam 2,000. Bangladesh enjoys duty-free access to the EU, and its garment sector is forecasted to quadruple in the next two decades. *Economist*, October 26, 2013. However, in early November a wage board recommended a doubling of the minimum wage to US\$68 a month; if approved, Bangladesh may be a less attractive location for the garment export industry. - *Asian Wall Street Journal* November 5, 2013.

³⁶ Chandra, V., Lin, J. Y. & Wang, Y., 2012, "Leading Dragon Phenomenon: New Opportunities for Catch-up in Low-Income Countries", *Asia Development Review*, Volume 30 no 1, 2013.



The Philippines is beginning to receive increased high-value foreign manufacturing investment, mostly Japanese firms relocating from China or offshoring from Japan. A European maker of Airbus components is a new investor. Some higher-end but labor-intensive garment and leather goods firms are also investing in the country. Industrial estates in popular areas such as CALABARZON and Cebu are full and undertaking expansion.

Monthly minimum factory wages have increased rapidly in recent years in China, Indonesia, Malaysia, and Thailand and now approximate or exceed rates in the Philippines.³⁷ In other competitor economies, such as Vietnam, wages are 50% lower than in the Philippines and are even lower in Bangladesh and Cambodia.³⁸ Four million workers in Bangladesh are employed in manufacturing garments for export, and 80% of Cambodia's exports are garments. Unfortunately, inflation of minimum wages and other cost factors decimated low-cost manufacturing in the Philippines in recent decades, especially the garment sector which has lost hundreds of thousands of jobs.³⁹ According to the World Bank, the "Philippines' high nominal minimum wage rate is a major contributing factor to the country's lack of competitiveness in labor-intensive manufacturing."⁴⁰

Minimum wage rates are less important to production costs of high-value manufacturing firms, which are more sensitive to expensive power.

Competing economies regularly adjust incentive regimes to attract foreign investment. China is currently reviewing its incentive package for foreign investors in special zones, while Indonesia is liberalizing its negative list.

Will the Philippines fully exploit the huge window of opportunity, revive low-cost manufacturing, and create millions of jobs, thereby making economic growth more inclusive? Can the Philippines use industrial policy to close the competitiveness gap with competing regional economies earlier, buying time while their manufacturing costs rise to levels close to the Philippines? The model of low-cost, labor-intensive zones in regions suffering from underemployment should be tested with supportive policies and practices. This may require strong leadership and a paradigm shift in government thinking, as well as support from business and labor.

³⁷ After many years of annual minimum wage increases, minimum rates in the Philippines approach the average rate. The recent two-tiered wage reform encourages a "productivity" rate added to a minimum rate set higher than the poverty level.

³⁸ The 23rd Survey of Investment Related Costs in Asia and Oceania (2012 survey), May 2013, JETRO.

³⁹ 19,000 manufacturing firms closed between 1999 and 2010. World Bank, op cit.


⁴⁰ P. 136, World Bank, op cit.

VIII. Conclusions and Recommendations

- (1) The Philippines—with a current GDP per capita (PPP) of \$4,414⁴¹—cannot reach high-income status without a large and robust industrial and manufacturing sector.
- (2) Manufacturing can accelerate and sustain economic growth while reducing unemployment.
- (3) Philippine export growth is much slower than other large ASEAN economies.
- (4) Each year over one million persons enter the Philippine labor force. Many cannot find jobs and go abroad—or stay at home and remain unemployed.
- (5) Unemployment (7.3% or 3 million) and underemployment (20% or 7 million) are extremely high and in number of persons has been rising.
- (6) **Important factors favor the growth of manufacturing in the Philippines:**
 - ✓ A demographic dividend with a large English-speaking work force trainable for high-skill and low-skill manufacturing jobs;
 - ✓ An emerging network of globe-spanning trade agreements provides enormous potential export markets;
 - ✓ Steadily increasing domestic demand from a growing middle class and remittances;
 - ✓ PEZA has been highly successful creating nearly 300 zones for exporters of goods and services with over 1 million jobs and US\$54 billion of investments (Table 3);
 - ✓ The international image of the Philippines has improved; the country's rank in almost all competitiveness ratings is rising;
 - ✓ GDP growth rate is high—despite a weak external economic environment;
 - ✓ Labor costs and supply constraints are rising fast in competing regional economies; and
 - ✓ Regional relocation of manufacturing is moving millions of jobs from rising-cost to lower-cost locations in Asia.
- (7) Competing regional economies are liberalizing incentives and opening restricted sectors to foreign investors. Myanmar is emerging as a low-labor cost competitor.
- (8) The peso exchange rate affects the competitiveness of Philippine manufacturing and needs to be taken into account.
- (9) **A two-pronged approach should be followed by the private and public sectors:**

Objective	The overall objective of reforming the manufacturing sector is to achieve a paradigm shift, breaking out of the cycle of low or no growth in manufacturing employment and moving up the scale of higher-value manufacturing, while also reviving labor-intensive manufacturing to take advantage of the country's demographic dividend.
Targets	<ul style="list-style-type: none"> • Create an average of 500,000 new jobs a year in manufacturing beginning in 2015 for a total of 4 million by 2022. • Attain 30% of GDP share of manufacturing by 2022. • Shift 4 million unemployed and underemployed workers to productive manufacturing sectors. • With a multiplier effect of 3 indirect jobs per new manufacturing job, 16 million Filipinos will benefit.
Core Strategies	<ul style="list-style-type: none"> • Create incentives to revive labor-intensive manufacturing by encouraging firms to locate in D/EEZs in less-developed regions with abundant low-cost labor and logistical connections to export ports. • Make production costs competitive with Cambodia, Indonesia, and Vietnam through temporary incentives for manufacturing firms who locate in D/EEZs. • Local officials should agree not to interfere in D/EEZs. • Upgrade/diversify high-value manufacturing where the Philippines is competitive.

⁴¹ Page 136, World Bank, op cit.


 **Singapore** US\$ 61,803

 **Malaysia** US\$ 17,143

 **Thailand** US\$ 9,815

 **Indonesia** US\$ 4,956

 **Philippines** US\$ 4,414

 **Vietnam** US\$ 3,635

	Low-Cost, Labor-Intensive	High-value Manufacturing
Key Product Sectors (to strengthen)	(1) Food and beverages (especially using domestic ingredients), (2) Garments, footwear, leather goods, and textiles, and (3) Furniture, toys, and household items.	(1) Semiconductors, computers, phones, electrical and home appliances, (2) Transportation equipment and parts (aircraft, motor vehicles, ships), and (3) Chemicals, plastic, and rubber products.

(10) **Ten horizontal cross-cutting categories of reforms** can strongly support both high-value and labor-intensive manufacturing.

Policy Issue	Reforms/Recommendations
(A) Electricity costs and power reliability	Build more baseload plants and implement open access; temporarily suspend VAT on electricity for manufacturers (competitor economies subsidize power); ⁴² introduce more competition by allowing foreign firms majority ownership in power distribution.
(B) Land transport infrastructure	Build an expanding interconnected network of limited access roads throughout Luzon; improve national roads and local roads servicing ports and farmers; introduce more competition by allowing foreign firms majority ownership in the transportation sector.
(C) Land ownership	Allow foreign ownership of factory sites.
(D) Maritime infrastructure	Modernize key ports; increase competition and reduce costs of inter-island shipping; consider cabotage reforms; decongest Manila port; utilize Batangas and Subic ports; reform PPA; strengthen Ro-Ro (Figure 11).
(E) Labor policy	Implement two-tiered wage system; allow piece rate; reduce holidays; allow holiday banking; ⁴³ reduce rice cost by freeing the market; introduce unemployment insurance; make hiring and firing policy flexible. ⁴⁴
(F) Human capital	Accelerate educational reforms; implement K+12; match curriculum to needed industry job skills; increase tech-voc program; expand TESDA programs.
(G) Red tape	Rationalize/minimize and speed up bureaucratic procedures; maximize e-governance with complete on-line interface.
(H) Weak planning	Develop and implement quality industry roadmaps; develop convergence for manufacturing.
(I) Smuggling	Strict enforcement and heavy punishment for offenders; tighten egress at freeports and SEZs; implement transparency measures (publishing inward foreign manifests, published values as required by Tariff and Customs Code, and base performance at each port).
(J) Tax policy	Lower corporate and personal income tax to regional averages; raise VAT (but exempt certain items, e.g. some food, medicine, books, power for lifeline and manufacturing).

⁴² Electricity rates are heavily subsidized in Malaysia (by 36%), Thailand (37%), Korea (51%), Taiwan (54%), and Indonesia (51%). While 1 kwh costs US\$ 19.85 in Manila, the price is only US\$ 8.51 in Jakarta.

⁴³ Holiday banking means a firm has the option of giving equivalent holidays at times of its choosing.

⁴⁴ A Tripartite Labor Code Review Committee is reviewing reforms that could encourage more employment.

(11) To jumpstart D/EEZs , **thirteen temporary incentives should be introduced:**

- (A) Establish a public-private joint venture to build, own, operate D/EEZs using public land.
- (B) Provide low-rent factory space for a fixed period.
- (C) Assure transport access at competitive costs to domestic and foreign markets, including by Ro-Ro.
- (D) TESDA-trained apprentices should receive partial pay from TESDA, DOLE, or CCT.^{45, 46, 47}
- (E) Employers should be able to double deduct wages and training expenses of apprentices in calculating taxes.⁴⁸
- (F) Employers should be able to include food and lodging provided to employees in wage calculations.
- (G) Suspension of security of tenure and minimum wage should be tested to see if it attracts investors, creates jobs, and increases productivity.
- (H) Extend length of apprenticeships beyond 6 months to 18 or 24 months.^{49, 50}
- (I) Locators should target trainees for 25% of their workforce and should be required to employ as regular workers at least 25% of apprentices.
- (J) Employers should be exempted from observing more than 10 paid holidays.
- (K) Employers should be allowed holiday banking.
- (L) Employers should have access to the least expensive power through open access.
- (M) Encourage competitive sourcing of local raw materials for D/EEZ locators.

- (12) A **public-private task force** should be assembled to prioritize incentives, recommend the fastest means of implementation, identify criteria for location of initial D/EEZs, design promotional programs to target investors, and the like, following the example of the **“convergence” approach** used for tourism.
- (13) The primary objective of the **special incentives is to attract high volumes of new investment by domestic and foreign manufacturers of labor-intensive products** who will train and hire Filipino workers in very large numbers. The new manufacturing capacity should be able to maintain production as the incentives are phased out once production costs of regional competitors rises.
- (14) The result should be more inclusive growth and a better chance for Filipinos to choose working at home rather than abroad.

⁴⁵ The Indonesian national training center is barely able to keep up with training seamstresses for the newly-built garment factories in Semarang of firms relocating there from Jakarta after its minimum wage was raised 40% in 2012. Keith Bradsher, *New York Times*, May 15, 2013.

⁴⁶ The government could “co-finance some training and apprenticeship programs...for disadvantaged groups or young workers.” 3. 183; “Employers should be allowed to use...extended-term apprenticeship contracts.” p. 205, World Bank, op cit.

⁴⁷ In the 2014 budget, Php10 billion will be added to encourage high school age students to finish high school. But what if there are no jobs? Another Php10 billion for the CCT program to fund 25% partial pay of apprentices could help to fund over 500,000 jobs.

⁴⁸ Double deduction of training expenses is proposed “for employees” in HB 2765 and SB 35 in the 16th Congress.
⁴⁹ A Tripartite Labor Code Review Committee has recommended reform of the apprenticeship program to make the apprenticeship period dependent on the duration of training required, based on the complexity of the skills to be learned.

⁵⁰ Apprenticeship programs are extremely strong in Germany, where the apprenticeship period can extend to 36 months.

Figure 11: Existing Ro-Ro ports



Source: Faustino et. al, 2010, p. 1

Table 2: Lall's technological classification of manufactured exports

Classification	Examples
Primary products	Fresh fruit, meal, rice, cocoa, tea, coffee, wood, coal, crude petroleum, gas
Manufactured products	Prepared meats/ fruits, beverages, wood products, vegetable oils
<i>Resource-based manufactures</i> Agro/forest-based products	
Other resource-based products	Ore concentrates, petroleum/rubber products, cement, cut gems, glass
<i>Low-technology manufactures</i> Textile/fashion cluster	Textile fabrics, clothing, headgear, footwear, leather manufacturer, travel goods
Other low technology	Pottery, simple metal parts/structures, furniture, jewellery, toys, plastic products
<i>Medium technology manufactures</i> Automotive products	Passenger vehicles and parts, commercial vehicles, motorcycles and parts
Medium technology process industries	Synthetic fibres, chemicals and paints, fertilizers, plastics, iron, pipes/tubes
Medium technology engineering industries	Engines, motors, industrial machinery, pumps, switchgear, ships, watches
<i>High-technology manufactures</i> Electronics and electrical products	Office/data processing/telecommunications equip, TVs, transistors, turbines, power-generating equipment
Other high-technology	Pharmaceuticals, aerospace, optical/measuring instruments, cameras
Other transactions	Electricity, cinema film, printed matter, special transactions, gold, art, coins, pets

Source: Lall, 2000, p. 7

Table 3: Philippine Economic Zone Authority (PEZA) data

Year Created by RA 7916	1995
Total Zones	293
Manufacturing Economic Zones	65
IT Parks/Centers	190
Tourism Economic Zones	18
Medical Tourism Park/Centers	2
Agro-Industrial Economic Zones	18
Total Enterprises	3,092
Total Direct Employment	1,000,238
Total Value of Exports (1995-2012)	US\$ 476 Bn
Total Ecozone Investments (1995-2012)	US\$ 54 Bn

Source: PEZA official website (<http://www.peza.gov.ph>), September 2013.

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Mr. Michael Raeuber	President and CEO of the Royal Cargo Group of Companies
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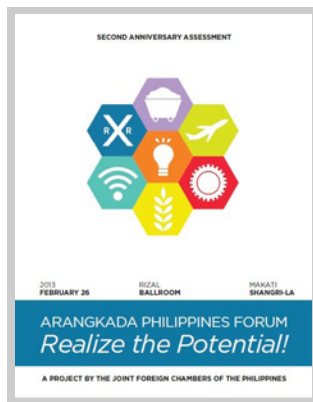
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Arangkada Second Anniversary Assessment Book Cover



On January 26, 2012, the JFC held the First Anniversary Forum and released the *First Anniversary Assessment*, which evaluated progress for the year 2011 towards completing 471 recommendations in the 2010 document. The advocacy coordinated some 40 experts—senior consultants, former public officials, business executives, and academics—who rated the recommendations.

The *Second Anniversary Assessment*, evaluating the year 2012, was released at the Second Anniversary Forum on February 26, 2013 with its theme “Realize the Potential!” A collaborative effort of 33 experts produced a document rich in current information about the business and investment climate of the country, and which for the second successive year showed considerable progress.

<http://www.investphilippines.info/arangkada/second-anniversary-assessment/>

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