ARANGKADA PHILIPPINES
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MANUFACTURING
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A BOLDER AND MORE INCLUSIVE DECADE

TOWARDS A GLOBALLY COMPETITIVE MANUFACTURING SECTOR

On January 22, 2016, the Japanese Chamber of Commerce and Industry of the Philippines (JCCIPI) organized a round table discussion on the manufacturing sector as part of the annual *Arangkada* review of the Philippines' Seven Big Winner Sectors. This policy note incorporates results of said discussions, including key challenges and issues confronted by manufacturing companies and proposed recommendations looking ahead a decade to address such challenges and support efforts to sustain the resurgence of manufacturing in the Philippines. It also discusses the connections between these recommendations and the Duterte Administration's 10-Point Socioeconomic Agenda.

MANUFACTURING PERFORMANCE

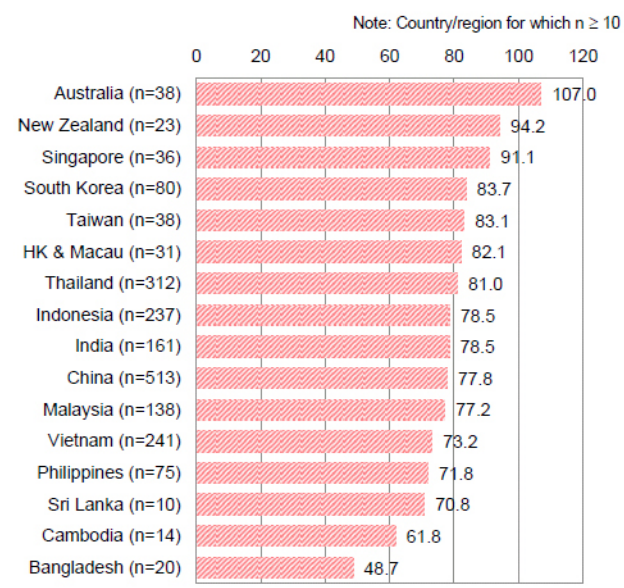
The manufacturing sector's performance in recent years has been characterized by steady growth, improved labor productivity, but sluggish employment growth.

Since the 1990s, manufacturing's average growth rate in terms of gross value added has been steadily increasing. From an average of 2.5% growth in 1991-2000, average growth reached 4.1% for the period 2001-2010. In the last four years, average growth exceeded 7%. In the same period, growth performance of manufacturing sub-sectors is highest for intermediate goods at 8.4%, followed by consumer goods at 6.5%, capital goods at 4.4%, and miscellaneous manufactures at 1.2%.

The sector's total gross value added reached PhP2.5 trillion while total revenues amounted to PhP7.5 trillion (US$150 billion). Manufacturing contributes 23% to the country's GDP. Labor productivity has significantly increased by as high as 6%.

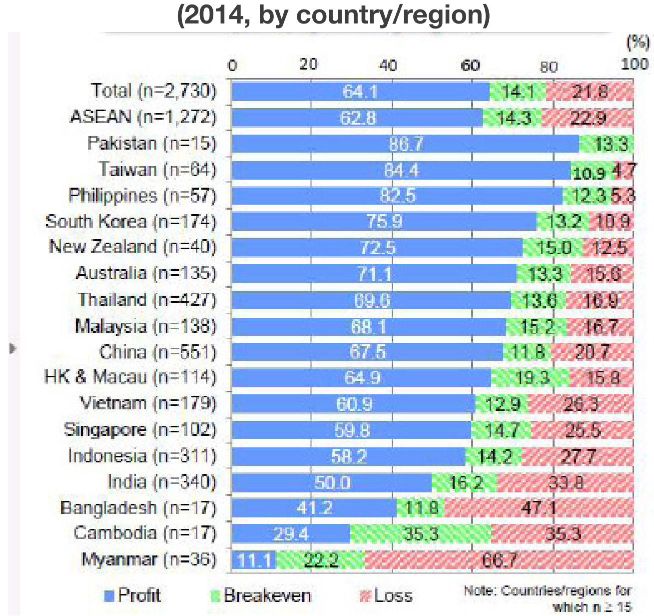
The Philippines' manufacturing growth is the second fastest in ASEAN. While the rest of ASEAN countries (except Viet Nam) experienced declines in manufacturing, the Philippine average growth rate continues to rise. In a recent study, JETRO reported that the Philippines has become a favored country for Japanese manufacturers given its production cost is among the lowest in Asia. In addition, the Philippines is among the most profitable locations for Japanese investors.

Table 1. Local production cost in comparison with production cost in Japan, which is taken as 100 (2014, by country/region)



Source: Survey of Japanese-affiliated companies in Asia and Oceania 2015, Japan External Trade Organization (JETRO).

Table 2. Operating profit forecast (domestic sales-oriented firms with export ratio < 50%) (2014, by country/region)



Source: Survey of Japanese-affiliated companies in Asia and Oceania 2015, JETRO.

Growth in manufacturing, however, has not translated to increased employment. While the sector continues to grow since the 1990s, its contribution to total employment has been declining. From an average share of 10% from 1991-2000, the sector's employment contribution contracted to 9.1% for the period 2001-2010. It further declined to 8% for the period 2011-2014. At the level of specific industries, total employment contribution contracted the most in wood and cork products, machinery, textile manufactures, and metal. The sector employs about 3 million people. Average employment growth since 2001 has only been 0.8%.

According to ADB's Dr. Jesus Felipe, no country reached industrialization without manufacturing labor reaching 18% of the total workforce. In *Arangkada's* previous manufacturing policy brief, The JFC recommended increasing manufacturing labor from 3 million in 2012 to 7 million by 2030 by shifting agriculture workers and low value service workers to manufacturing.

The government of the Philippines is giving increased emphasis and support to manufacturing under its Manufacturing Resurgence Program (PhP 289 billion in 2016) and its many roadmaps.

Over 23 manufacturing subsectors roadmaps were crafted by industry associations in collaboration with the DTI. A Manufacturing Roadmap and the Comprehensive National Industrial Strategy was formulated by government.

INDUSTRY CHALLENGES

The manufacturing sector is challenged to sustain its growth and contribute to efforts to reduce unemployment in the Philippines. While existing data spark optimism, industry players are cognizant that a number of constraints hamper the sector's upward trend. Outlined here are seven (7) key issues that cut across the diverse sub-sectors under manufacturing.

Infrastructure – Power and Ports

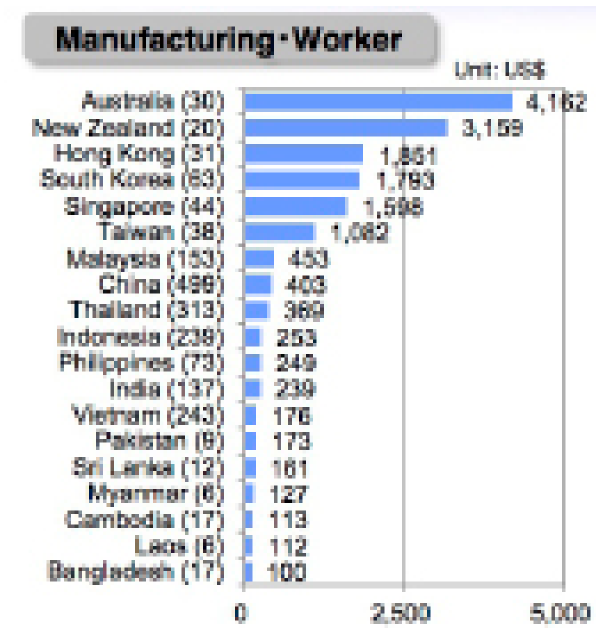
The high cost of electricity in the Philippines is an issue raised by many manufacturing companies, particularly those in power-intensive industries such as textile, automotive, petrochemical, etc. The electricity cost in the Philippines remains among the highest in Asia. Manila has the 3rd most expensive power cost in terms of residential tariff, generation cost, grid charges, and electricity taxes; second only to Sydney and Tokyo.

Meanwhile, congestion issues at Manila and Cebu ports significantly impact transportation and logistics efficiency, as well as manufacturing industries that highly depend on goods passing through ports. Congestion is driven by two (2) major factors: the port's utilization level and the flow rate of containers in and out of the terminal. In 2014, Manila Port's utilization level or the number of its piled laden containers totaled 85,000 twenty-foot equivalent units (TEUs), occupying about 104% of its yards. This is way beyond target utilization rate of less than 80%.

Labor Cost

Another often cited issue affecting manufacturing's competitiveness is labor cost. The minimum wage in the Philippines is higher than several of its ASEAN neighbors, including Viet Nam, Myanmar, and Cambodia, countries with sizeable supply of labor. Textile and garments, both labor-intensive industries, are the most affected by this issue. However, there are labor shortages in Malaysia and Thailand so in both countries companies must pay above the minimum wage for entering workers, but this is not so in the Philippines.

Table 3. Wages Base Salary, select Asian countries (in US dollars)



Worker: Regular general workers with around three years of work experience, excluding contract-based and probationary workers.

Source: Survey of Japanese-affiliated companies in Asia and Oceania 2015, JETRO.

Bureaucracy in Regulatory Processes

The government bureaucracy experience when applying for permits and licenses hampers growth of manufacturing. Companies go through multiple steps and submit hundreds of documents to secure regulatory requirements. An astonishing 7,500 products require import and permits by multiple agencies.

Chemicals and other highly regulated imports have to pass through a series of steps before these can be released from the Bureau of Customs. Food manufacturers need months to comply with Food and Drugs Administration (FDA) regulations. Industry players observe that while the number of products requiring FDA certifications has expended, FDA has not increased the number of the chemists and personnel involved in product testing and certification. Specific concerns and experiences per sub-sector in manufacturing may vary, but all concerns are attributed to bureaucracy.

Taxes

According to the IFC Doing Business Report, the total tax rate (% of profit) in the Philippines is 43%, highest of the ASEAN-10. Indonesia (30%), Thailand (28%), and Cambodia (21%) are much lower.

Broken Linkages in the Supply Chain

Manufacturing industries are constrained by broken linkages in the supply chain. Weak backward and forward linkages or poor access to raw materials compel manufacturers to rely on imported parts and intermediate goods. This situation hampers the ability of companies to move up the value chain.

In the case of food and beverage manufacturers, the broken linkage is attributed to low agricultural productivity. Most farmers, due to scarce land or lack of access to technology, financing, and equipment, are unable to meet demands for raw material inputs. Climate change is also seen as a factor in farmers' inability to produce and reliably supply required resources.

Non-Inclusion in TPP

In light of the signing of the Trans Pacific Partnership Agreement (TPP) on February 4, 2016, manufacturing companies are wary of the impact of the non-inclusion of the Philippines in the TPP. In the textile and garments industry, some buyers from TPP signatory-countries are said to have expressed preference to transact with manufacturers located in TPP countries, such as Viet Nam, over the Philippines.

The TPP is one of the world's biggest trade agreements, comprising 40% of the global GDP and 800 million people among 12 nations including the United States, Japan, Australia, New Zealand, Canada, Chile, Mexico, Peru, and 4 ASEAN countries - Malaysia, Singapore, Viet Nam, and Brunei. A key feature of the TPP is the elimination of tariffs on thousands of product lines traded among TPP signatory countries.

MSME Concerns

Micro, Small, and Medium Enterprises (MSMEs) comprise a large part of the manufacturing sector particularly food and agribusiness. They continue to face competitiveness challenges and need the strong support and intervention in terms of access to capital, market, technology, and human resources.

MSMEs' growth and integration with the supply chains of large companies are constrained by, among others, their failure to meet regulatory requirements. In food manufacturing, MSMEs or backyard enterprises have to pass high-level standards and hurdle various certifications in order to market and export. Most MSMEs are unable to meet these requirements due to either lack of facilities or lack of skills and knowledge.

RECOMMENDATIONS

The manufacturing sector is seen as a key driver in accelerating economic development and achieving inclusive growth in a country that would have a population of 200 million by 2050. The goal is to create a globally competitive manufacturing sector that would contribute 30% of the Philippines' total value added and 15% of total employment. To maximize the sector's potential and address issues and challenges hampering its growth, broad approaches applicable across sub-sectors must be pursued.

1. **Address high cost of power through tax credits and discounts.** High electricity cost is one of the biggest concerns of most manufacturers particularly those in textile and garments. Government is urged to consider actual electricity usage and expenses of power-intensive companies as said companies' tax credits. Study as well the possibility and impact of exempting power-intensive companies from paying the 12% VAT. Another approach is to facilitate direct negotiation of power-intensive companies with energy generators and power companies for discounted electricity costs.

2. **Prioritize infrastructure critical to industry growth.** There is a need to prioritize development of infrastructure critical to various sub-industries in manufacturing. Build expanded and interconnected access roads to and from port areas, production sites, markets, and farms. Develop the country's major ports and its non-operating inter-urban railways. To support electronics sector, enhance air cargo capacity of NAIA and Clark.

3. **Support labor-intensive companies through wage subsidies or waiver of minimum wages.** Reviving low-cost, labor intensive manufacturing sub-sectors will provide underprivileged Filipinos increased chances to be employed. For purposes of employment retention

and employment generation, industry players call on government to subsidize workers' salaries. This subsidy could apply either to companies that meet minimum number of employees or those with new employment. The neglected apprenticeship program offers great potential for fresh high school graduates to get jobs. Also, waiver of minimum wages for a limited number of years could be adopted as an incentive for large manufacturers in garments, footwear, and similar labor-intensive products.

4. **Streamline regulatory processes.** Government agencies should review and streamline existing processes for licensing, permits, and certification for manufacturers. Conduct regulatory impact assessments. Eliminate old unnecessary rules and paperwork at the national and local level, e.g. the annual business registration requirement or the annual registration of "aliens." Facilitate collaboration among government agencies involved to identify and eliminate overlaps and duplication, as well as address conflicting rules. Utilize online and digital technologies to establish e-governance.

5. **Support MSME development by providing access to technologies and facilities.** Upgrade/improve the quality of products offered by MSMEs. Help enterprises meet product standards and certifications, including export standards. To enable this, develop more common/shared services facilities that MSMEs can use for product testing and improvement. Moreover, increase their access to technologies that trigger innovation and creativity in product development and production. Increase financing programs.

6. **Conclude a EU-Philippine FTA and join the Trans-Pacific Partnership.** Complete in preparing to negotiate to join the TPP, assess the possible impact and benefits of Philippine participation in the TPP to each manufacturing sub-sector/industry. Leverage on learning from existing free trade agreements. Aside from the ASEAN Free Trade Agreement, the Philippines, through ASEAN, is also a signatory to five other ASEAN FTAs, including with China, Japan, Korea, Australia, New Zealand, and India. Also has a bilateral trade agreement with Japan. Complete negotiations with the EU and EFTA in 2016.

7. **Establish more economic zones; keep incentives.** Support the establishment of more economic zones. Economic zones have incentivized and support new investments - both local and foreign direct investment. Companies registered in economic zones, subject to each zone's specific policies, enjoy tax incentives, long-term land leases, access to the domestic market (subject to limitations), and assistance in dealing with government agencies. The PEZA has demonstrated great success in attracting investment in manufacturing and creating jobs. Maintain current incentives for PEZA locators and expand zones to include more domestic market manufacturers.

8. **Tap industry experts.** Review the relevance of the Philippine Investment Priorities Plan. Strengthen business sector's involvement in the said review as well as in government's industry planning and road-mapping programs. For each industry, embed an industry expert with international perspective as consultant and/or adviser to the Department of Trade and Industry and the Board of Investments. Each expert should be able to guide government in various aspects of industry development, including trade and investment negotiations, policy making, strategic planning, promotions, incentive schemes, and industry evaluation and monitoring.

9. **Reduce Taxes** Gradually lower the tax burden by 10% to be closer to the ASEAN-6 average of 33%.

10. **Increase total employment in manufacturing.** Achieve a target of 18% of total labor in manufacturing as this would amount to about 10 million people by 2030.

CONCLUSION

The current environment favors the resurgence of the manufacturing sector in the Philippines; GDP growth rate remains high; Filipino workforces are proven to be skilled, effective, and competitive on high-skilled production; there is stronger domestic demand; and the country's competitiveness continues to improve.

As ASEAN economies integrate and regional, plurilateral, and bilateral trade agreements are forged, the country's viability as an investment destination site for manufacturing is further boosted. This will provide impetus for the manufacturing sector to deepen its participation in regional production hubs, and eventually, link and integrate its activities with agriculture and services industries. This scenario is expected to trigger continued and inclusive growth in the Philippines. The road towards this scenario starts with the operationalization of the recommendations listed above.

i Manufacturing sub-sectors include (a) Consumer Goods such as food, beverage, tobacco, footwear and wearing apparel, and furniture and fixtures; (b) Intermediate Goods such as textile, word and cork, paper products, publishing and printing, leather production, rubber, chemicals, products of petroleum and coal, and non-metallic minerals; (c) Capital Goods like basic metal, metal, machinery, electrical machinery, and transport equipment; and (d) Miscellaneous manufactures.

ii Source: Electricity prices, The Lantau Group "Global Benchmark Study of Residential Electricity Tariffs" paper, Energy Market Authority, Singapore

10-POINT SOCIOECONOMIC AGENDA AND THE MANUFACTURING SECTOR

The 10-point socioeconomic agenda of the new administration can address many of the constraints of Philippine manufacturing. In the following table, four (4) points are most aligned to the policy note recommendations. However, all ten (10) policy note recommendations can align to at least one of the administration's agenda and several to more than one. An alignment to the *Arangkada* policy documents and the 10-point agenda appears on page 7.

A. **Adopting comprehensive tax reform**. The proposed reduction on corporate income tax brings domestic manufacturing closer to regional levels. It can potentially increase attractiveness to domestic manufacturing investments, especially if reforms further relax foreign ownership requirements. Tax reform that supports a domestic manufacturing zone could significantly enhance domestic manufacturing competitiveness. On the other hand, proposed taxes on fuel and sugar related products could reduce activity in these two sub-sectors, so new and robust safeguards against a potential increase in smuggling should be instituted to ensure that the revenues from these taxes are protected. Streamlining the tax-credit process enables domestic products to supply PEZA-registered export manufacturers increasing local content and value added.

B. **Fast track and shorten the process of doing business.** Strongly align to the needs of industry that is faced with every increasing, complex regulations implemented by multiple agencies. Increase cost and efficiency not just for the manufacturers but also for government agencies mandated to regulate various aspects of the manufacturing value chain. This would aggressively reduce the regulatory overlaps that have accumulated over the decades.

C. **Develop regional industries**. This can enable the dispersion of industry to the countryside, not just beyond Metro Manila, but beyond Region 4-A, which is already close to congestion. Planning is critical to ensure that industries are consistent with each region's comparative advantage and supported with smart industrial planning driven primarily by market forces. This is where the linkage between the agricultural and resource-based sectors to manufacturing will be critical. Initiatives on infrastructure and transportation networks are essential to its success. Programs to enable the movement of agri-labor to new manufacturing investments in the country side should be provided. This is where CCT can be leveraged.

D. **Reduce PPP bottlenecks and respect contracts**. Providing for a sustained and accelerated investment in infrastructure, with the engagement of the private sector. Infrastructure investment underpins the industry's continuing growth, especially towards the countryside that is currently not well-connected to global supply chains. Infrastructure investment also drives the cement, steel, and paint manufacturing sub-sectors as well as synergizes with commercial and residential private sector construction.

All the other points of the new socioeconomic agenda directly or indirectly enable the long term and sustainable growth of the Philippine manufacturing industry. Nearly all points support the increase in total employment in manufacturing. This manufacturing note envisions that manufacturing reaches 18% of total employment (a historical benchmark for full industrialization), which may well be beyond the 6 year-term of the current administration. Nevertheless, the 10-point agenda accelerates the process enabling future administrations to attain full industrialization.

Table 4: 10-Point Agenda and Manufacturing Policy Note Alignment

10-Point Socioeconomic Agenda \ Manufacturing Policy Note Recommendations	1. Address high cost of power through tax credits and discounts	2. Prioritize infrastructure critical to industry growth	3. Support labor-intensive companies through wage subsidies or waiver of minimum wages	4. Streamline regulatory processes.	5. Support MSME development by providing access to technologies and facilities	6. Conclude a EU-Philippine FTA and join the Trans-Pacific Partnership.	7. Establish more economic zones; keep incentives	8. Tap industry experts	9. Reduce Taxes	10. Increase total employment in manufacturing
1. Continue current macroeconomic policies, including fiscal, monetary, and trade policies.	X					X	X			X
2. Institute progressive tax reform and more effective tax collection, indexing taxes to inflation	X								X	
3. Increase competitiveness and the ease of doing business. Relax constitutional restrictions on foreign ownership, except for land, to attract FDO.			X	X		X	X		X	
4. Accelerate annual infrastructure spending to account for 5% of GDP, with PPP playing a key role.		X								
5. Promote rural and value chain development toward increasing agricultural and rural enterprise productivity and rural tourism.		X		X			X			
6. Ensure security of land tenure to encourage investments and address bottlenecks in land management and titling agencies.				X			X			
7. Invest in human capital development, including health and education, and match skills and training to meet business and private sector demands.			X		X			X		X
8. Promote science, technology, and the creative arts to enhance innovation and creative capacity towards self-sustaining, inclusive development.					X			X		
9. Improve social protection programs and CCT to protect the poor.										
10. Strengthen RH Law to enable especially poor couples to make informed choices on financial and family planning.										

PRESIDENT DUTERTE'S 10-POINT SOCIOECONOMIC AGENDA

AGENDA

Arangkada Philippines Policy Briefs/Notes

1. Continue and maintain current macroeconomic policies including fiscal, monetary, and trade policies.
2. Institute progressive tax reform and more effective tax collection, indexing taxes to inflation. A tax reform package will be submitted to Congress by September 2016.
3. Increase competitiveness and the ease of doing business. This effort will draw upon successful models used to attract business to local cities (e.g., Davao) and pursue the relaxation of the Constitutional restrictions on foreign ownership, except as regards land ownership in order to attract foreign direct investment.
4. Accelerate annual infrastructure spending to account for 5% of GDP, with Public-Private Partnerships playing a key role.

   + BROADBAND
5. Promote rural and value chain development toward increasing agricultural and rural enterprise productivity and rural tourism.
6. Ensure security of land tenure to encourage investments, and address bottlenecks in land management and titling agencies.
7. Invest in human capital development, including health and education systems, and match skills and training to meet the demand of businesses and the private sector.
8. Promote science, technology, and the creative arts to enhance innovation and creative capacity towards self-sustaining, inclusive development.
9. Improve social protection programs, including the government's Conditional Cash Transfer program, to protect the poor against instability and economic shocks.
10. Strengthen implementation of the Responsible Parenthood and Reproductive Health Law to enable especially poor couples to make informed choices on financial and family planning.

Legends:

- AGRIBUSINESS
- BUSINESS PROCESS OUTSOURCING
- CREATIVE INDUSTRIES
- INFRASTRUCTURE
- LEGISLATION
- MANUFACTURING
- MINING
- TOURISM, MEDICAL TRAVEL AND RETIREMENT

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