Transforming the Philippine Economy

Industrial Upgrading and Diversification

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ADB-AFD-JICA Joint Forum
“Taking the Right Road to Inclusive Growth”
28 February 2012

Presentation

Issues: A missing link between growth and development, long-term development puzzle, and vulnerability to external shocks

Approach: Analyzing the structural transformation and its implications on inclusive growth

- Economy-wide productivity
- Product upgrading and diversification

Findings:
- Lagged growth is rooted in productivity growth deficit due to sluggish industrialization
- Limited job opportunities resulted in slow poverty reduction
- Growing services provide jobs, but it cannot be a magic trick

Recommendations:
- "Waking on two legs"
- Targeted public sector interventions:
  - Product identification
  - Public and private dialogues

Solid growth over the 2000s

GDP growth in the past 5 decades
(annual average, %)

<table>
<thead>
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<th>Decade</th>
<th>GDP Growth</th>
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<td>1960s</td>
<td>4.9</td>
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<td>1970s</td>
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Solid growth over the 2000s
Weak labor market indicators

![Graph showing unemployment and underemployment trends over years.]

Persistent poverty

![Graph showing poverty incidence over years.]

Growth and investment paradox

![Graph showing growth rates and investment over years.]

Chronic problems even in the regional context

![Graphs showing slow poverty reduction and stagnant investment in various countries.]

Persistent poverty

Poverty incidence (%)

- By Population
- By Families

- Series Break
Recent development: sharp drop of export
How about your neighbors?

Total exports
(3 month moving average, % change, year-on-year)

Long-term growth puzzle
Once upon a time......
After five decades......

Was it because of high population growth?

GDP per capita growth (%), annual average

Growth and Structural Change
The two sides of a coin

Growth is not just more of the same
“A growth miracle sustained for a period of decades...must involve the continual introduction of new goods, not merely continual learning on a fixed set of goods”
(Robert Lucas)

Structural Change is about the transformation of the economy by:
transferring resources from less productive activities to more productive ones
1. Diversifying production
2. Upgrading production
3. Increasing labor productivity
“Lego” and Development

- Products
- Capabilities
- Country

Distance between products

- Far away
- Nearby

How products are linked each other?

Ricardo’s Metaphor
Monkeys in a Forest

Can I jump to the distant tree?...No! But, I can jump to the near one.

Product Space

- Firm
- Product 1
- Product 2
- Product 3

Core-Periphery structure, with some ‘clusters’
Where are the monkeys?

Denotes RCA≥1 (Hidalgo et al. 2007)

THA 1965

THA 1975

THA 1985
Do you want to see PRC and India?

You have depended more on services

% Contribution to GDP Growth: 1980-2008

Growing business process outsourcing
A magic trick?
Assessment – Summing up –

- The past growth has been largely led by services
- Lagged growth is rooted in persistent productivity growth deficit due to stagnant industrialization, in particular lack of product diversification
- Limited job opportunities resulted in the slow poverty reduction
- The service-led growth did not require a relatively high investment
- Booming BPOs create jobs, but its impact is limited given the scale of utilized workforce, and its bias toward educated labor
- To join the growth club in the region and translate the growth into inclusive one, the country needs to “walk on two legs” both in industry and modern services

How can we help entrepreneurs jump to new products?

- Growth diagnostics, cross country regressions
- Resolving long-standing issues:
  - Infrastructure
  - Business and investment climate
- Horizontal interventions: Is that all?
- Critical importance of focusing on product-specific constraints
- Public and private dialogue (joint diagnostic exercise)

High electricity price
Is it a real headache for all?

Share of electricity cost in total production cost (including labor cost, depreciation, net tax)

Electronics……..have you fully exploited the opportunities?

Manufacturing

Philippines

Indonesia

Malaysia

Thailand

Viet Nam
Targeted Public Sector Support
- Policymakers’ headaches -

**Headache 1:** Product identification (targeting)

**Headache 2:** Diagnostics of binding constraints for the targeted products

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**Are we “picking winners”?”?**

- *Picking winners* in the old sense of the term is about protecting and subsidizing low productivity

- Many inputs that the government has to provide are sector and/or product-specific – ‘doomed to choose’
  - Not about subsidizing low-productivity, but investing in higher productivity
  - The product space gives additional information to inform that choice

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**How can we “choose”?**

**Key dimensions of product identification**

- **Easiness to jump:** Nearby? Middle? Far Away?
  - Above average sophistication (direct effect)
  - Opportunities for further structural change (spillover effects)
  - Capacity to absorb labor (job creation)
  - Others such as global demand growth

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**If your targets are far away……**

**foreign direct investment**

(\$ billion, cumulative)

- Indonesia: 42
- Malaysia: 51
- Philippines: 18
- Thailand: 71
- Vietnam: 43

1970s, 1980s, 1990s, 2000s

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Public - Private Dialogues

- How to provide highly specific, high dimensional public inputs that are complements in private production?

- Private inputs:
  - Prices: information
  - Profit-motivated firms: incentives
  - Capital markets: move resources

- Public inputs:
  - No price: where to get the information?
  - What are the incentives? Political?
  - Even with incentives, how would resources move?

Private Inputs
Information, Incentives, Resources

Public Inputs
Exchange of Information & Shared Risks

In the absence of coordination, monkeys can only jump to trees that require inputs that are already present.

Thank you

For further information, please contact:
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The findings, interpretations, and views expressed are entirely those of the author, and do not necessarily represent the views of the Asian Development Bank, its executive directors, or the countries they represent.

Capabilities

Producing (& exporting) mango requires:

- a certain type of soil
- mechanized farming equipment
- agribusinesses firms that know the market, etc.,

but also “public goods” such as:

- specific property rights
- port infrastructure
- road system
- cold-storage facilities
- phytosanitary regulations
- market access agreements, etc.
How far unexploited products from your current export basket?

RCA≥

RCA<

Far Away

Nearby

Where do you want to go?

Nearby

Middle

Far away

For example, if you want to choose “sophisticated products”

For example, if you want to choose “sophisticated products”

Where do you want to go?
### High opportunities for further structural change

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<th>&quot;Nearby&quot; Commodities</th>
<th>Leamer Classification</th>
<th>SITC Code</th>
<th>Share to export world growth rate (%)</th>
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