



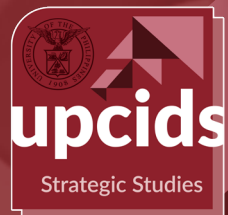
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University of the Philippines
CENTER FOR INTEGRATIVE AND DEVELOPMENT STUDIES

Lower Ground Floor, Ang Bahay ng Alumni, UP Diliman, Quezon City
Telephone: 981-8500 loc. 4266-4267 & 435-9283 / Telefax: 426-0955
E-mail: cids@up.edu.ph / cidspublications@up.edu.ph
Website: cids.up.edu.ph

Steering the Economy Amidst Global Uncertainties and New Developments

GILBERTO M. LLANTO, Ph.D. and MA. KRISTINA P. ORTIZ

ABSTRACT

The Philippine economy has exemplified a remarkable performance despite uncertainties both in the domestic and global markets in the past years. Its growth outlook is expected to remain strong and robust, but significant internal and external risks and challenges lie ahead. Geopolitical tensions (e.g. West Philippines Sea dispute, a pending global trade war, rising protectionism), increasing oil prices followed by rising inflation rates, and the evolving landscape of the labor marketplace (i.e. rise of disruptive technologies) pose serious threats to the country's current growth trajectory. In the near-term, domestic demand will continue to be one of the major contributors to growth and thus main economic policy actions should focus on removing various barriers to investments, upholding competition, reducing regulatory burdens, expanding fiscal space to finance infrastructure and wider social protection coverage, and ensuring more efficient public sector spending. In the face of the threat of a trade war and of protectionist policies in major trading partners, serious efforts to pursue reforms that will hasten structural transformation and modernization of the economy must be executed. Finally, policymakers have to step up and formulate appropriate policy measures to enable the economy to be productively engaged with the new digital economy in the cusp of the Fourth Industrial Revolution.

Keywords: Philippine economy, growth outlook, Fourth Industrial Revolution, global economy, protectionism, trade war

1. Introduction

The Philippine economy is at a very interesting phase of growth and development. It has proven its resilience in the past decades and is forecasted to become a high middle-income economy in the near term given its recent remarkable performance. Recent developments in the global economy and at the local level have created challenges that the Philippine economy has to deal with as it tries to pick up speed in its quest to become a high middle-income economy. Risks and challenges, both domestic and global, abound. The *2017 Global Risks Report* of the World Economic Forum has identified a few of those risks and divided these into what are most likely to occur and what would be the most impactful on the global economy and on individual economies.¹ The top five global risks in terms of likelihood are the following: (1) extreme weather events, (2) large scale involuntary migration, (3) major natural disasters, (4) large scale terrorist attacks, and (5) massive incidents of data fraud and theft. The top five global risks in terms of impact are as follows: (1) weapons of mass destruction, (2) extreme weather events, (3) water crises, (4) major natural disasters, and (5) failure of climate change mitigation and adaptation.

The economy needs thoughtful steering as it deals with such risks and challenges, and it must also learn how to discover and exploit prospects for inclusive growth amidst global uncertainties. It can also capitalize on its proven resilience to internal and external shocks. This is an important point to emphasize because economies with resilient systems are more capable of bearing various environmental, political, economic,

¹ WEF 2017

² OECD 2014

and social risks, stresses, and shocks.² The challenge to Philippine policymakers is how to identify and implement policy interventions, that is, policies, programs, and projects that will strengthen the economy's resilience. These interventions must be in line with a growing global awareness of the adverse impacts of exogenous shocks to economies and of the importance of identifying responses that enable affected economies to recover from shocks and eventually rebuild itself.³

This paper first analyzes some of the immediate challenges faced by the economy and their implications. It then discusses a few policy measures that may be necessary in dealing with those challenges. The paper is organized as follows: after a brief introduction, Section 2 provides a snapshot of the global economy, which provides context to the discussion. Section 3 discusses the status of the economy amidst global uncertainties. Section 4 gives some remarks on prospects for growth and sketches a way forward.

2. Snapshot of the Global Economy

In 2017, the global economy has regained momentum as indicated by improved economic performance in both advanced and emerging market economies. The World Economic Outlook (WEO) report published by the International Monetary Fund (IMF) (2018) describes the recovery as largely supported by an increase in investments and strengthened trade and industrial production. Rising business and consumer confidence are deemed to contribute to the uptick in the global economy. **Figure 1** (on page 6) shows the IMF's projected trend of the growth of the global economy in the immediate future.

³ Llanto 2016

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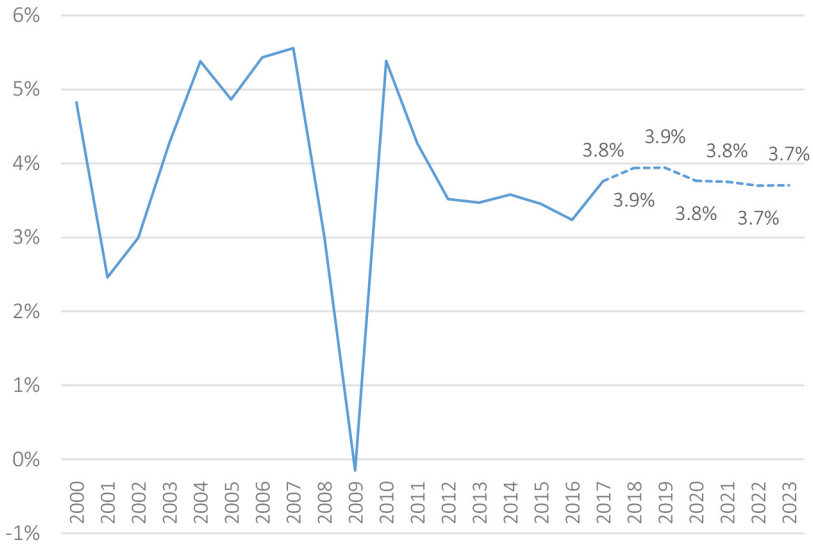


Figure 1. World GDP growth rates, 2000-2017 and 2018-2023 forecasts

Source: IMF World Economic Outlook Database (as of April 2018)

The global economy is expected to expand by 0.1 percent in 2018 and 2019 as forecasted by the IMF. The actual growth in 2017 was 3.8 percent. This forecast is backed by growth in emerging markets and developing economies with growth rising from 4.7 percent in 2017 to 4.9 percent in 2018, and 5.1 percent in 2019. Advanced economies are projected to maintain their growth of 2.4 percent in 2017 and are expected to slow down at 2.2 percent in 2019. The immediate impact of a growth slowdown is a decline in global trade in the coming years, with imports declining after a mild expansion until 2018 (See **Figure 2** on page 7). The hopeful sign of a future source of growth, notwithstanding the slowdown in trade, is the projected rise in investments as a percentage of world gross domestic product (GDP), driven particularly by investments in manufacturing and real estate.

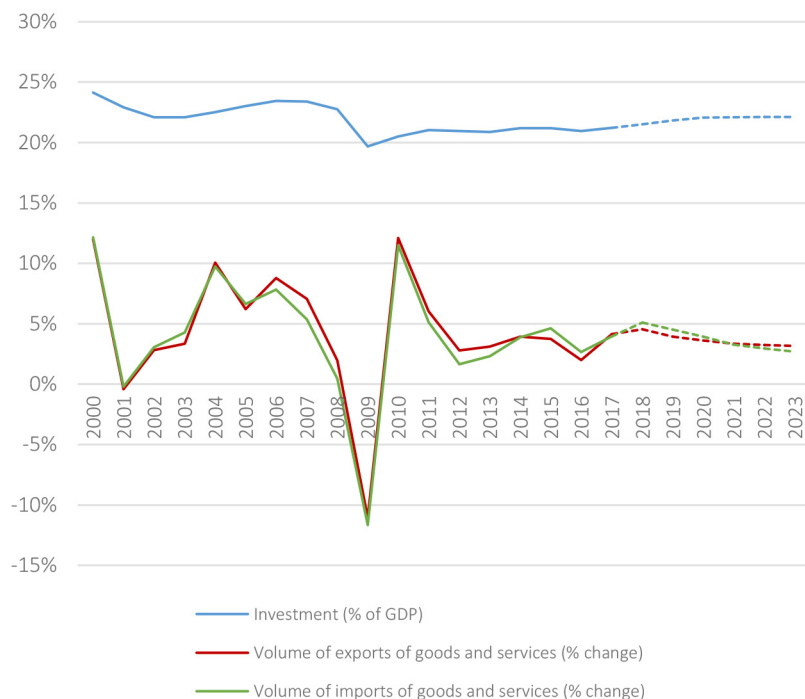


Figure 2. World investment and trade growth rates, 2000-2017 and 2018-2023 forecasts

Source: IMF World Economic Outlook Database (as of April 2018)

Many factors have arisen threatening to undo global recovery, notably rising protectionism, increasing oil prices, and more seriously, the incipient trade war between the United States and China. If not managed well, these challenges will dampen global growth expectations, which, when realized, will result in another slowdown of the global economy, consigning many countries to a prolonged period of very low growth with all its dire implications (e.g. job losses, societal discontent, political upheavals). The July 2018 WEO Update by the IMF indicates that growth among economies has become less synchronized,

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implying divergent performance even among close trading partners and weakening of growth linkages. Meanwhile, rising old-age dependency ratios in developed (e.g., Japan) as well as in developing countries (e.g., China and Thailand) put pressure on fiscal systems, productivity, and employment generation.

Rising protectionism emanating from Trump's policies to protect American jobs and the potentially explosive and damaging trade war with China loom as the biggest damper on global growth. The 2017 *Global Trade Alert Report* has documented the trade measures implemented by G20 countries with harmful trade measures outnumbering liberalizing measures (See **Figure 3** on page 8).⁴

The rise of harmful trade measures—protectionist policies, for instance—is detrimental to global, regional, and individual country growth prospects, especially for economies that have barely rebounded from the disastrous effects of the global financial crisis spawned by failures of sub-prime mortgage market transactions in the United States. Protectionist policies and a damaging trade war will disrupt trade flows and will do very great damage to trade-dependent economies by undoing multinational supply networks that promote global convergence and integration.⁵ Many trade-dependent economies and developing economies that draw economic sustenance from well-functioning global supply chains will be severely impacted by a disastrous trade war. A disruption of trade flows and the supply chains will have profound negative impacts on those economies, with the vulnerable, trade-dependent states being

⁴ Evenett and Fritz 2017

⁵ Draper 2012

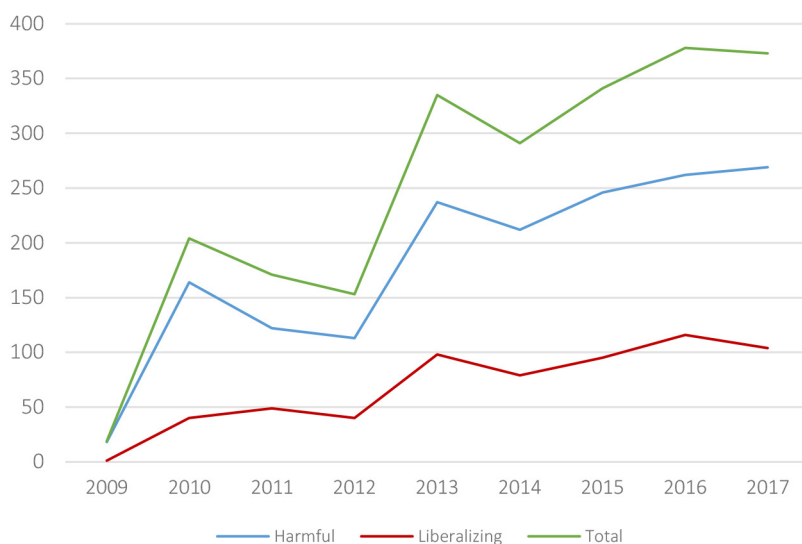


Figure 3. Number of implemented trade measures by G20 countries

Source: 2017 Global Trade Alert Report

more severely affected.⁶ Protectionist policies can interrupt and even damage these value chains, which would consequently impose serious costs on both producers and consumers across economies, especially those that largely depend on trade.⁷ Data from the OECD-WTO Trade in Value Added database shows that the foreign content of exports from the US significantly increased from 11.5% in 2009 to 15% in 2011.⁸ This indicates how closely integrated the US and its trading

⁶ Ibid.

⁷ Llanto 2018

⁸ Trade in value added (TIVA) is a statistical approach that estimates the sources (by country and industry) of the value that is added in the production of goods and services for exports. See Organisation for Economic Co-operation and Development and World Trade Organization (2015).

partners have been, thus measures such as erecting high tariff walls and resorting to harmful trade measures are bound to hurt everyone.⁹

What is the cost of economic protectionism? OECD points out that it holds back economic growth for all countries.¹⁰ On the contrary, there are benefits that countries, especially the trade-dependent ones, stand to lose with protectionist policies by major trading partners. The benefits of full liberalization of trade in goods and services are non-trivial. It would help increase average real incomes of developing countries by 1.3%, and by 0.76% in high-income countries. Newly-emerging economies would gain 3% to 6% of GDP.¹¹

While trade-dependent economies worry about a trade skirmish morphing into a full-scale trade war between the United States and China,¹² recent phenomena, notably the rise of disruptive technologies like artificial intelligence, big data, robotics, among others, that impact traditional output and job structures should be a greater cause of concern on the part of policymakers, private business, and the people as a whole (See **Table 1** on page 11).

The Fourth Industrial Revolution is drastically changing not only the economic landscape but also how society itself will behave as it is affected by these changes. Today, remarkable progress in artificial intelligence, nanotechnology, complex and cutting-edge computing power, and big data analysis are bringing into reality the Internet of Everything (IoE), which

⁹ Llanto 2018

¹⁰ OECD n.d.

¹¹ Ibid.

¹² Stiglitz 2018

Table 1. Twelve potentially economically disruptive technologies

Mobile internet	Increasingly inexpensive and capable mobile computing devices and internet connectivity
Automation of knowledge work	Intelligent software systems that can perform knowledge work tasks involving unstructured commands and subtle judgments
The Internet of Things	Networks of low-cost sensors and actuators for data collection, monitoring, decision making, and process optimization
Cloud technology	Use of computer hardware and software resources delivered over a network or the Internet, often as a service
Advanced robotics	Increasingly capable robots with enhanced senses, dexterity, and intelligence used to automate tasks or augment humans
Autonomous and near-autonomous vehicles	Vehicles that can navigate and operate with reduced or no human intervention
Next-generation genomics	Fast, low-cost gene sequencing, advanced big data analytics, and synthetic biology (“writing” DNA)
Energy storage	Devices or systems that store energy for later use, including batteries
3D printing	Additive manufacturing techniques to create objects by printing layers of material based on digital models
Advanced materials	Materials designed to have superior characteristics (e.g., strength, weight, conductivity) or functionality
Advanced oil and gas exploration and recovery	Exploration and recovery techniques that make extraction of unconventional oil and gas economical
Renewable energy	Generation of electricity from renewable sources with reduced harmful climate impact

is envisaged to supersede the Internet of Things (IoT). The IoT, a term coined by Kevin Ashton back in 1999, refers to physical devices like smartphones and desktop computers that are able to connect and exchange data.¹³ IoT devices such as vehicles, wearables, and appliances have become embedded with

¹³ Karl 2018

sensors, control systems, and processors that enable horizontal communication throughout an open, multi-node network.¹⁴

At a higher plane is the IoE, where rather than physical objects communicating, network intelligence is used to combine people, data, and things together to make networked connections more relevant and valuable.¹⁵ Current narrative in the science, technology, business, and policy communities is how the Fourth Industrial Revolution is giving birth to cyber-physical systems providing new capabilities for people and machines and allowing technology to be embedded within societies and even the human body.¹⁶ On the other hand, digital platforms and digital markets create immense possibilities in developing new and advanced products, but these are consumed mostly by the well-to-do in society, giving another dimension to inequality and social discontent. As an astute observer of IoE has pointed out, while organizing transport, booking restaurants, buying groceries and various services, listening to music, making payments, watching films, and others may be easily done with the appropriate application on a smartphone anytime and anywhere, these may not necessarily contribute to broad-based economic growth because the ultimate question is whether everyone is able to access, afford, and enjoy these innovations.¹⁷ Thus, concurrent advances in the Internet of Things (and by extension, the Internet of Everything), big data analytics, cloud computing, and artificial intelligence (AI) that enable tremendous innovations will fundamentally transform business, government, and society.¹⁸

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Davis 2016

¹⁷ Ibid.

¹⁸ International Telecommunication Union 2017

These new developments are truly disruptive as they profoundly impact production, distribution, and consumption. Developing economies, such as the Philippines, will face greater challenges in developing requisite production and distribution systems that will deliver goods and services anchored on these new technologies and innovations and in creating quality jobs for a growing labor force. A recent estimate shows that 30% to 45% of the global working age population is underutilized—either being unemployed or underemployed.¹⁹ The picture for the Philippines and other developing countries could not be very far. New technologies and innovations create new jobs, but also destroy traditional ones as well. For example, ride-hailing services have disrupted the traditional way of providing transport services to the public. Robotics have invaded new areas of work like clerical and white-collar jobs after demonstrating its usefulness in traditional manufacturing shop floors, for example, automotive manufacturing. A recent study laid caution on the impact of technologies like the Web, artificial intelligence, big data, and improved analytics on labor markets, as these may have helped to automate many routine tasks but these also resulted in the disappearance of traditional jobs in service industries (e.g., post office, customer service).²⁰ The same study puts it simply but elegantly that “automation is reducing the need for people in many jobs,” citing among others the introduction of industrial robots like Rethink Robotics’ Baxter, which is more flexible and far cheaper to produce than previous models, to perform simple jobs for small manufacturers in a variety of sectors.²¹

Figure 4 (on page 14) is a simple representation of the changes taking place in today’s labor marketplace. Ten years ago (2007),

¹⁹ Manyika et al. 2013

²⁰ Rotman 2013

²¹ Ibid.

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Figure 4. Market capitalization and employment in large companies, 2007 and 2015
Source of basic data: Financial Times Global 500 Rankings

the biggest companies in terms of market capitalization are resource-based firms (e.g., ExxonMobil, PetroChina), energy companies (e.g., General Electric), or financial firms (e.g., Bank of China, Hongkong and Shanghai Banking Corporation). In 2015 and more recently in 2017, these types of companies have been replaced by technology firms, service companies in information and technology businesses, such as Apple, Microsoft, Google, Alibaba, Tencent, Baidu, Infosys, and many others.

With changes in these sectors taking place at a breathtaking pace comes a drastic change in the labor markets: demand for jobs in these technology firms will become fewer as they rely more and more on artificial intelligence, more sophisticated algorithms, and robotics for their day-to-day operations. A report by McKinsey Global Institute estimates the likely impact of technical automation: around 50% of current work activities are technically automatable by adapting currently demonstrated

technologies while six of ten current occupations have more than 30% of activities that are technically automatable.²²

To balance, while traditional jobs are being destroyed by new processes, new technologies, and innovation, new jobs are also created. What has happened in the automotive sector is an example of new job creation after modern technologies were introduced. Keith Block, Vice-Chairman and President of Salesforce, pointed out that the introduction of diesel, the internal combustion engine, and electricity disrupted the workplace as workers moved from farms to cities, yet these innovations led to the production of Ford's Model T, refrigeration, mechanized agriculture, and an age of mass production that produced a new global middle class.²³ These new products and services created demand for new types of workers and professionals that are far different and far advanced in skills, education, and orientation than farm workers in an agrarian economy. Block admits that many jobs in manufacturing, transport, retail, healthcare, and administration may be destroyed by increased automation, but on the other hand, he points out that the new technologies will create new jobs such as those found in crowdsourcing, autonomous vehicles, and the sharing economy.²⁴ He cites a report of McKinsey Global Institute that one-third of jobs that were created in the United States over the past twenty-five years such as in information technology (IT) development and systems management, did not exist, or barely existed, a quarter of a century ago. This is how dynamic the job market has been in responding to changes in technology and innovation, but the point is whether an economy is nimble and fast enough to deal with adjustments in the product and labor markets.

²² McKinsey Global Institute 2017

²³ Block 2018

²⁴ Ibid.

The challenge facing developed and developing countries is how to harness the new technologies and innovations in creating more labor-intensive productive sectors to meet the desired job creation goals of the economy. Despite their advanced stage of development, developed countries have not been spared from the problem of adjustments, re-skilling, re-educating, and re-tooling their work force. On the other hand, developing countries which are not as well-endowed and developed certainly face more daunting tasks. The new digital economy brings forth many new opportunities for employment creation, but how can developing countries take advantage of this new phenomenon? This is indeed a big challenge for developing countries which are yet to develop capacities to engage the new digital economy. The International Telecommunications Union (ITU) showed in its 2017 *Measuring the Information Society Report* that the Philippines was ranked 101st among 176 countries in the Information and Communication Technologies (ICT) Development Index or IDI in 2017. This was lower than its rank of 100 in 2016. The IDI is a composite index that combines eleven indicators of ICT readiness, access, use, and skills, capturing key aspects of ICT development in one measure that allows for comparisons between countries and over time.²⁵ In contrast, in the same 2017 ITU Report, Malaysia had an IDI rank of 63, while Thailand was 78, Viet Nam was 108, Indonesia was 111, and Cambodia was 128. To cope with the digital age, the Philippines needs to address readiness, access, use, and skills in ICT development in order to engage more productively in the digital economy.

Meanwhile, the January 2018 Speedtest Global Index report placed the Philippines 94th out of 125 countries in terms of internet speed, which was four spots lower than its ranking in the previous month. The current average speed of the country in

²⁵ International Telecommunication Union 2017

megabits per second (Mbps) is at 12.55 Mbps, which is below the global average of 22.23 Mbps. For fixed broadband, the Philippines ranked 87th out of 128 countries, a spot higher than the previous month's. The current fixed broadband download speed in the country is at 15.67 Mbps, again below the global average of 41.88 Mbps.²⁶

In this vein, there has been a call for a redirection of investments into labor-intensive productive sectors and retraining (some call it reskilling) in the face of a changing labor marketplace that is impacted by new technologies and innovations that destroy traditional jobs, while creating new types of jobs in a technological society.²⁷ This should include more investments in cross-cutting public goods such as health and nutrition, education (with emphasis on lifelong learning), and infrastructure in order to increase overall economic capacity and productivity. This is no longer about developing resilience in the face of exogenous shocks, but investing deeply in improving productive capacity and productivity of workers. This is a big challenge laid at the doors of policymakers, educators, firms (that need reskilled workers), and even households. Using data from the World Economic Forum (WEF), a recent paper pointed out that approximately 35% of the skills demanded for jobs across industries will change by 2020.²⁸ The same paper avers that “most children entering primary school today will work in occupations that don’t even exist yet.”²⁹

²⁶ Ookla, LLC 2018

²⁷ Wharton 2017

²⁸ Block 2018

²⁹ Ibid.

3. The Philippine Economy amidst Global Uncertainties

In the face of these challenges to the global economy, the Philippines' economic growth outlook appears to be strong and robust. Average gross domestic product (GDP) growth across the years indicates the country's strong economic performance vis-à-vis other countries, some of which are more developed than the Philippine economy (*See Table 2* below). The economy has become more resilient as it continues to undergo structural transformation and this has enabled it to absorb the impact of natural disasters such as flooding and earthquakes. Growth forecasts remain positive and bullish despite recent inflationary pressures and volatility in oil prices experienced by the Philippine economy.

Table 2. Comparative GDP growth rates (in %), 2012–2019

	2012	2013	2014	2015	2016	2017	Ave. (2001- 2005)	Ave. (2006- 2010)	Ave. (2011- 2015)	2018	2019
China	7.9	7.8	7.3	6.9	6.7	6.9	9.8	11.3	7.9	6.6	6.4
Japan	1.5	2.0	0.4	1.4	0.9	1.7	1.2	0.2	1.0	1.2	0.9
S. Korea	2.3	2.9	3.3	2.8	2.9	3.1	4.7	4.1	3.0	3.0	2.9
Brunei	0.9	-2.1	-2.3	-0.6	-2.5	1.3	2.1	0.7	-0.1	1.0	8.0
Cambodia	7.3	7.4	7.1	7.0	7.0	6.8	9.2	6.7	7.2	6.9	6.8
Indonesia	6.0	5.6	5.0	4.9	5.0	5.1	4.7	5.7	5.5	5.3	5.5
Lao PDR	8.0	8.0	7.6	7.3	7.0	6.9	6.2	8.0	7.8	6.8	7.0
Malaysia	5.5	4.7	6.0	5.0	4.2	5.9	4.8	4.5	5.3	5.3	5.0
Myanmar	7.3	8.4	8.0	7.0	5.9	6.4	12.9	11.1	7.3	6.9	7.0
Philippines	6.7	7.1	6.1	6.1	6.9	6.7	4.6	5.0	5.9	6.7	6.8
Singapore	4.1	5.1	3.9	2.2	2.4	3.6	4.9	6.9	4.3	2.9	2.7
Thailand	7.2	2.7	1.0	3.0	3.3	3.9	5.5	3.8	3.0	3.9	3.8
Viet Nam	5.2	5.4	6.0	6.7	6.2	6.8	6.9	6.3	5.9	6.6	6.5

Source: IMF World Economic Outlook Database (as of July 2018)

During the first quarter of 2018, the economy grew by 6.8 percent, which is faster than that of the previous year's. Manufacturing, other services, and trade drove this growth. Industry grew the fastest among the three major economic industries at 7.9 percent, which is also faster than the previous year's Q1 growth at 6.7 percent. Services also grew by 7 percent from 6.5 percent in the first quarter of 2017. However, in the case of agriculture, a 1.5 percent growth was recorded, which is way lower than its growth during the same period last year at 4.9 percent.³⁰ Figure 5 presents the value-added of the sectors to GDP.

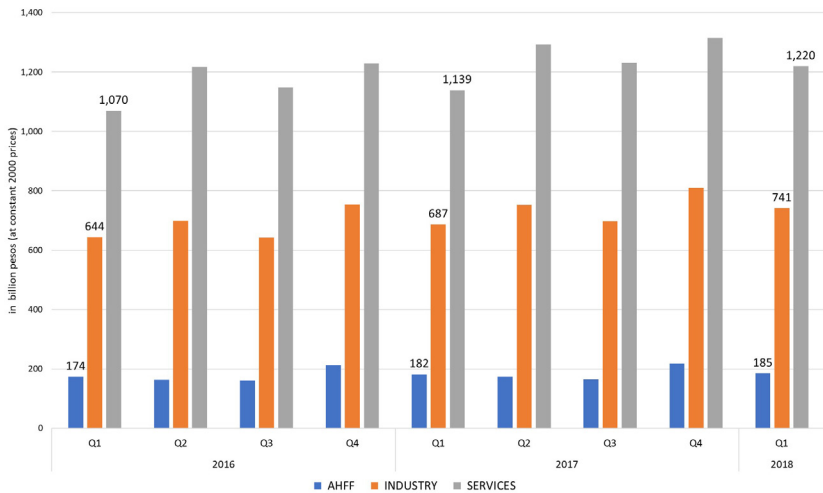


Figure 5. Value added of sectors of the Philippine economy, 2016–2018

Source of basic data: Philippine Statistics Authority

Structural transformation of the economy continues with services still having the biggest share of output and employment. Although agriculture is shrinking in terms of output contribution

³⁰ Philippine Statistics Authority 2018

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to the economy, it still holds a large share of employment. Industry contributes a third of total output and only one-tenth of employment (See **Figure 6** below). Industry is expanding albeit slowly from its lowest share of 31% of GDP in 2009 to 34% of GDP in 2017. This is an important development because of the output and job creation potential of the manufacturing and industry sectors. High value-added activities in these sectors also create quality jobs that go well with the inclusive growth objective.

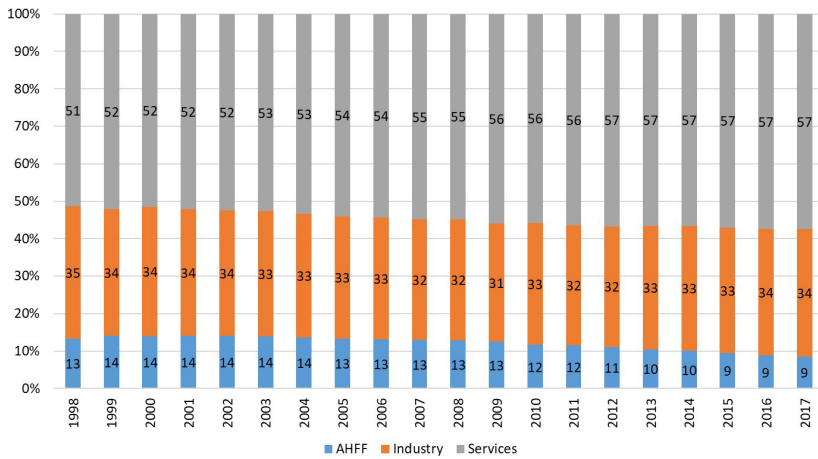


Figure 6. Percentage share of GDP by industry, 1998–2017

Source of basic data: Philippine Statistics Authority

A summary picture of the economic performance of the economy and sectoral growth is shown in **Figure 7** (on page 21). The reforms of the past years have contributed to this remarkable growth record. It looks robust but the critical question is can the growth trajectory be sustained in view of external and internal risks and challenges?

Another way of understanding the economic growth record is to look at it from the expenditure side, in order to see what

has been driving growth. **Figure 8** below shows that private consumption has been the main growth driver during all

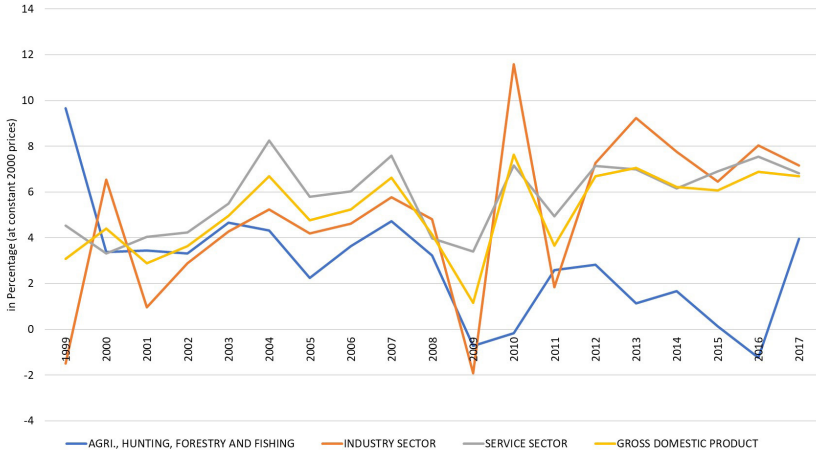


Figure 7. Overall GDP and sectoral growth rates, 1999–2017
 Source of basic data: Philippine Statistics Authority

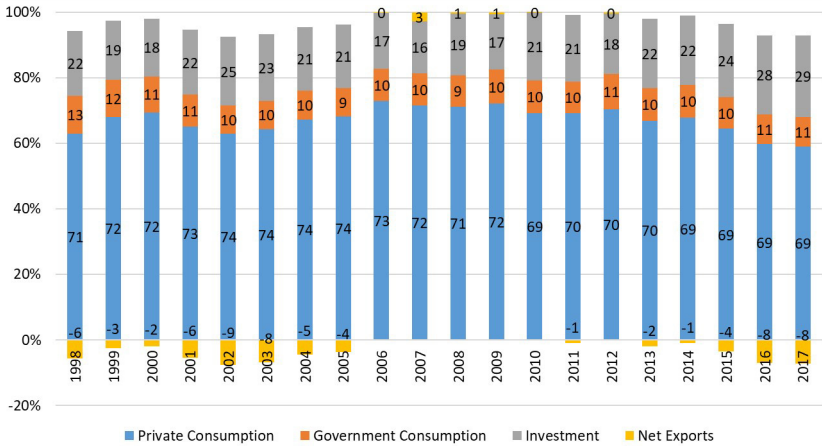


Figure 8. GDP share by type of expenditure, 1998–2017
 Source of basic data: Philippine Statistics Authority

these years. It is stable, although slightly declining. An important development is the rise in investments in the last few years because this will provide greater output capacity in the future. Based on these figures, it seems that trade is not the economy's strong suit, as net exports continue to decline. It also appears that growth depends on domestic demand coming from a rising middle-income class and a young population.

There is an improvement in terms of the poverty situation, as shown in the declining rate of poverty incidence across the years, but the reduction in poverty is extremely slow (See **Figure 9** below). This indicates the need for more effective policies and innovative interventions designed to more rapidly bring down poverty. This is not a far-fetched or unrealizable goal because neighboring countries such as Viet Nam, Thailand, and Malaysia have been more successful in poverty reduction than the Philippines through more effective policies and

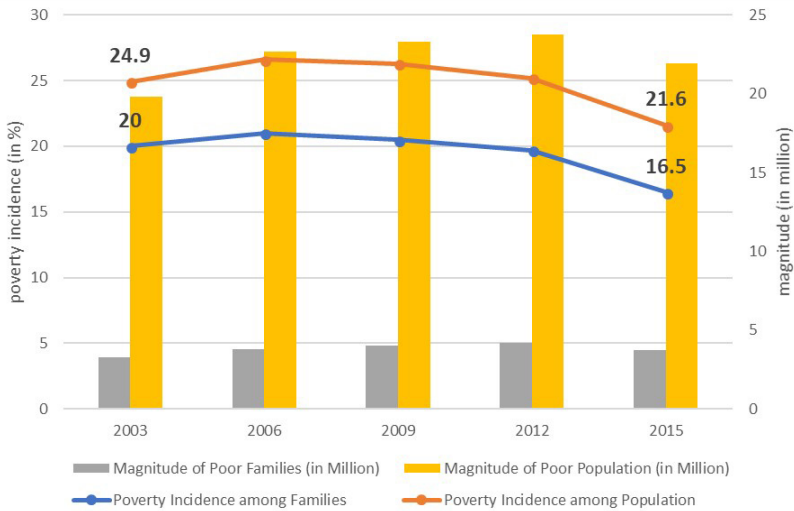


Figure 9. Poverty incidence, 2002–2015
Source of basic data: Philippine Statistics Authority

interventions. What is noticeable in the poverty reduction experience of these countries is their embrace of market-enhancing policies and openness to foreign investments that have been their source of technology, innovation, job creation, and greater access to foreign markets. On the other hand, the Philippines has long adopted protectionist policies which have shielded inefficient domestic producers and vested interests from market competition. The Philippines has belatedly turned to competition policy through the enactment into law of the Philippine Competition Act, efforts to reduce regulatory burden through the Ease of Doing Business Act and the Anti-Red Tape Act, among others, and a less restrictive policy stance toward foreign investments in a bid to have competitive markets.

Preliminary data in 2017 show that the Philippines' unemployment rate has slightly increased to 5.7% in 2017 from 5.5% in 2016 (See **Figure 10** on page 24). Underemployment rate showed a significant improvement from 18.3 percent in 2016 to 16.1 percent in 2017. Since 2012, there seems to be a declining underemployment rate, and this is a positive sign that the labor markets can provide more quality jobs. This is a far better situation than the unemployment and underemployment rates five years or even ten years ago. The challenge faced by policymakers is how to prompt the economy to create more quality jobs.

Looking at other significant indicators of the economy's performance, the country's macroeconomic fundamentals look sound (See **Figure 11** on page 24). There is fiscal space as a result of tax and other reforms in the past decade, even as the government tries to have more efficient budget allocation and spending. As shown earlier, since 2009, the Philippine economy has sustained a remarkable growth record. The government has maintained a sound fiscal balance along a sustainable debt path. On monetary policy, the Bangko Sentral ng Pilipinas (BSP) has

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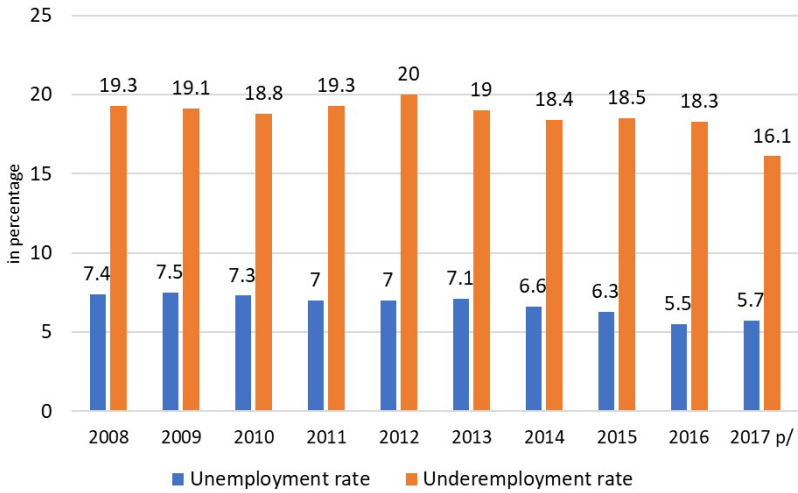


Figure 10. Unemployment and underemployment rates, 2008–2017

Source of basic data: Philippine Statistics Authority

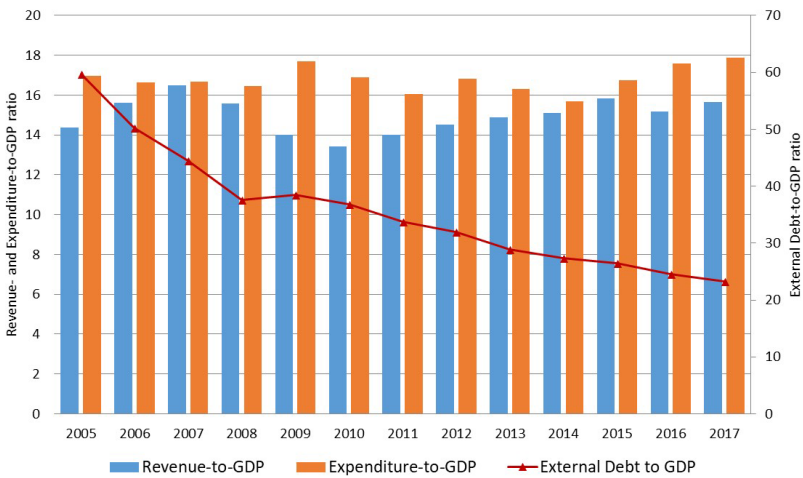


Figure 11. Fiscal indicators, 2005–2017

Source of basic data: Philippine Statistics Authority

managed inflation well, which was approaching double-digit levels in 2010, but since then has remained under five percent (which is the official target). However, the recent uptick in the inflation rate brought about by external events (e.g., rising oil prices) and internal factors (e.g., supply-side constraints in the food sector) has impressed on policymakers the need for a more nuanced approach to maintaining price stability.

4. Prospects for Growth and Policy Decisions

The Philippine economy has rendered a remarkable performance amidst global uncertainties and risks, indicating an inherent resiliency and great potential to graduate into high middle-income status. Basic macroeconomic indicators appear sound but policymakers have to find an astute way of managing current upward inflationary pressure. The Philippines has a relatively substantial trade sector, but given the problems faced by major trading partners, which have knock-on effects on participants in the global trading and supply chain networks, near-term growth cannot solely depend on the trade sector. The main growth driver in the near-term will continue to be domestic demand, and the main policy actions should focus on removing various barriers to investments, upholding competition policy, reducing regulatory burden, expanding fiscal space to finance infrastructure and wider social protection coverage, and ensuring more efficient public sector spending.

Because near-term growth hinges on robust domestic demand, it is useful to check on the sentiments of the business sector and consumers regarding the economy at the onset. In the immediate past, economic growth has been driven by significant consumption but recently, the rise in investments augurs well for the economy. This will result in improvements in future capacity and total factor productivity that are necessary to sustain

economic growth. Business sentiments may be gauged from the Business Expectations Survey (BES)³¹ done by the Bangko Sentral ng Pilipinas, which provides some sort of advance information on changes in overall business sentiments, as well as company operations and selected economic indicators. Data from the BES seem to indicate a generally positive and optimistic outlook, and this is a good sign for entrepreneurs and investors (See **Figure 12** below).

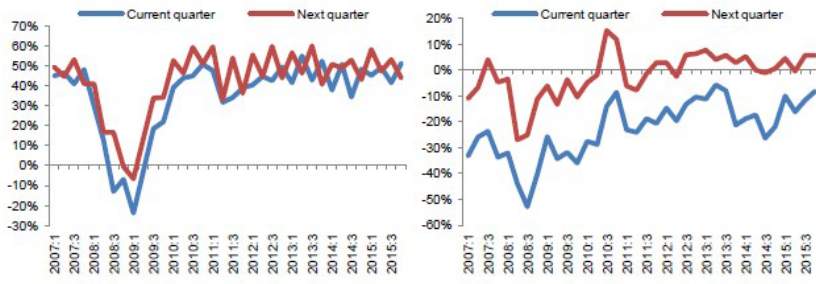


Figure 12. Business confidence and consumer outlook, 2007–2015

Source: Bangko Sentral ng Pilipinas

The BSP reported that the business confidence remains steady for the second quarter of 2018. According to the BSP:

“Specifically, respondents with steady outlook noted that sustained demand and ongoing market adjustments as a result of the recently enacted Tax Reform for

³¹ The Business Expectations Survey (BES) is a quarterly survey of firms drawn at random from the combined list of the Securities and Exchange Commission’s Top 7,000 Corporations in 2010 and Business World’s Top 1,000 Corporations in 2016. Results of the BES provide advance indication of the direction of the change in overall business activity in the economy and in the various measures of companies’ operations as well as in selected economic indicators.

Acceleration and Inclusion (TRAIN) Law were to be expected for the current quarter. Outlook remained optimistic due to the (a) usual higher demand during summer (given the expected arrival of local and foreign tourists), enrolment and harvest periods, (b) increase in orders and volume of production, (c) ongoing rollout of government infrastructure projects with the “Build, Build, Build” strategy of the administration, (d) positive view on the TRAIN Law as its revenue is expected to support infrastructure projects of the government, which may attract new investments, (e) expansion of businesses and new product lines, and (f) sound macroeconomic conditions. However, there was a slight dent on optimism caused by expectations of higher consumer prices, partly due to oil price hikes, and peso depreciation.”³²

Policymakers also have to deal more decisively with poverty reduction because it has seemed impervious to many attempts at eliminating it. Policymakers have to admit that their policy measures and interventions have failed and have not worked as effectively as those pursued by their counterparts in neighboring countries (e.g., China, Malaysia, Thailand, Viet Nam, Indonesia, and even Cambodia). Philippine poverty-oriented policies and interventions have hardly made a dent in poverty reduction. Policymakers in those countries seem to understand better the problem of poverty and thus, they were able to develop more appropriate and effective poverty reduction policies and instruments (See **Table 3** on page 28). It is a shame that Philippine policymakers have continued to falter in addressing this most critical problem of society and it is unfortunate that there is no serious program solve the poverty problem. Eating their humble pie, they must study how these countries were able

³² Bangko Sentral ng Pilipinas 2018

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Table 3. Proportion of population below the international poverty line

Country	2000	2015
China	32 (2002)	1.9 (2013)
Malaysia	0.4 (2004)	0.3 (2009)
Thailand	2.6	0.0 (2013)
Indonesia	39.8	8.3 (2014)
Viet Nam	38.8 (2002)	3.1 (2014)
Cambodia	18.6 (2004)	2.2 (2012)
Philippines	18.4	13.1 (2012)

Source: Asian Development Bank. 2017. *Key Indicators for Asia and the Pacific (Table 2.1)*. <https://www.adb.org/sites/default/files/publication/357006/ki2017.pdf>

to achieve significant poverty reduction so quickly in contemporaneous times.

The National Economic and Development Authority (NEDA) has an upbeat assessment of where growth will come from in the near-term. The NEDA is bullish on the prospects for growth of the economy. For the demand side, the Philippine economy can rely on (a) household consumption, (b) government spending, (c) investment, and (d) exports to contribute to growth. The NEDA cites as positive factors the following: tax reform, competition policy, lifting of quantitative restrictions on rice imports, the expansion of social protection programs (such as the conditional cash transfer), public construction (the so-called “Build, Build, Build” Program), reduction in cost of doing business, proposed relaxation in foreign investment restrictions, closer ASEAN economic integration, improving bilateral relations with China, and good prospects for the tourism and the business process management industries.³³ As for the supply side, the following

³³ National Economic and Development Authority (NEDA) Secretary Ernesto M. Pernia’s presentation during the 2018 budget hearing at the House of Representatives, unpublished.

factors were mentioned: (a) construction and infrastructure development, (b) manufacturing resurgence, (c) business process management (BPM), (d) international and domestic tourism, and (e) wholesale and retail trade.

The government has also formulated a Comprehensive National Industry Strategy Framework and an Inclusive Innovation Industrial Strategy (i3s) under the auspices of the Department of Trade and Industry, whose overall objective is to build globally-competitive industries with strong domestic and global linkages. The government has identified twelve priority industries, namely: electrical and electronics; aerospace parts; automotive and auto parts; chemicals; shipbuilding; construction; IT-BPM and e-commerce; tool and die; iron and steel; furniture, garments, and creative activities, e.g., entertainment; tourism; transport and logistics; and agribusiness. **Figure 13** below shows a listing of the top industrial priorities, the challenges faced by industries, and the various initiatives to be undertaken

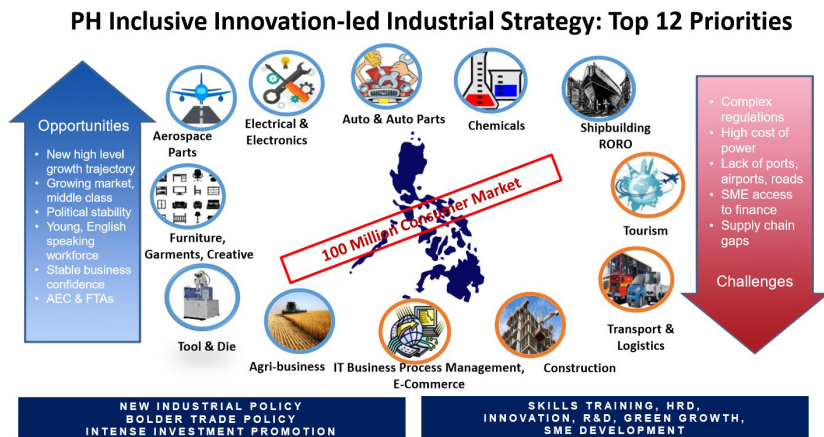


Figure 13. Priority industries of the Philippine Inclusive Innovation Industrial Strategy
Source: Department of Trade and Industry

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by government—such as skills training, human resource development, and intense investment promotion, among others—to support the country’s new industrial strategy. The new industrial strategy will be anchored on competition, innovation, and strategic infrastructure development.

The government seems to be saying the right things that people want to hear and believe. It has announced and is trying to implement a number of big ticket items: building infrastructure, providing more social protection, investing in education, expanding the coverage of health insurance, pursuing a nuanced industrial strategy, among others. But in an era of rapid changes and global uncertainties brought about by new technologies, innovations, contrarian protectionist policies, and threat of a trade war—not to mention continuing geopolitical tensions in many parts of the globe, such as in the West Philippine Sea—policymakers should think hard and assess whether the policies and interventions that they are implementing will be able to deal with the disruptions brought about by new technologies and innovations. In the face of the threat of a trade war and protectionist policies in major trading partners, policymakers should continue with serious efforts to pursue reforms that will hasten structural transformation and modernization of the economy. Part of the reform effort will consist of formulating and implementing unpopular policies such as reforming the tax system and reviewing the rationale and system for the grant of fiscal incentives. Policymakers should just stay the course and look at the big picture of an economy facing huge challenges in the global arena that would need market enhancing policies, openness to the inflow of outside resources, and appropriate public sector interventions.

Manufacturing seems to be on an upsurge after decades of dismal performance after it was hollowed out during the trade liberalization efforts in 80s and 90s. Again, the government seems

to be saying the right things. The Manufacturing Resurgence Program (MRP) presented by the Department of Trade and Industry (DTI) has the enhancement of the competitiveness of domestic manufacturing industries as key strategy for integration into higher value-added, ASEAN-based production networks and global value chains. However, several constraints conspire to prevent this integration from happening. These are indicated in **Table 4** below.

Table 4. Critical constraints to be addressed in the MRP

Area	Major Constraints
Regulation	<ul style="list-style-type: none"> • Complex/costly business procedures • Need for policy consistency, transparency, predictability • 60-40% equity rule that restrict foreign investments
Infrastructure	<ul style="list-style-type: none"> • High cost of power, inefficient transport and logistics • Lack of ports, airports, road infrastructure, and poor connectivity
Finance and related matters	<ul style="list-style-type: none"> • Lack of access to finance, technology, support for start-ups, product standards, network links
Human capital	<ul style="list-style-type: none"> • Lack of skilled workers, problems with standards and certifications, poor quality of education
Innovation	<ul style="list-style-type: none"> • Poor industry-academe linkage, absence of research and development (R&D) facilities
Supply/value chain	<ul style="list-style-type: none"> • Weak linkages among manufacturing, agriculture, and services • High cost of transport
Cross-cutting issues	<ul style="list-style-type: none"> • Non-availability of raw materials, high cost of power, lack of modern technology

Source: Aldaba 2014, modified by the authors

The following are critical actions that government should undertake to address the major constraints outlined in Table 4: (a) address the supply/value chain gaps, (b) expand the domestic market base, (c) invest in human capital skills trainings, (d) use innovation and technology to power up firms, and (e) address

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cross-cutting issues such as power, regulation, transport and logistics, and doing business procedures.

Overall, business and consumer sentiments seem to look forward to higher growth in the near-term, and at the same time, the NEDA, BSP, and DTI agree on the different factors and areas where growth will come from and the development constraints that should be addressed. It is important to note that the services sector, which currently accounts for 57.4% of GDP, remain as a major growth contributor. The services sector has to be fully exploited in view of the economy's comparative advantage in this sector. The Philippines has been recognized as a source of high-quality human resources in areas such as accounting, tax consultancy, bookkeeping, auditing, business and management consultancy, engineering services, and computer and information services. The bulk of services are exported (e.g., IT-business process outsourcing (BPO) services), but boosting services through investments in technology and innovation and cross-cutting public goods and strengthening linkages with the domestic sectors such as manufacturing can spur more inclusive growth. Policymakers have to formulate appropriate policy measures to enable the economy to be productively engaged with the new digital economy in the cusp of the so-called Fourth Industrial Revolution.

It is heartening to note about positive developments in the economy in this respect. We can cite an example. In response to expanding the reach of technical and vocational training and education, the Technical Education and Skills Development Authority (TESDA) launched in 2012 the TESDA Online Program (TOP), the first Philippine institution to offer massive open online courses. The TOP utilizes an open education resource framework and uses ICT to make technical education accessible and inclusive. As of February of 2018, TESDA offers 59 online courses across different sectors—from agriculture, electronics,

and entrepreneurship to maritime, tourism, and ICT learning. Current data from TESDA recorded that as of December 2017, about 1,114,445 Filipinos registered for the program and 791,617 or 72.7% of them enrolled in any of the courses offered since 2012.³⁴ However, these online programs, which were developed by TESDA in coordination with private sector providers, are constrained by inadequate ICT infrastructure. It has been reported that enrollees usually complain about the slow speed of the internet, costly access to data and other materials provided online, unstable data connection, and at certain times, the lack of internet access.³⁵ Here is another instance of what seems to be a working approach toward inclusive growth only to be stymied by inadequate and uncompetitive internet service. Policymakers and regulators have to make internet services and mobile telephony more competitive. Other ASEAN countries have been much more successful in providing competitive mobile telephone and internet services to their respective populations than the Philippines, which is aspiring to be a high middle-income country in the near-term. The DTI has provided a to-do list that nobody could quarrel with and these constraints should have been addressed a very long time ago. What is needed now is a resolute demonstration of political will to act on this to-do list. It will be a supreme irony to be at the level of aspirations rather than action because policymakers are much more concerned with the politics of the reforms and do nothing to seize every opportunity to address critical development constraints.

³⁴ Cabautan et al. 2018

³⁵ Ibid.

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About the Authors

GILBERTO M. LLANTO, Ph.D. is a member of the Board of Trustees and the immediate past president of the Philippine Institute for Development Studies (PIDS). He is Associate Editor of the *Philippine Review of Economics*; Co-Chairman of the Editorial Board of the *Philippine Journal of Development*; Member of the Advisory Council, Microfinance Council of the Philippines, Inc. (MCPI); Member of the Governing Board of the Agricultural Guarantee Fund Pool; and Member of the Board of the National Research Council of the Philippines. He was formerly President of the Philippine Economics Society.

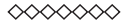
He has Ph.D. and M.A. degrees in Economics from the School of Economics of the University of the Philippines. His research interests include public economics, growth economics, financial inclusion, microfinance, regional integration, and infrastructure regulation. His most recent publications are *Unintended Consequences: The Folly of Uncritical Thinking* (Philippine Institute for Development Studies, 2017; co-edited); *Logistics Service Liberalization in the Philippines” in Services Liberalization in ASEAN: Foreign Direct Investment in Logistics* (ISEAS-Yusof Ishak Institute, 2018); and *Philippine Infrastructure and Connectivity: Challenges and Reform* (*Asian Economic Policy Review* 11, no. 2, July 2016).

MA. KRISTINA P. ORTIZ is a Senior Research Specialist at the Philippine Institute for Development Studies (PIDS). She holds a bachelor’s degree in Economics (minor in Public Administration) from the University of the Philippines School of Economics and is a Master of Statistics candidate at the UP School of Statistics. She works on different research areas such as regulation analysis (e.g. regulatory impact analysis, reducing unnecessary regulatory burdens), logistics and infrastructure, and ASEAN integration. Currently, she is involved in education policy research, including the K-to-12 program and the free tuition policy.

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