Why Has the Philippines’ Growth Performance Improved? From Disappointment to Promising Success

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The study has been jointly conducted with Gemma Estrada, ADB and Matteo Lanzafame, Università degli Studi di Messina. The views expressed here are those of the authors and not necessarily those of the Asian Development Bank, its Executive Directors, or the Bank’s member countries.
Philippines: over 70 quarters of positive growth and the pace has picked up in recent years: Why?
Our conjecture about the Philippines

• The country’s potential growth rate is increasing and actual growth is adjusting to it

• If we are right, this is good news for the country
Overview of the presentation

A. Potential Growth: concept, estimation and results

B. Analysis of Labor Productivity: standard decomposition and regression

C. Conclusions
A. Potential Growth: concept and estimation
What is potential growth?

• Maximum sustainable growth rate that technical conditions allow
• It is the rate to which the economy will gravitate in the long-run (deviations in the short run)
  • Actual > Potential: Lower unemployment & Inflationary pressures
  • Actual < Potential: Increasing unemployment & Wages down…

• Long-run: faster potential growth leads to faster actual growth

• How fast can an economy grow in the long-run? **Harrod’s Natural Growth Rate** ($\overline{NGR}$) = Labor force growth ($\overline{LF}$) + Labor productivity growth ($\overline{YP}$) (Technical Progress)
Potential Growth estimated through the Kalman filter
(time-varying model)

- Potential growth steadily rising.
- Actual > Potential in 40 out of 61 years (average gap 1.1 ppt).
- Actual < Potential in 21 years (average gap -2.1 ppt).
- When Actual > Potential, potential growth is significantly higher than when Actual < Potential.
- From 2012 onwards, the economy has been above or within potential growth (record-high 6.3% in 2017).
Labor productivity growth = Natural growth rate - Labor force growth

- Labor force trend growth began declining in 1981.
- Implied productivity growth gradually rising since the mid-1980s.
- Implied productivity growth exceeds labor force trend growth since 2003.
- Much of the increase in potential growth lately is due to productivity growth as trend labor force growth has started declining.
B. Analysis of Labor Productivity

- Standard decomposition into *within* and *relocation* effects
- Regression of the determinants of potential labor productivity growth.
Labor Productivity and Employment

- Most productive sector (EGW) is the one with the lowest employment share; while the least productive sector (Agri) is the one with the highest employment share.
- Within services, Financial, Real Estate and Business Activities is the most productive but has a small employment share.
- Manufacturing labor productivity is rising while its employment share is declining.
But number of workers in manufacturing is up (Philippines)
Employment is shifting toward “low-productivity” services (non-tradable)

Agriculture (25%) plus non-tradable services (45%) = 70% of all Filipino workers

Across the world: Employment is driven by domestic demand rather than by export-oriented activities
What Sectors Contribute the Most to Overall Productivity Level?

![Sectoral Contributions to Productivity (%)](image)

- Agriculture
- Mining & quarrying
- Manufacturing
- Construction
- Electricity, gas & water
- Wholesale & retail trade
- Transport, storage & com.
- Financial, real estate, & bus. activities
- Other services
• 1989 to 1999: within effect was negative and lower than reallocation effect.
• Other subperiods: within effect was positive and accounted for around 70% of productivity growth.

• 1989-1999: large and positive reallocation effect was due to increased employment in financial, real estate, & business activities; wholesale & retail trade; and transport, storage, and communication.
• Next subperiods: reallocation effect was smaller and also driven by service subsectors.
• Falling employment share in manufacturing reduced reallocation effects (except in 2009-2017).
## Determinants of “Potential” Labor Productivity Growth

<table>
<thead>
<tr>
<th></th>
<th>1990-2016</th>
<th>1990-2010</th>
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<tbody>
<tr>
<td><strong>Change in employment shares:</strong></td>
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<td></td>
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<tr>
<td>Agriculture</td>
<td>0.054</td>
<td></td>
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<tr>
<td></td>
<td>(0.331)</td>
<td></td>
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<tr>
<td>Manufacturing</td>
<td></td>
<td>-0.148</td>
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<tr>
<td></td>
<td></td>
<td>(-0.337)</td>
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<tr>
<td>Services</td>
<td>-0.016</td>
<td>-0.106</td>
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<tr>
<td></td>
<td>(-0.010)</td>
<td></td>
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<tr>
<td>FDI to GDP</td>
<td>0.196</td>
<td>0.166</td>
</tr>
<tr>
<td></td>
<td>(1.276)</td>
<td>(1.161)</td>
</tr>
<tr>
<td>External trade to GDP</td>
<td>0.251**</td>
<td>0.243**</td>
</tr>
<tr>
<td></td>
<td>(2.490)</td>
<td>(2.229)</td>
</tr>
<tr>
<td>External trade to GDP, squared</td>
<td>-0.001**</td>
<td>-0.001*</td>
</tr>
<tr>
<td></td>
<td>(-2.382)</td>
<td>(-2.016)</td>
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<tr>
<td>Manufacturing exports</td>
<td>0.029***</td>
<td>0.028***</td>
</tr>
<tr>
<td></td>
<td>(3.464)</td>
<td>(3.250)</td>
</tr>
<tr>
<td>Economic complexity</td>
<td>1.387***</td>
<td>1.388***</td>
</tr>
<tr>
<td>index (standardized)</td>
<td>(8.289)</td>
<td>(7.637)</td>
</tr>
<tr>
<td>Gross fixed capital growth rate</td>
<td>0.031**</td>
<td>0.030**</td>
</tr>
<tr>
<td></td>
<td>(2.282)</td>
<td>(2.314)</td>
</tr>
<tr>
<td>Gross secondary enrollment rate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Hard infrastructure</td>
<td>0.133***</td>
<td>0.264***</td>
</tr>
<tr>
<td>(standardized)</td>
<td>(7.703)</td>
<td>(4.121)</td>
</tr>
<tr>
<td>Constant</td>
<td>-10.914**</td>
<td>-10.549**</td>
</tr>
<tr>
<td></td>
<td>(-2.638)</td>
<td>(-2.442)</td>
</tr>
<tr>
<td>Observations</td>
<td>27</td>
<td>27</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.910</td>
<td>0.910</td>
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**Note:** *** p<0.01, ** p<0.05, * p<0.1.
C. Conclusions
The Philippines is enjoying a ‘growth momentum’: it has never been this good

• Growth in the Philippines has picked up. We show that actual is adjusting to an increasing potential growth rate: over 1 ppt increase in potential during 2010-17 (5.9%) with respect to 2000-09 (4.7%)

• In 2017, potential growth reached 6.3%: highest ever

• Increase potential growth to continue enjoying the ride

• The Philippines has entered a phase of rapid growth despite that the manufacturing employment share is less than 10%, and declining
Objective: increase potential growth by 1-2 ppt

• Labor Force growth is declining but still high.

• Focus of policy: productivity growth:
  ▪ Regional disparities in productivity.
  ▪ Firm-level productivity: organizational capabilities (work rules – efficient utilization of workers) and ‘competitive pressure’.
  ▪ Limited role of transfer of workers in raising productivity.
  ▪ Productivity within each sector. Determinants of productivity are: (External trade/GDP); (Manufacturing exports/GDP); Growth in gross fixed capital formation; Gross secondary enrolment rate; Economic complexity; Infrastructure.
How to reach 7-8% potential growth....

- **Agriculture** is still a large employer, though the absolute number of workers began declining in 2012. Needs modernization.

- Although the number of workers in **manufacturing** is increasing, the manufacturing employment share is declining.
  - Find niches in **manufacturing** so that productivity continues increasing.
  - If the Philippines manages to create a core industrial base and ensures sectoral upgrading, it could further develop the **Business Services** sector, which the literature shows is an intermediate that caters to manufacturing for more specialized functions.

- Programs like *Industry 4.0* could be useful if they are much more than a wish list of “sectors” to promote (how?)

- Modern Industrial Policy principles

- Focus on ‘new products’, not ‘old sectors’

- Involve the private sector
Questions and comments

Thank you

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