8

Philippine Services Sector: Domestic Policy and Global Markets

Antoinette R. Raquiza

The Philippines is having a moment. With a growth rate of 6.8 per cent in 2016, it distinguished itself as the fastest growing economy in Asia, second only to China. Equally noteworthy is the fact that the economy has been able to sustain its buoyancy, with the gross domestic product (GDP) registering an annual growth average of 6.3 per cent since 2010. Given its stellar performance, the country would seem to be on track to becoming Asia's next economic miracle.

Not too long ago, the Philippines was considered an economic basket case, unable to keep pace with a rising Asia. In fact, the World Bank (2013) noted that the country's agriculture and manufacturing suffered from low productivity while its services sector specialised in low-value, low-skilled activities. Yet, since the 2000s,

A.R. Raquiza (✉)
Asian Studies Graduate Programme, Asian Center University of the Philippines
Diliman, Metro Manila, Philippines
e-mail: araquiza@gmail.com

Khoo Boo Teik et al. (eds.), *Southeast Asia beyond Crises and Traps*,
Studies in Economic Transition,
DOI 10.1007/978-3-319-55038-1_8

the economy has taken off. Today, the Philippines has made the leap to emerging market status.

To what does the country owe its new-found economic dynamism? This paper examines the factors responsible for the Philippines' rapid growth and makes a two-step argument highlighting the interaction between trends in the global economy and domestic policy.

One, I will argue that the Philippines' economic turnaround owes much to the dramatic expansion of its international trade in services. The current wave of globalisation is characterised not only by greater labour mobility but also by the disaggregation of production and services into global value chains. This has created growth opportunities for developing countries previously unable to break into the elite group of industrialising countries. For the Philippines, its large English-speaking, Western-oriented, skilled workforce has positioned the country to take advantage of the new demands of the global services industries. With these new income streams, the country has rapidly expanded its middle class, which has, in turn, fuelled the growth of its services sector.

Two, this new globalisation wave could have passed the Philippines by, but for government policies that worked to aggressively link the country's labour force to global markets through services. The dramatic expansion of the country's international services trade could be traced to the latter half of the 2000s when a beleaguered Gloria Macapagal Arroyo administration, confronting economic and political challenges to its rule, undertook programmes to promote the labour export and business process outsourcing (BPO) industries. The country's international trade in services has allowed it to transcend not only the perennial boom-and-bust cycle but also the vagaries of Philippine politics. This has contributed to delinking the economy from the structural constraints that had weighed it down in the past.

This chapter is divided into three sections. The first section discusses trends in the global economy that have dramatically reconfigured the country's services sector. It examines the rapid growth of the BPO and labour export industries in the context of the changing nature of global services and domestic policy. Next is a discussion of the country's political economy, focusing on the interaction between politics and policy in the growth of the country's international trade in services since the mid-2000s. The third and final section examines the challenges confronting the specific configuration of the Philippine services economy. It explores how the so-called middle-income trap, usually referring to developing countries specialising in low-value, mass production, might apply to relatively low-income, services-led economies. The paper concludes with the recommendation that the Philippines must deepen its human resource base and expand the services-manufacturing nexus to go up the services value chain.

1 Philippine Services and Globalisation

Since 1980, the services sector has been the main source of Philippine economic growth. In fact, it is the only sector that has consistently grown, with its contribution to GDP increasing from 36 per cent in 1980 to 59 per cent in 2015; in contrast, during this period, the contributions of agriculture and manufacturing declined dramatically, as Table 8.1 illustrates. This pattern of sectoral growth is unique among the four emerging, liberal economies in Southeast Asia. In Thailand, Malaysia, and Indonesia the decline of agriculture went hand-in-hand with growth in services and manufacturing (Usui 2011) – a pattern of development that suggested a substantial portion of labour and other production inputs lost to agriculture were absorbed by the manufacturing and services industries. The Philippines is like other countries where both agriculture and manufacturing have been declining: labour is then absorbed into low-value services (UNRISD 2010: 29).

In this light, the services sector's significant contribution to Philippine GDP growth did not always translate into rapid economic expansion. An ADB (2007) study, for instance, calculated that in 1981–90 and 1991–2000, the services sector's annual contribution to GDP growth stood at 75.3 per cent and 51.9 per cent, respectively; during the same periods, annual GDP per capita growth rate averaged –0.6 per cent and 0.9 per cent (ADB 2007: 6–7). Studies conducted as late as the 1990s cited the Philippines as an example of a human-capital rich country that fell by the wayside of industrialisation (Rodrik, Grossman, and Norman

Table 8.1 Sectoral contribution to GDP growth (%)

	1980	1985	1990	1995	2000	2005	2010	2015
Agriculture	25.1	24.6	21.9	21.6	14.0	12.7	12.3	10.3
Industry	38.8	35.1	34.5	32.0	34.5	33.8	32.6	30.8
Manufacturing*	25.7	25.1	24.8	23.0	24.5	24.0	21.4	20.1
Services	36.1	40.4	43.6	46.3	51.6	53.5	55.1	59.0

Note: *Manufacturing here is a subsector of industry (which includes construction and other such activities).
Source: Based on World Bank (2017).

1995; Booth 1999). Despite its high-skilled labour and competitive investment promotion schemes, the country was unable to attract as much FDI as its neighbours.[1] Instead, the decline in the growth contribution of the manufacturing and agricultural sectors since the 1980s (Usui 2011) left the country's skilled workforce underutilised.

Significantly, it was only in the past decade that economic growth rates began to match the dramatic expansion of the services sector, suggesting its rising productivity. For 2001–11, services' annual contribution to GDP growth averaged 59 per cent, while the annual GDP per capita growth rate averaged 3.1 per cent (up from the previous decade's 0.06 per cent). What would account for the rise in productivity in the sector and thus its greater impact on the economy? I argue that the boom in the global trade in services has been the key to unlocking the country's growth potential, despite or perhaps because of the country's limited structural transformation. The changing demands of the global labour market provided a niche – servicing foreign clientele – for the country's young college graduates who considered English as their second (if not their first) language and were culturally attuned to Western lifestyles and values, a legacy of Spanish and American colonial rule.

To better appreciate the factors behind the dramatic growth of the services sector, let us examine the two leading industries in the context of the global economy and domestic policy.

1.1 BPO Industry

Today's changing production and services patterns have ushered in a new wave of globalisation. Led by the so-called digital revolution, advances in information and communication technology (ICT) facilitated the further fragmentation and dispersal of production processes. This has given rise to global value chains in manufacturing since the late

[1] In 2010, for instance, FDI flows in the ASEAN-4 countries were estimated as: Philippines, $1.1 billion; Thailand, $9.1 billion; Malaysia, $10 billion; and Indonesia, $15.3 billion (World Bank 2015).

1980s; value chains in services followed suit and experienced rapid growth in the early 2000s (ADB 2013: 46–7). For services, previously dominated by direct exchanges in the market, cutting-edge ICT has allowed information to be stored and transported across wide distances (Hermelin and Rusten 2007; Bartels and Lederer 2009). This has meant that the service supplier and consumer no longer need to be in one territory; service delivery has evolved to allow for cross-border transactions. The fragmentation of such processes, thus, enabled corporations to outsource their front and back offices (involved in accounting, human resources, marketing, and the like) as well as customer care services to subsidiaries or third-party service providers located in places where skilled labour is cheaply available.

In fact, global trade in services has grown faster than that in merchandise, and it is from this wave that the Philippine economy, which was lagging behind its industrialising neighbours, caught its second wind. In October 2004, President Gloria Macapagal Arroyo signed Executive Order No. 372 establishing a Public-Private Task Force for the Development of Globally Competitive Philippine Service Industries, led by the Bureau of Export Trade Promotion of the Department of Trade and Industry (DTI). The task force was responsible for identifying incentives that would attract foreign investments in the following industries: health and wellness tourism, retirement and leisure, IT and IT-enabled services, and logistics (Avila 2011).

This propitious coming together of domestic and global forces and interests may be gleaned from the history of the Philippine BPO industry. Its dramatic expansion came in the wake of the 1997–98 financial crisis, with the idea of transforming many of the country's then vacant premier, high-rise residential and commercial buildings into special IT economic zones. A prime mover of this trend was real estate magnate Andrew Tan of Megaworld, who lobbied to have IT parks and buildings officially recognised as special economic zones (SEZs); due to his efforts, his Eastwood City development project in Pasig, Metro Manila, became the country's first cyberzone registered under the Philippine Economic Zone Authority or PEZA (Raquiza 2016).

Accordingly, the country's investment-promotion programmes, anchored on the provision of fiscal and non-fiscal incentives, expanded to cover trade in services more systematically. The Board of Investments (BOI), under the DTI, and PEZA, the main incentive-granting agencies (previously concerned with the promotion of export manufacturing) expanded their programmes to include export services. The PEZA has since provided incentives to mostly foreign investors setting up IT-BPO offices in the country and Philippine property developers and operators of IT parks and centres for these businesses. In no time, the country, with its highly skilled workforce, was attracting BPO giants such as Accenture and Convergys. In 2014, its BPO industry raked in \$18.4 billion and employed 1.03 million people (Remo 2015) – a far cry from the \$350-million industry it was in 2001 (Satumba 2008). The industry also contributed to the expansion of support industries (such as transportation, banking, telecommunications, and energy).

The close link of the Philippine BPO industry to global markets may also be gleaned from three other distinct characteristics (Raquiza 2016). One, it is dominated by MNCs (Mitra 2013). Foreign investments grew from \$329 million in 2005 to over \$7.8 billion in 2013, representing an increase of foreign-to-total equity ratio from 67.9 per cent to 93 per cent during the period (BSP 2007, 2014). Two, as foreign capital participation grew, export receipts have come to represent most of the industry's earnings: from 69 per cent in 2005 to more than 90 per cent in 2012 (BSP 2007, 2014). This means that the Philippine BPO industry mainly provides services to a foreign clientele.

Finally, while efforts are being made to draw investments into high-skilled services, call centres located at the lower end of the services spectrum and catering mostly to foreign markets remain the industry's top-dollar earner. From 2005 to 2012, for instance, contact centres' share in total industry revenues went up from 49 per cent to 54.8 per cent (BSP 2014). Finance and accounting services have picked up, as evidenced by the number of multinational financial institutions (such as JP Morgan Chase and HSBC) that have set up subsidiaries in the country. Nevertheless, by 2014, only the software development and transcription services showed marked growth: from 2005 to 2013, their share in total industry revenue grew from 20 per cent to 22.4 per cent and 0.4 per cent to 2.8 per cent, respectively (Fig. 8.1).

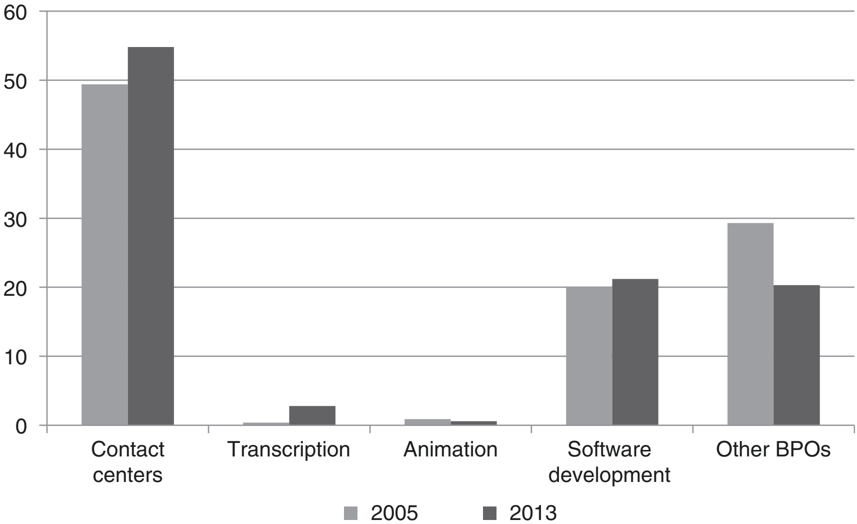

Fig. 8.1 Revenue by IT-BPO category (percentage of total)
Source: Based on Bangko Sentral ng Pilipinas (2014).

The shift in economic strategy had two causes – the close links between global markets and the domestic economy and the flexible character of the institutional arrangements in which economic activity is embedded. The historical connections between global markets and Philippine business – a colonial legacy – have made the country's private sector highly sensitive to changing and new international business opportunities. At the same time, Philippine policy tools, the most important of which have been fiscal and non-fiscal incentives, represented exceptionally flexible and efficient ways of shifting investments toward international trade in services.

1.2 Labour Export

While BPO has become the country's sunshine industry, labour export has been the country's biggest dollar earner since the Marcos government opened the programme in the 1970s. The passage of the 1974 Labor

Code or Presidential Decree (PD) No. 442 formally launched the labour export industry, designed 'to ensure the careful selection of Filipino workers for the overseas labour market to protect the good name of the Philippines abroad'. During the Marcos period, other policies were passed to promote, oversee, and regulate the deployment of Philippine labour. As such, the number of overseas Filipino workers (OFWs) increased from 36,029 in 1975 to 372,784 in 1985 (Medina 2012).

Nevertheless, the 2000s marked a qualitative change in the demographics of the OFW population, the government's approach to labour migration, and the impact of remittances on the domestic economy. Global trends and domestic policies represent the pull and push factors, respectively, that effected a dramatic change in labour migration. The past decade witnessed the rise of 'global householding', referring to the nurturing and sustenance of households through international transactions in receiving and sending countries (Douglass 2007: 158).[2] The growing needs of aging populations and changing arrangements of households in developed countries in East Asia and beyond and the crises of householding (forming and sustaining households) in developing countries have created a market for domestic help.

For the Philippines, this trend has meant that the demographics of new hires are shifting toward a younger, female population (Abinales and Amoroso 2005: 298). A government survey found that in 2013 more than one in two or 51.4 per cent of women OFWs worked as household helpers, cleaners, launderers, and other domestic workers; about 20 per cent worked in sales and other relatively low-skilled service activities (PSA 2014). It can be argued that this trend represents the third generation of OFWs, following the discernible outflow of professionals who have settled in the USA and other northern countries since the 1950s and the mass contracting of seamen, Middle East-bound construction workers, and entertainers from the 1970s. In 2014,

[2] Global householding has grown through the years due also to factors such as declining fertility, changing welfare policies, and shifting gender roles in labour-receiving, developed countries; and higher wages for labour-sending, developing countries (Douglass 2007).

Filipinos living and working abroad on a permanent or temporary basis were estimated to number more than 10 million (CFO 2016).

The changing global labour market forms only part of the explanation of the massive outflow of OFWs. Domestic policy has played a key role in the institutionalisation of labour migration. In the 2000s, under the Arroyo presidency, the government's approach to overseas labour experienced a subtle yet fundamental shift. While official policy since the 1970s consistently regarded labour export as a key source of foreign exchange, up until the past two decades, the government stressed its role as a temporary solution to unemployment and foreign currency shortfall.[3] This approach changed to one that promotes labour export as integral to the government's national development programme.

Accordingly, interagency mechanisms were set up, led by the Bangko Sentral ng Pilipinas (BSP, or Central Bank of the Philippines) (in charge of foreign currency transactions), Department of Labor and Employment (human resources), and the DTI (services export). The role of the Philippine Overseas Employment Authority (POEA), established in 1982, was expanded from largely regulating the movement of OFWs and ensuring the protection of their rights and welfare to promoting aggressively the deployment of Filipino workers abroad. Moreover, the Technical Education and Skills Development Authority (TESDA) reoriented its curricula toward training 'globally competitive' Filipino workers.

In 2005, just as the country was on the brink of a deep fiscal crisis largely due to a record national debt of PhP 3.36 trillion[4] – a staggering amount equal to 78 per cent of the country's GDP (De Dios et al. 2004) – the POEA set and achieved the goal of deploying one million contract

[3] For instance, Republic Act No. 8042 or the Migrant Workers and Overseas Filipinos Act of 1995 stipulates that the government 'does not promote overseas employment as a means to sustain economic growth and achieve national development' even as it called for the deregulation of recruitment operations.

[4] Arroyo holds the distinction of being the biggest borrower among all Philippine presidents until that time. In 14 out of his 21 years in office, Marcos incurred a debt of PhP 570 billion while Presidents Aquino, Ramos, and Estrada borrowed a total of PhP 1.51 billion – 'P2.03 trillion less than what Arroyo borrowed in her first six years in office' (Pablico 2008).

workers abroad. Measures the agency undertook that year included (POEA 2005: 4):

- Increasing the number of accredited recruitment agencies;
- Establishing government-to-government recruitment and placement programmes, such as the Philippines-Korea Employment Permit System;
- Organising international labour fairs in Manila that brought together foreign and domestic recruitment agencies;
- Sending marketing missions to Taiwan, the Middle East, and Cyprus; and,
- Decentralising its services further to secure access to provincial labour markets.[5]

This massive deployment of OFWs immediately produced a 25 per cent increase in remittances, from \$8.6 billion in 2004 to \$10.7 billion in 2005 (POEA 2005: 9). In 2006, OFW remittances surpassed official development aid and FDI flows combined (Jimenez 2006). In 2007, remittances jumped to \$14.5 billion, contributing to a 6.3 per cent increase in private consumption for the year (Oxford Business Group 2009: 15).

In 2008, the success of the deployment drive led Arroyo to issue Administrative Order No. 247, instructing the POEA to 'execute a paradigm shift by refocusing its functions from regulation to full-blast market development efforts [and] the exploration of frontier, fertile job markets' for OFWs. Toward this end, the POEA sought to widen its global network by tapping global recruitment or placement agencies and international headhunters. Owing to such efforts, the government hit another milestone in 2012 when it facilitated the deployment of two million OFWs.

Thus, the policy environment and infrastructure for the country's full-blown services export economy was set in the mid-2000s. The Philippines has not only ranked among the world's top remittance-recipient countries, bringing in about \$28.7 billion in 2014 (World Bank 2015), it also competes with India as the world's foremost BPO destination. The

[5] In 2005, the POEA operated regional offices in 14 key cities across the country.

unrelenting, massive outflow of Filipino workers and the dramatic growth of the BPO industry have created a consumer class that has fuelled the domestic services industries.

The relationship between the country's international trade in services and the domestic services sector has been the subject of studies on the OFW phenomenon. One such study notes that incomes of remittance-receiving households increased by an average six percentage points in a year (Orbeta 2008). This has meant higher incomes for those with at least one family member who works abroad and sends money home than those without. For instance, in 2006, the average yearly income of a remittance-recipient household was estimated to be 73 per cent more than that of a non-recipient household – a trend that benefitted a growing percentage of Filipino households, from 20 per cent in 2000 to 26 per cent in 2006 (Ang, Sugiyarto, and Jha 2009: 12).

The increase in the number of remittance-receiving households, suggesting that more than one in every four households receive financial support from abroad, has expanded the domestic consumer class and raised the demand for housing, education, health, transportation, communications, and durable goods (Tabuga 2007). At the meso-level, this consumption pattern has influenced the business decisions of the country's biggest conglomerates: since the mid-2000s, greater investments have flowed into banking (through which remittances are funneled), real estate, private education, healthcare, and retail (Raquiza 2014).

2 Politics and Economic Performance

In 2013, Fitch Ratings gave the Philippines its first ever investment-grade credit rating, citing the country's current account surpluses and improved fiscal management that began with reforms undertaken under the Arroyo administration (Wassener and Whaley 2013). The Aquino administration lost no time in claiming that the upgrade was due to its handling of the country's finances and its 'integrity-based leadership'. The two administrations had undoubtedly implemented macroeconomic reforms to stabilise the economy (for example, Arroyo adopted the Reformed Value-Added Tax or R-VAT on oil and electricity in 2005 and Aquino adopted 'sin' taxes on tobacco and alcohol products in 2012). Both had also used the good housekeeping rhetoric to point to rising investor confidence. The then recently appointed BSP Governor, Amando M. Tetangco, claimed that growth under Arroyo's second term was due to 'sound macroeconomic fundamentals', which included 'low inflation, low interest rates, a broadly competitive exchange rate, adequate foreign reserves, manageable external debt levels, well-capitalised banks with stronger balance sheets and commitment to structural reforms' (Tetangco 2007: n. p.). Tetangco, who was retained by Aquino as central bank governor, would give the same explanation for the robust growth under the new dispensation.

Nevertheless, if we were to go back in time to pinpoint when a laggard Philippine economy turned a corner to become Southeast Asia's top performer, one might be surprised to find that this did not begin at a high point in the country's history. Rather, the origins may be traced to 2004–2005, an unlikely moment because this was perhaps the lowest point of the Arroyo presidency. Anticipating a fiscal debacle, Manila at that time was rife with talk that an economic crisis could be the last straw for the beleaguered president. Arroyo was struggling to move past allegations of having won the 2004 national elections through massive electoral fraud and hounded by threats of military coups[6] and impeachment proceedings. In 2006, poverty and underemployment rates stood at a staggering 32.9 per cent and 23.5 per cent, respectively (Landingin 2008). The deteriorating economy, coupled with the regime's crisis of political legitimacy, saw the administration's popularity plummeting to a negative 38 per cent, depths not seen since the last days of the Marcos regime (Pablico 2008).

[6] In 2006, for instance, rumours of an attempted coup led Arroyo to declare a short-lived emergency rule (Conde 2006).

Yet, two years later, the Philippines began an economic take-off that would rescue the regime from going under. In 2007, the government proudly announced that the country had attained a three-decade high 7.3 per cent growth rate (Tetangco 2007). The proximate factor for this stunning turnaround was the imposition of higher taxes on oil and electricity (from 10 to 12 per cent) in 2005, which immediately raised revenues for the cash-strapped government. Equally if not more important was the government decision to promote international trade in services as integral to its national development programme. As discussed earlier, the dramatic increase of OFW remittances and the rise of the BPO industry provided the Arroyo government with much-needed resources and international credibility, enabling it to get ahead of the political and economic storm that had been building since 2004.

The Philippine turnaround, in fact, puts into sharp focus the different ways in which services and the other sectors connect to the domestic economy. The Philippine experience raises questions on the relationship between politics and economic performance. The country's relatively slow development has been attributed to weak institutions and an economic oligarchy (Yap 2011). Elsewhere, I argue that state configuration, defined as the level of embeddedness of the political leadership and economic technocracy in state institutions and the pattern of interaction between these two sets of policy actors, impacts a country's structural development (Raquiza 2012). The more institutionally embedded these two sets of state elite are, the more likely it is that policies will have long time-horizons and the less economically disruptive political contestation will be. This state configuration, in turn, is more conducive to long-gestating production investments.

The present work's investigation of the country's growth trajectory bears out this finding. As pointed out earlier, the dramatic expansion of the Philippine services sector was due to the convergence of external and domestic factors: the explosion of the global services industries, on the one hand, and the then embattled Arroyo administration's aggressive push to link the country's workforce to global markets, on the other hand. On the domestic front, quick thinking and action was possible due to the Philippine government's long engagement in the labour export industry, a history that has given rise to a 'labour brokerage state' (Magalit Rodriguez 2010). Policy innovation, therefore, did not entail a major reconfiguration of state power as the tools to facilitate labour migration were readily available for an enterprising state elite. In fact, in the last years of the Arroyo presidency, the economic management team largely comprised politicians who could deliver votes for the administration in the 2004 and 2007 mid-term national elections.[7]

The Philippine experience suggests that the services sector, which is fragmented and less capital-intensive than the manufacturing sector, can thrive alongside weak state institutions unlike economic activities that would require longer periods and huge resources to turn a profit. This seems truer in relation to long-distance services. It is beyond question that OFW remittances have been critical to the country's growth economy. They have helped solve many of the country's perennial money problems. Remittances are a major source of foreign exchange; they improve the country's foreign currency account balance and raise the level of savings and investments (Lim 2013). With the OFW population reaching millions, labour export has helped lessen unemployment and poverty in the country. Increased mobility under globalisation allows labour to 'vote with their feet' (Hirschman 1978) and literally take its business elsewhere during periods of scarcity or uncertainty in their home countries. Simply put, the Philippines' quick turnaround during the brief 2004–2007 period illustrates how foreign capital flows in the form of overseas workers' remittances could save a regime without effecting deep structural transformation or even broad-based growth.

The Philippine pattern of development, where the outflow of labour and massive inflow of remittances have become key to domestic economic performance, could present a 'labour export hazard'. I attach the term 'hazard' to this trend in a more self-conscious

[7] In 2010, the heads of the National Economic Development Authority, Finance Department, and the Department of Budget Management were, respectively, former Senator Ralph Recto and House Representatives Margarito Teves and Rolando Andaya.

evocation of the economic term ‘moral hazard’ (in which the provision of some sort of insurance removes the incentives for the insurance recipient to be prudent and struggle against failure). The concept of moral hazard has, in fact, been used in relation to labour migration. It has been shown to negatively impact the participation of remittance-receiving households in the domestic economy. It can also remove the incentive for the national government to work toward the growth of the domestic economy (Pernia 2011: 22-24; United Nations ESCAP 2016).

‘Labour export hazard’ is used in the present work as a more precisely targeted concept, referring to the specific case of overseas labour. The expanded economic capacity of a new, or perhaps proto-middle class is based less on their domestic employment, their skills, or their entrepreneurial drive, and more on remittances from relatives employed overseas. Therefore, at least initially, economic development places no pressure on weak state institutions. On the other hand, the country’s economic oligarchs have diversified into commercial activities aimed at capturing the windfall gains from remittances; they have begun to shift investments to match the consumption patterns of OFW families (Raquiza 2014).

The classic back and forth between a rising middle class and a state striving to provide the economic, regulatory, and infrastructural services that support economic activity does not take place in the Philippines. Elsewhere, investments create and expand productive economic activity; in the Philippines, investments concentrate on providing more venues for consumption and recreation. Hence, if the services sector can thrive without strong state institutions, those who benefit from employment in these services and from overseas remittances, including the country’s commercial elite, have little reason to push for a more responsive or responsible state.

If the labour export hazard removes the back-and-forth struggles between a rising middle class and the state, it also makes state institutions less inclined to aggressively promote productive activities. Indeed, an economy with scant opportunity for gainful employment may be precisely the condition that drives domestic labour into the profitable remittance-creating international labour market.

3 The Work Ahead

Globalisation has allowed for greater diversity in development pathways than the traditional sequence of agriculture leading to manufacturing and industrial development, with the services sector only fully coming into its own in the post-industrialisation phase. UNRISD (2010: 32–3) argues that globalisation 'weakens the organic links between agriculture and industry' since freer trade lessens the pressure on domestic markets to expand production – a situation, that in turn, means displaced rural labour cannot be absorbed in manufacturing and instead ends up in the services and informal sector. As such, in many developing countries, the services sector has always played a significant, if not leading, role in growth. Whether this development path translates into rapid growth is an empirical question, contingent on other factors such as its institutional context.

The Philippine experience adds yet another dimension to the emerging pattern of services-led growth: its dynamism derives from and ends in foreign shores. In fact, because trade in services has become the main source of profit in the sector, the most dynamic businesses are those that are fully integrated in the global economy, with very limited linkages to the domestic real economy. The country's labour export industry's main contribution to the economy is to drive domestic consumption, rather than provide investments to build productive capacities. On the other hand, a 2008 study on the BPO industry noted that it was more of a consumer of inputs from, rather than a supplier of inputs to, other sectors. It availed of services from 40 industries, including banking, telecommunications, and power but itself only provided services to three: tourism, wholesale and retail trade, and banking (Magtibay-Ramos et al. 2008: 6).

That the services export industries have had limited linkages to higher value-added sectors in the Philippines may be attributed to the labour-export hazard issue. That is, while an economic development programme could conceivably connect services industries to other sectors of the economy, the Philippine policymaking environment has insufficient incentives for such development. With so many new consumers being created via remittances, investors have every incentive to shift to retail businesses, and consumers do not need better-paying manufacturing jobs to buy what they need. Nor, in fact, does government have the incentive to undertake long-gestating investment projects. Rather, government strategies have focused on incentivising BPO work in the country and the movement of OFWs abroad. The massive flow of OFW remittances has led to the appreciation of the peso that makes investments in other tradable goods less attractive (Sicat 2012) – a situation that Philippine economists have likened to the negative effects of the Dutch disease or resource curse on manufacturing (Medalla et al. 2014: 3).

Like any emerging economy in the region, the Philippines is confronted with the challenge of moving to the next level. The response to the so-called middle-income trap, particularly for countries specialising in low-cost mass manufacturing, is to shift to a knowledge-based economy. For most developing countries, this has meant investments in services, to improve agricultural or manufacturing efficiency and product competitiveness (ADB 2013). This option would seem like the natural progression for the Philippines, a country that has made its skilled labour force its selling point.

Unfortunately, the path for the Philippines may not be entirely straightforward. As discussed earlier, the sequence of its sectoral development, with international trade in services leading growth in the absence of vibrant agriculture and manufacturing sectors, has an adverse effect on the latter. Moreover, the labour-export hazard, created by the institutionalisation of labour migration, makes remittances (rather than other capital inflows) more important to rapid growth. As the Philippines illustrates, state officials are incentivised to create or maintain the domestic conditions that propel more Filipinos to search for greener pastures abroad. This, in turn, dampens the domestic market for skilled labour. Beyond the government's aggressive push, labour export remains viable only when incomes are lower than elsewhere and unemployment rates are high (Swan 1985: 344). The surge in remittances thus becomes a disincentive for the state to improve the economy.

The rising BPO industry – also in the international trade in services – may constrain this trend in the long run. There is one paradox: labour export and the BPO industries make competing claims on the country's workforce (Raquiza 2016) and may thus work against each other. The country is losing highly skilled labour that could otherwise be tapped by the domestic BPO and other knowledge-based industries. The Department of Science and Technology found that, from 1998 to 2009, the outflow of science and technology workers increased 148 per cent, from 9,877 to 24,502, a seemingly small number until one takes into consideration that the country's R&D population of 165 per million Filipinos is way below the UN Educational, Scientific, and Cultural Organization (UNESCO) recommendation of 380 needed for economic development (Roblas 2011). Nevertheless, outmigration also afflicts the BPO industry that can keep the wages of its workers relatively low and, therefore, attractive to MNCs. Anecdotes abound where domestic call centres lose their agents to higher paying call centres abroad (notably, Singapore). Simply put, a country in which one of the attractions for MNCs is the relatively low wages of its talent pool would find it difficult to keep this workforce in an era of greater labour mobility (Raquiza 2016).

That said, the country today has the wherewithal and is in a better position to address structural constraints that prevented it in the past from developing agriculture and manufacturing. Besides the obligatory nod to good governance reforms and infrastructure development, the work ahead needs to include going back to the basics.

First, the government needs to invest more in education at all levels. To be sure, education gets the biggest allocation in the national budget today. Nevertheless, as the Department of Education itself acknowledges, government spending on education is much smaller than the United Nation's recommendation, which is 6 per cent of GDP. The nominal increase in the education budget in 2012 represented only 2 per cent of GDP (Quismundo 2012). This limited budget impacts the quality of education, a problem manifest in the low hiring rate of the BPO industry. As an industry official noted in 2012, for every 100 applicants only five met industry standards and were hired.

The limited education budget also means fewer opportunities for youth to go to school, a situation that exacerbates inequality.[8] One study provides evidence that the surging Philippine services industries (notably, BPO and labour export) have had limited impact on households with low human capital; instead, these industries have benefited households with already high capital levels (Ducanes 2015). As private schools mushroom in Manila to meet the demand of remittance-receiving households for quality education, the government needs to step in and increase its spending for public education to better ensure inclusive development.

The country can also jumpstart its stalled agriculture and manufacturing industries. The growing trade in services has worked to increase the middle class and consequently the domestic market, making the Philippines today a much more viable manufacturing investment site. A case in point is the automobile industry where brisk car sales (registering a 30 per cent increase in 2014) have caught the eye of Japanese automakers (Cruz 2015). Small and medium-sized Filipino businesses can also benefit from this pattern. The government should assist these businesses so they can compete with the inflow of foreign brands, on the one hand, and enter global production and services networks, on the other hand, a move that in effect might help forge a broader services-manufacturing nexus.

The Philippine experience could be considered a case in which rapid growth highly dependent on global markets might lessen the urgency to effect the structural transformation necessary to push for balanced, more inclusive development. Nevertheless, the rise of the BPO industry, which has a stake in improving and maintaining human capital in the country, and the expansion of a consumer class that would attract investments in domestic manufacturing, could push for a fundamental rethinking of the country's current development strategy. The development of more accountable state institutions would also go a long way toward promoting industries with wider linkages in the domestic economy.

[8] An ADB study, for instance, noted that one in four youth (those in the 14 to 24 age group) are out of school or out of work or both (Medenilla 2015).

References

Abinales, Patricio N. and Donna J. Amoroso. 2005. *State and Society in the Philippines*. Lanham, MD: Rowman & Littlefield.

Ang, Alvin P., Guntur Sugiyarto, and Shikha Jha. 2009. 'Remittances and Household Behavior in the Philippines', ADB Economics Working Paper Series No. 188. Metro Manila: Asian Development Bank.

Asian Development Bank. 2007. *Philippines: Critical Development Constraints*. Metro Manila: ADB.

Asian Development Bank. 2013. *Asia's Economic Transformation: Where to, How, and How Fast?* Metro Manila: ADB.

Avila, John Lawrence V. 2011. 'Managing Trade in Service: A Network Approach to Services Policymaking'. In *Globalization, Governance, and the Philippine State*, compiled by Philippine Institute for Development Studies, pp. 233–294 Makati: Philippine Institute for Development Studies.

Bartels, Frank and Suman Lederer. 2009. *Outsourcing Markets in Services: International Business Trends, Patterns and Emerging Issues, and the Role of China and India*. Vienna: United Nations Industrial Development Organization.

Booth, Anne. 1999. 'Initial Conditions and Miraculous Growth: Why is South East Asia different from Taiwan and South Korea?' *World Development* 27 (2): 301–21.

BSP (Bangko Sentral ng Pilipinas). 2007. 'The 2005 Benchmark Survey of IT'. Accessed 15 October 2014, http://www.bsp.gov.ph/downloads/Publications/2007/ICT_2005.pdf.

BSP (Bangko Sentral ng Pilipinas). 2014. 'Philippine IT-BPO Services Industry Sustains Double-Digit Growth in 2012'. Accessed 15 October 2014, http://www.bsp.gov.ph/publications/media.asp?id=3432.

Commission of Filipinos Overseas. 2016. *2014 Commission on Filipinos Overseas (CFO) Compendium of Statistics on International Migration*. Metro Manila: CFO.

Conde, Carlos H. 2006. 'Emergency Rule in Philippines After Failed Coup'. *The New York Times*, 25 February.

Cruz, Chelsea. 2015. 'Japanese Business Delegation Presses Philippines for Auto Industry Road Map', InterAksyon.com, 6 February. Accessed 16 March 2015, http://www.interaksyon.com/business/104558/japanese-business-delegation-presses-philippines-for-auto-industry-road-map.

De Dios, Emmanuel S. et al. 2004. 'The Deepening Crisis: The Real Score on Deficits and the Public Debt'. Discussion Paper (DP 2004–09), University of the Philippines School of Economics. Accessed 16 March 2015, http://www.econ.upd.edu.ph/dp/index.php/dp/article/view/28.

Douglass, Mike. 2007. 'The Globalization of Householding and Social Reproduction in Pacific Asia.' *Philippine Studies*, 55 (2): 157–181.

Ducanes, Geoffrey. 2015. 'Has Economic Growth Benefited Households with the Least Human Capital Level?: Examining the Inclusiveness of Philippine Growth in the Past Two Decades'. Report prepared for the National Economic Development Authority and the United Nations Development Programme.

Hermelin, Brita and Grete Rusten. 2007. 'The Organizational and Territorial Changes of Services in a Globalized World'. *Geografiska Annaler*, Series B, Human Geography, 89: 5–11.

Hirschman, Albert O. 1978. 'Exit, Voice, and the State', *World Politics* 31(1): 90–107.

Jimenez, Cher S. 2006. 'Aquino Faces Exodus Challenge', *Asia Times*, 10 June. Accessed 16 March 2015, http://www.atimes.com/atimes/Southeast_Asia/LF10Ae02.html.

Landingin, Roel. 2008. 'Philippine Poverty Rate Rises to 32.9%', *Financial Times*. 5 March.

Lim, Joseph. 2013. 'The Impact of the Global Financial Meltdown and New Growth Strategies for the Philippines'. *Institutions and Economies* 5(2): 69–100.

Magalit Rodriguez, Robyn. 2010. *Migrants for Export: How the Philippine State Brokers Labor to the World*. Minneapolis, MN: University of Minnesota Press.

Magtibay-Ramos, Nedelyn, Gemma Estrada, and Jesus Felipe. 2008. 'An Input–Output Analysis of the Philippine BPO Industry'. *Asian-Pacific Economic Literature* 22(1): 41–56.

Medalla, Felipe M., Raul V. Fabella, and Emmanuel S. de Dios. 2014. 'Beyond the Remittances-Driven Economy: Notes As If the Long Run Mattered'. UP School of Economics Discussion Papers (DP 2014-11). Accessed 10 February 2015, http://www.econ.upd.edu.ph/dp/index.php/dp/article/view/1465.

Medenilla, Samuel. 2015. 'ADB: 1 in 4 Young Pinoys Unemployed'. *Manila Bulletin*, 9 February.

Medina, Andrei. 2012. 'Are OFWs the Solution to Economic Woes, or a Problem That Needs Resolution?' *GMA News* Online, 22 September. Accessed 15 March 2014, http://www.gmanetwork.com/news/story/

275146/news/pinoyabroad/are-ofws-the-solution-to-economic-woes-or-a-problem-that-needs-resolution.

Mitra, Raja Mikael. 2013. 'Leveraging Service Sector Growth in the Philippines'. ADB Economics Working Paper Series No. 366, September.

Orbeta, Aniceto. 2008. 'Economic Impact of International Migration and Remittances on Philippine Households: What We Thought We Knew, What We Need to Know'. Philippine Institute for Development Studies, Discussion Paper Series No. 2008–32.

Oxford Business Group. 2009. *The Report: The Philippines 2009*. Accessed 20 January 2015, https://books.google.com.ph/books?id=eY-Oq1IGzdMC&printsec=frontcover&source=gbs_ge_summary_r&cad=0#v=onepage&q&f=false.

Pablico, Alecks P. 2008. 'Gloria's Inglorious Record: Biggest Donor, Least Popular'. *iReport*, Philippine Center for Investigative Journalism. Accessed 5 January 2015, http://pcij.org/stories/glorias-inglorious-record-biggest-debtor-least-popular/.

Pernia, Ernesto M. 2011. 'Is Labor Export Good Development Policy?' *The Philippine Review of Economics* 48(1): 13–34.

Philippine Overseas Authority Office. 2005. *Annual Report 2005*. Metro Manila: POEA.

Philippine Statistics Office. 2014. 'One in Every Two Female OFWs is an Unskilled Worker' (Results from the 2013 Survey on Overseas Filipinos), 30 April. Accessed 10 April 2015, http://web0.psa.gov.ph/content/one-every-two-female-ofws-unskilled-worker-results-2013-survey-overseas-filipinos.

Quismundo, Tarra. 2012. 'Philippine Education Spending Still below UN Standard'. *Philippine Daily Inquirer*, 30 March.

Raquiza, Antoinette R. 2012. *State Structure, Policy Formation, and Economic Development in Southeast Asia Structuring Development: The Political Economy of Thailand and the Philippines*. London and New York: Routledge.

Raquiza, Antoinette R. 2014. 'Changing Configuration of Philippine Capitalism'. *Philippine Political Science Journal* 35(2): 225–50.

Raquiza, Antoinette R. 2016. 'The BPO Industry and Philippine Trade in Services: Boon or Bane?' In *The Local Outcomes of the Latest Wave of Globalization in South and Southeast Asia*, eds. Bart Lambregts, Niels

Beerepoot, and Robert Kloosterman, 46–59. Abingdon, Oxon and New York: Routledge.

Remo, Amy. 2015. 'IT-BPO Sector Posted 18.7% Revenue Growth in 2014'. *Philippine Daily Inquirer*, 15 March.

Roblas, Mark Ivan. 2011. 'PH S&T OFW Brain Drain Rises to 148%'. Accessed 27 February 2015, http://www.dost.gov.ph/index.php/knowledge-resources/news/36-2011-news/295-ph-s-t-ofw-brain-drain-rises-to-148.

Rodrik, Dani, Gene Grossman and Victor Norman. 1995. 'Getting Interventions Right: How South Korea and Taiwan Grew Rich'. *Economic Policy* 10(20): 55–107.

Satumba, Ahmma Charisma L. 2008. 'Business Process Outsourcing in Financial and Banking Services in the Philippines'. Working Paper Series 2008, Institute for Labor Studies.

Sicat, Gerardo. 2012. 'Peso Appreciation and the Economy (Once Again)'. *Philippine Star*, 5 December.

Swan, Neil M. 1985. 'The Service Sector: Engine of Growth?'. *Canadian Public Policy /Analyse de Politiques* 11 (Supplement): 344–50.

Tabuga, Aubrey D. 2007. 'International Remittances and Household Expenditures: The Philippine Case'. Discussion Paper Series No. 2007–18, Philippine Institute for Development Studies, Makati City.

Tetangco, Jr, Amando M. 2007. 'Governor's Foreword', *Bangko Sentral ng Pilipinas* 2007 *Annual Report*. Manila: Bangko Sentral ng Pilipinas.

United Nations Economic and Social Commission on Asia and the Pacific. 2016. *The Asia-Pacific Migration* Report *2015: Migrants' Contributions to Development*. Bangkok: UN ESCAP.

United Nations Research Institute for Social Development. 2010. *Combating Poverty and Inequality: Structural Change, Social Policy and Politics*. Geneva: UNRISD.

Usui, Norio. 2011. 'Transforming the Philippine Economy: "Walking on Two Legs"'. *ADB Economics* Working Paper Series No. 252, Asian Development Bank, Metro Manila.

Wassener, Bettina and Floyd Whaley. 2013. 'Philippines Gets Investment-Grade Credit Rating'. *The New York Times*, March 27.

World Bank. 2013. *Philippine Development Report: Creating More and Better Jobs*. Washington D.C.

World Bank. 2017. 'World Development Indicators'. Accessed 30 April 2017 http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators#.

Yap, Josef T. 2011. 'The Philippines: Weak Institutions Drag on Economic Performance'. *East Asia Forum*, 1 January. Accessed 5 January 2015 http://www.eastasiaforum.org/2011/01/01/the-philippine-economy-in-2010-recent-developments-and-challenges/.