The Strategic Importance of the Philippine Manufacturing Sector[1]

By Roberto Batungbacal

Abstract:

With the rapid expansion of the service sector of the Philippines, it is easy to forget that the main engine of an economy is the manufacturing sector. After two decades of globalization and liberalization, the Philippine manufacturing sector remains to be the most important sector for long-term productive employment, revenue and value-added generation and innovation. Understanding the strategic importance of its manufacturing sector will enable the Philippines to capitalize on the unique combination of events which could lead to higher economic growth, and these events are the ongoing exodus of manufacturers from Coastal China searching for skilled talent and competitive total cost, the new wave of Japanese manufacturers relocating abroad and significant improvement in macro-economic condition, leadership and governance in the Philippines.

[1] This article is prepared by Roberto Batungbacal, Director of the Federation of Philippine Industries, to elicit discussion and comments. Views expressed are entirely those of the author, and do not necessarily represent the views of the Federation of the Philippine Industries or its directors. Questions and comments can be addressed to the author. (bobbybatungbacal@gmail.com).

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Manufacturing is dead

How many times have we heard someone say that there is no more manufacturing in the Philippines? If we look around the Metro Manila, we see many of the factories abandoned, idle, or being torn down to give way to commercial establishment, logistic warehouses or high-rise condominiums. As one passes the newly completed and modern Skyway, you see the once proud row of manufacturers along the South Superhighway, is now a series of rusty roofs, with faded signages, doors permanently closed, halls empty of activity. Is manufacturing a thing of the past? Is the real-estate boom, shopping malls, and new high-rises filled with BPOs, bustling 24 hours, the present and the future of the Philippines?

The rise of the Service Sector

If you think about it, how many people really prefer to work in a factory versus a fully air-conditioned call center. It's the evolution of man and his livelihood, from working in the farm under the blistering sun, into the hot, sweaty factory, and then finally landing into the office with all the modern conveniences. As the service sector continue to expand at a much faster rate than the agricultural sector and the industrial sector, one would think that the Philippines may soon succeed where so many countries have not....leap-frogging from the farm to the service sector. Philippine Industrialization...yes we tried...many times, but now it's time to move on. There's whole world out there demanding English speaking talents, with computer skills, accounting, HR, training and administration skills. We have this kind of talent, with 300,000 to 400,000 tertiary graduates every year.[2] *On top of the BPO sector, another bright spots is the ever growing overseas remittance of our modern day heroes, the OFW. This year, their remittance will reach US$ 19 Billion.*[3] *That's cash, going to straight to the millions of households from Aparri to Jolo. An far more efficient method of wealth distribution than what we've seen in our past, so efficient that it's changing society. The newest homes in the provinces are not owned by the few landed families, they are now owned by OFW families. Remittances are now driving consumption of new houses, condominiums, hard goods, motor vehicles and consumer goods.*

But then, we continue to have 7% unemployment, 19% under-employment.[i4] *Growing ranks of non-farm rural poor, end up as urban poor as they migrate to urban centers. Today, we have 95 million Filipinos, the 12th largest population in the world. Can the service sector, with all its promise truly sustain our economy and our people. How can so few provide for so many....*

Manufacturing is alive after all

Here's another side of our story. Remember the manufacturing sector, with factories torn down, and land sold off to real estate developers? This sector is no longer visible to the Metro Manila city dwellers, which contributes to the impression that there is no more manufacturing in the Philippines. The reality is manufacturing

[2] Given that there are 2.7 million tertiary level students in the Philippines. Source: Department of Education
[3] Based on 6.29% growth rate of Jan-July 2011 YTD versus Jan-July 2010 YTD, Banko Sentral ng Pilipinas.
[4] As of July, 2011, Labor Force Survey, NSO

have moved out of the cities. The large electronic and semiconductor sector are in the PEZA zones, where most things work like clock-work. No red-tape, no corruption, everything is fast and efficient, the way it should be. The PEZA zones also contain manufacturers producing a wide range of non-electronic products, from plastic products, medical devices, watches, chemicals, paper products, garments, etc. Thanks to globalization, these manufacturers have a bigger market.....a global market made up of more than 200 countries. In 2010, our total exports have reached US$ 51.39 billion, up 33% from 2009. Out of the total exports of the Philippines, 85% are manufactured goods.[5]

The National Statistics Office conducts an annual survey of formal business establishments with at least 20 employees, across all sectors, across the Philippines. Their latest survey was the 2008 Annual Survey of Philippine Business and Industries (ASPBI). It was released in July 2010. The survey covered 21,040 business establishments that employed 2.7 million workers. The NSO press release on the ASPBI was clear and direct: ***"Manufacturing dominates economy".*** *Manufacturing generates the highest employment (31.5% of the total workforce), and nearly half of the total revenues come from Manufacturing, 46.7% reaching Php 3.16 trillion.*[6]

So it is dead or alive?

Why is it that the statistical data doesn't "jive" with our personal experience. It says manufacturing dominates the economy, and yet most of the products in my grocery list are not made in the Philippines. Most of the things I buy from the mall, clothes, shoes, appliances, electronics are made every else but the Philippines. Are the surveys wrong? Poor data collection? Flawed interpretation and analysis of the data?

One answer is that a huge part of the manufactured goods are for export hence they don't end up in our store shelves, while a lot of imported goods can be sold competitively. That's free trade.

Another answer is in the way products are manufactured today. In the globalized world, components are made in the most "total-cost" advantage country. Electronic chips are made in Japan, Korea or Taiwan, assembled and tested in Philippines, Malaysia, Thailand, then packaged into an electronic products like a mobile phone or computer in China. So, is your mobile phone made in Japan, Philippine or China? There's a similar process in the automobile industry, clothing, appliance. In the globalized world where trade is friction less, then it works. So the key to participate in this manufacturing model is to get into these regional production networks. Fortunately, Southeast Asia, is currently in these regional production streams.

So far, the electronic and semi-conductor sector have thrived in regional production networks. But this is probably the only success story. This success needs to be duplicated in the other manufacturing subsectors of the Philippines in order to diversify our production. Countries are now realizing that diversifying their manufacturing products is imperative to

[5] Calculations based on data provided in http://www.census.gov.ph/data/sectordata/2010/ex101202a.htm
[6] NSO, July 17, 2010, http://www.census.gov.ph/data/sectordata/aspbi2008tx.html

economic growth.[7] The more diversified your basket of goods, the more stable your total production versus the changes in global demand for different product groups. The more diversified your products, you increase your ability to innovate and create new things. As you diversify, you have more complimentary products to offer. For instance, a robust domestic chemical, plastic, rubber and metal industry would have many raw materials and parts to offer Toyota, Samsung, Sony or Apple.

It maybe alive but can it grow?

The impression that manufacturing is stagnant in the Philippines is due to one famous statistics: Manufacturing as a % of GDP...which has been constant at around 24% from year 2000 to 2006[8]. Data suggest that it is flat, in a plateau, stagnant. But the truth is manufacturing is growing, every year, and if the percentage is constant, then it is growing at the exact rate as the GDP.

Now, is 24% good or bad? Depends....it's certainly lower than China, Thailand and Malaysia. But these countries are the world's factories. But on the other hand, 24% is higher than that those of three of the BRICs countries Brazil, Russia, India. It's even higher than highly industrialized countries like Japan and Italy[9].

So, in absolute terms, manufacturing is growing, but not enough, given the rise in our population, our expanding labour pool and the increasing unemployment from the rural sector which is the consequence of slower growth in the agricultural sector.

But then is it possible to shift agricultural labor to the fast growing service sector? Yes, and we see that every day, as the rural non-farm poor flock the city to take up informal jobs as domestic helpers, drivers, construction workers, jobs with low productivity, limited learning opportunities and no job security. These are the jobs beyond reach of mandated minimum wage.

As history has shown, only manufacturing can absorb agricultural workers, providing them the possibility of secure, increasing productive work, and learning opportunities that increase one's chances of improving his or her well-being.

Why Manufacturing is strategic to the economy

Manufacturing has far more benefits than just employment opportunities. Manufacturing has the highest multiplier effect to the economy compare to other sectors. Based on studies of The Manufacturing Institute, the manufacturing sector has a multiplier effect of 1.4.[10] For every liter of paint produced, it required a range of raw chemical raw materials, packaging like metal or plastic containers, printed paper labels, delivery trucks, it required capital equipment that grinds, blends filters and stores the product. It employed chemist in laboratories, engineers and operators to run and maintain the plant. It requires utilities like electricity and water. It requires "services" such as financial, marketing, sales and logistics services. This is why, manufacturing is called the engine of the economy. Many services exist because of

[7] Based on the work of Dani Rodrik and Ricardo Hausmann. (Harvard University, John F. Kennedy School of Government)
[8]NSO
[9] Based on figures from the World Economic Forum's Global Competitiveness Report

[10] The Manufacturing Institute, Facts about Modern Manufacturing, 2009.

manufacturing. And many service jobs will disappear if manufacturing disappears.

Manufacturing is indispensible. It is an imperative for the growth of any economy. Even the most competitive and advanced economies like Singapore and Switzerland[11] *understands the strategic importance of their manufacturing sector. The US, UK and other western countries are seeking to bring back manufacturing into their country. The recent credit crisis and the current global financial crisis, further highlights the vulnerability of service related jobs, and the urgent need to create manufacturing jobs.*

Manufacturing is also essential to innovation. Innovation is today's buzz word because growth is the way out of the financial crisis and stagnation. To grow you need to create something new or use something existing in a new or different way. Apple didn't invent the MP3 player, they just made it more simple and easy to use and called it iPod. That is innovation. Now everybody knows that Apple no longer manufactures their products. They're made in China. But as the inventors stay farther and farther away from the production of the product, then innovations becomes more difficult for the designer, but at the same time, innovation becomes easier for the producer. After all, the producer works with the product every single day.

Investing in Philippine manufacturing... and why now after all these years.

The challenge is in inducing foreign and domestic investments in manufacturing in the Philippines and we have heard so many reasons not to invest in the Philippines, and choose Vietnam or Indonesia instead. From high power cost, to rising labor cost vis-a-vis our competitors, to land ownership, poor infrastructure, to corruption and poor governance. No doubt these are disincentives to investing, but investors choose based on different requirements. The most common and relevant measure for choosing a location for manufacturing is total production cost and availability of skilled labor. Tax incentives are fleeting if the cost rises fast or if the labour pool dries out quickly. Low power cost are relevant only to products that consumes a lot of electricity. Lack of land ownership and corruption never stopped thousands of investors from going to China, Vietnam and Indonesia. High labor cost never stopped the manufacturing sector in Singapore.

There is a lot of capital, the banking sector is as healthy as ever, always looking for better returns. There's also lots of "foreign" capital coming from OFWs. As foreign remittances begin driving the growth of small and medium enterprises, their investment can be directed towards manufacturing and not just service related businesses like retail, restaurants, etc. Manufacturing is not only for large enterprises. Countries like Japan are supported by hundreds of thousands of manufacturing SMEs who specializes on products that are procured by larger manufacturers.

Now if all if this is true, why did countless of enterprises lose their livelihood in the past 20 years of globalization and liberalization, where everything can be done in China, and everything can be imported cheaply to the country.

The answer is in the only constant that we know.....change. Things have changed. Today,

[11] A Renaissance at Risk: Threats and Opportunities for Swiss Manufacturing, Swiss-American Chamber of Commerce

Japanese companies are looking at relocating again from Japan due to the strength of the yen and for some, due to their vulnerability to natural calamity as demonstrated by the recent earthquake and tsunami. Second, the huge exodus of manufacturing from Coastal China due to the rapid rise in labour cost and shortage of skilled labour[12]. Third, macro-economic condition and national leadership and governance in the Philippines has never been this conducive to investments. Fourth, there continous to be an abundance of labour from the rural and urban sectors, and potentially, given the right conditions, the availability of highly skilled manufacturing talent from overseas Filipino workers.

We have never seen this unique combination of conditions in the past twenty years. The Philippines is in a position to capitalize on this today and start a virtuous cycle of growth and prosperity.

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[12] Frontier Strategy Group executive Briefing by Shenjie Chen, September 2011