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Economic Competitiveness of the Philippines: 2014 Update

Asian Institute of Management Policy Center[1]

Executive Summary

In this year's World Competitiveness Yearbook (WCY) ranking, the Philippines dropped four notches to 42nd from 38th. This almost reversed the five-place improvement the country posted last year, making it a net one notch improvement in ranking in the past two years. Among Asia-Pacific countries in the sample, the country ranked 12th this year from 11th last year. Although GDP grew by 7.2 percent – second highest among WCY countries – and credit rating agencies recently upgraded the Philippines, export growth was less impressive during this period, and stock markets cooled significantly after a hot streak in 2012. Some of the factors behind this also affected many other emerging market economies. Nevertheless, several factors influencing the ranking decline are Philippines-specific: poor infrastructure, a looming power crisis, and high-profile corruption accusations last year likely contributed to a decline in perceptions of government and business efficiency. This article dissects Philippine competitiveness as presented in the WCY and analyzes the figures to investigate the decline in ranking.

Last Year's Strong Improvement Evened Out

The five-notch improvement in last year's WCY ranking elicited guarded optimism for the Philippines. While the country's rank last year was pulled by robust *growth* in different economic indicators, it still lagged behind its neighbors in terms of the *level* of these indicators. This year, some of this growth, particularly exports and the stock market, slowed down. Moreover, infrastructure such as roads, public transport, and airports remain poor. The looming

[1] The World Competitiveness Yearbook is produced by the International Institute for Management Development, with the AIM Policy Center as its Philippine partner since 1997. Questions and comments on this article could be addressed to: policycenter@aim.edu.

energy crisis also affects the potential for growth, especially in the surging Industry sector. High-profile allegations of corruption last year also dented perceptions about the government and its ability to fight it.

The Philippines was not the only large emerging Asian country that experienced a decline. China fell from 21st to 23rd, India from 40th to 44th, and Thailand from 27th to 29th. However, Indonesia gained two places from 39th to 37th, while Malaysia improved three notches from 15th to 12th.

Ranking Factors

The WCY uses four broad factors in ranking the competitiveness of countries – economic efficiency, government efficiency, business efficiency, and infrastructure – with each factor divided into five sub-factors. Economic efficiency is divided into domestic economy, international trade, international investment, employment, and prices. Government efficiency is disaggregated into public finance, fiscal policy, institutional framework, business legislation, and societal framework. The following makes up the business efficiency factor: productivity and efficiency, labor market, finance, management practices, and attitudes and values. Finally, infrastructure is divided into basic infrastructure, technological infrastructure, scientific infrastructure, health and environment, and education.

Economic Performance

The Economic Performance factor fell six places in the ranking from 31st to 37th. This came after an eleven-place improvement in ranking last year from 42nd in 2012. Among the sub-factors, Domestic Economy actually improved 10 places from 32nd to 22nd, backed by the 7.2 percent GDP growth – the second highest among WCY countries. GDP growth was paced by the Industry Sector, which grew by 9.5 percent, while Services by 7.1 percent. The Industry Sector, after a fluctuating and even a negative growth in the last decade, seems to have created a momentum in the last four years. It has outpaced the annual average growth rate of the Services Sector in the 2010s, 7.4 percent against 6.7 percent. In spite of the natural calamities that hit the Philippines last year, the Agriculture Sector managed to grow by 1.1 percent. It is the slowest-growing sector last year, as has been the case for the past decade.

Investment is also a bright spot in 2013, growing by 18.2 percent. Some of this growth, however, is due mainly to base effects as it recovered from a 3.2 percent decline in 2012. Investments also posted 31 percent and 23 percent increases in 2010 and 2008 but both were preceded by years of negative growth. Nevertheless, in the last four years, investments grew by an annual average of 11.3 percent. And with improving credit ratings and renewed investor confidence, investments may just as well continue to build on this momentum.

However, the international trade sub-factor fell 10 notches from 30th to 40th. This was mostly driven by the slow growth in exports. Merchandise exports grew by only 3.6 percent last year, down from 7.6 percent the previous year. Also, preliminary data from the BSP shows that total exports of goods and services declined by 0.4 percent in 2013 after growing by 16.9 percent in 2012. This came in spite of the minor improvements felt last year by countries affected by the global crisis, including Japan and the United States, the Philippines' largest and third largest export markets. The second largest buyer of Philippine exports, China, continued its robust economic growth.

The largest drop in ranking in Economic Performance was by the Prices sub-factor – from 23rd to 46th. Although inflation in the Philippines remains largely controlled, other countries posted lower inflation, partly because of slower economic growth. A similar case is Foreign Direct Investments (FDI). While the country posted US$3.86 Billion net FDI inflows in 2013 – a 20 percent increase from 2012 and almost twice that of 2011 – it still fell in the International Investment sub-factor from 55th to 57th as other countries raked in more FDIs. For instance, in 2013, Malaysia posted US$11.6 Billion net FDI inflow, Indonesia has US$18.4 Billion, and Thailand has US$12.8 Billion.

Government Efficiency

Government Efficiency fell from 31st to 40th. Among its sub-factors, only Public Finance improved its ranking, from 38th to 35th. This was mostly from the 32.4 percent decline in budget deficit and 11.8 percent increase in national government revenue (see Figure 1). The slight decline of debt as share of GDP from 51.4 percent to 49.2 percent also helped.

However, it must be noted that the two largest revenue collection government agencies – the Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC) – both missed their targets for 2013. The BIR collected PhP1.217 Trillion in 2013, 15 percent higher than in 2012;

but fell short by three percent – or PhP37 Billion – of its PhP1.254 Trillion target[2]. The BOC fell short by about 10 percent – or PhP35.5 Billion – of its PhP340 Billion target. The BOC's 2013 collection is higher by 5.1 percent than in 2012.[3]

Nevertheless, these revenue shortfalls are not uncommon during periods of reform. Reforms in these revenue collecting agencies may take time to be fully effective, yet these are critically important for the long run competitiveness of the country. On the bright side, the Philippines climbed 13 notches in the Paying Taxes criteria, from 144th to 131st, of the World Bank's Ease of Doing Business Report. Making tax payments easier, both for businesses and for individuals, can potentially increase tax collection, thus improving services for taxpayers while at the same time minimizing opportunities for corruption.

Some of the perceptions-based indicators of Government Efficiency posted large drops in ranking. The bribing and corruption indicator declined 13 places from 41st to 54th, while transparency dropped from 24th to 28th. It is possible that some of the changes in perceptions could be traced to the high-profile corruption charges against some top-level government officials last year such as the Pork Barrel issue and the MRT bidding bribing accusation.

Other perceptions-based indicators that posted significant declines, in score or in ranking, includes the perception that 'investment incentives are attractive to foreign investors', which dropped from 35th to 41st; and 'customs authorities facilitate the efficient transit of goods', which dropped from 53rd to 57th. These dragged the Institutional Framework sub-factor down from 33rd to 40th.

Also, opinion on the efficiency of competition legislation fell from 44th to 52nd, and on 'subsidies not distorting fair competition and economic development' dropped from 36th to 43rd. These led the decline in Business Legislation sub-factor from 51st to 54th.

Business Efficiency

Business Efficiency dropped six notches from 19th to 27th. This was mostly contributed by the Finance sub-factor, which declined from 26th to 37th. This decline is mostly accounted for by the tapering down of the Philippine stock market in 2013 after a hot streak in 2012. Last year, the

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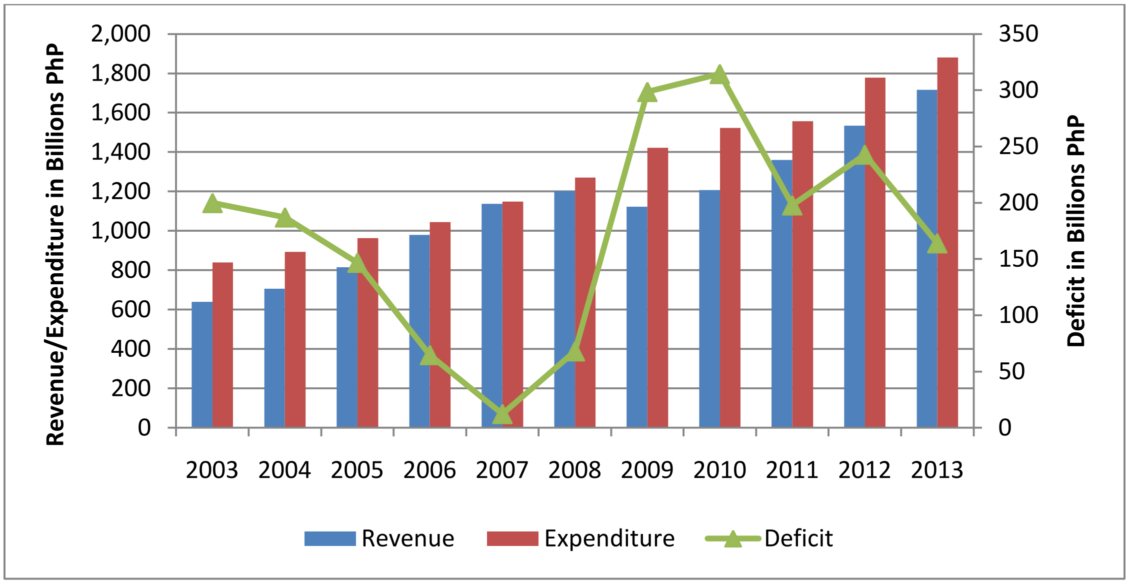
[2] Interaksyon.com. 2014. 'BIR misses 2013 collection target'. February 19. Available at <http://www.interaksyon.com/business/81076/bir-misses-2013-collection-target>.

[3] ABS-CBNNews.com. 2014. 'Customs misses 2013 collection target. February 28. Available at <http://www.abs-cbnnews.com/business/02/28/14/customs-misses-2013-collection-target>.

Philippines posted the fifth highest increase in stock market index among WCY countries; this was down to 41st this year.

Figure 1. National Government Revenues, Expenditure and Deficit, 2003 to 2013.



Source: Bureau of Treasury

Infrastructure

The Philippines dropped in the infrastructure ranking, from 57th to 59th. It is consistently the lowest-ranked factor for the Philippines, highlighting the major improvements needed in this area. There have been recent efforts to address this, most notably the Public-Private Partnership program, but progress has been slow, with only seven projects awarded to contractors so far. Nonetheless, in spite of this, the government recently reiterated its plan to increase infrastructure spending to five percent of GDP[4]. Poor infrastructure is a hindrance not only to more efficient domestic economic activity, but also to attracting foreign investments. The country's ASEAN neighbors Malaysia, Thailand and Indonesia, are ranked 25th, 48th, and 54th, respectively, in infrastructure. It is not surprising that these countries also perform much better in attracting foreign investments.

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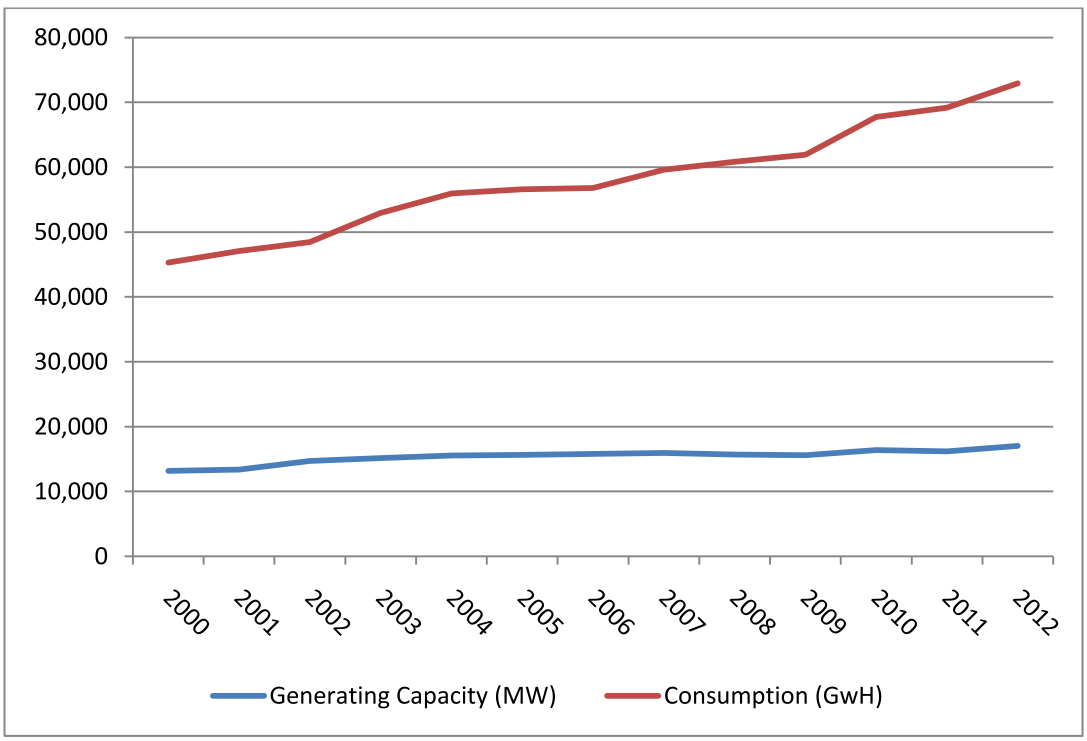
[4] Ordinario, C.U. 2014. 'Government to raise infrastructure-to-GDP ratio target in next 2 years, NEDA says'. BusinessMirror. April 14. Available at < http://www.businessmirror.com.ph/index.php/en/news/top-news/30635-government-to-raise-infrastructure-to-gdp-ratio-target-in-next-2-years-neda-says>.

An emerging serious infrastructure problem is power supply. The Philippines will face a power crisis if generating capacity will not be increased in the coming years. During the last decade, growth in generating capacity has been slow relative to growth in demand. During the last 10 years, generating capacity grew by an annual average of only 1.5 percent. In comparison, electricity consumption increased by an annual average of 4.2 percent while peak demand by 3.4 percent during the same period. In the near term, the Department of Energy is projecting a power supply deficit (projected demand is greater than capacity) beginning middle of 2015. If no new power plant will start operation, the department projects about 180MW deficit by the middle of 2015 in Luzon alone, and estimates that the Visayas grid will have a deficit of 30MW to 90MW before the current year ends. The projected deficit for Mindanao is 50MW to 190MW by 2014 and 120MW to 280MW by 2015. Even if the committed power generation projects will be considered, Luzon is still projected to go on deficit by the middle of 2017, Visayas by late 2015, and Mindanao by as early as the start of 2015[5].

Figure 2. Installed Generating Capacity and Consumption of Electricity, 2000 to 2012.



Source: Department of Energy

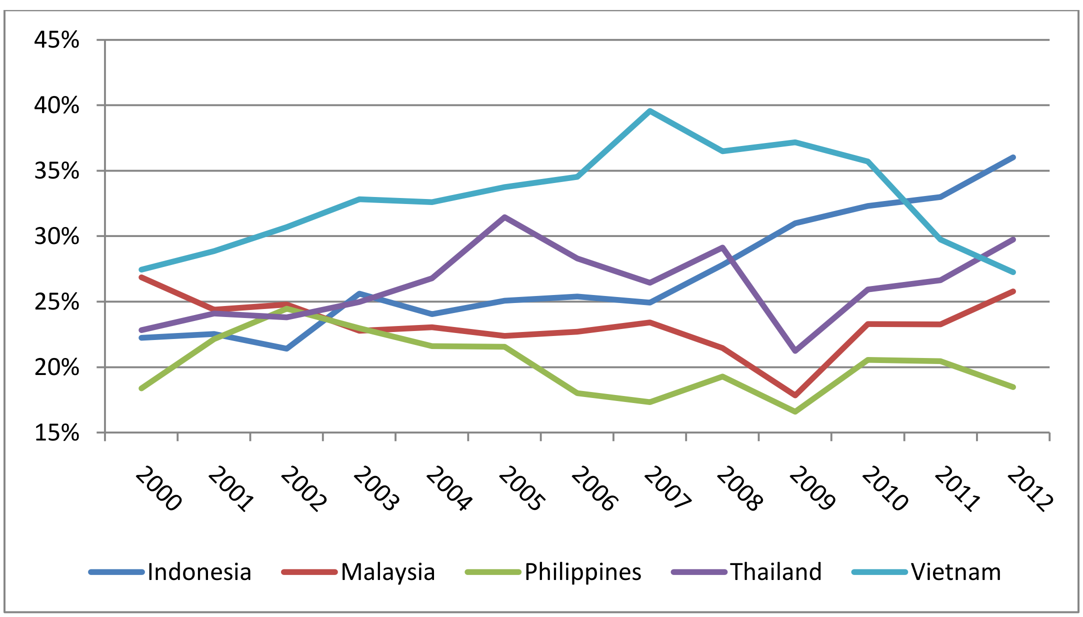
[5] Petilla, C.J.L. "Draft Demand Supply Outlook". Presentation at the 8th MAP Breakfast Dialogue with the P-Noy Cabinet, 2 August 2012. Makati City.

Some Notes on Philippine Competitiveness

The Philippines' drop in WCY ranking this year is accounted for by three factors. First is the slowdown in the growth of previously fast growing indicators. For instance, the soaring stock market and robust export growth two years ago contributed in pulling the country up the rankings last year, but precious points were lost when growth of these variables tapered off. Second is that although the Philippines fared well in some indicators, other countries simply fared better. FDIs and prices come to mind here. Third is due to indicators in which the country indeed fared poorly.

Nevertheless, there are positive signs that may elicit cautious optimism for Philippine competitiveness. For one, the three percentage point decrease in poverty incidence in 2013 compared to the previous year may be a sign that several years of strong economic growth may finally be affecting the poor. Another bright spot is investments, which grew by an annual average of 11.3 percent in the last four years after growing by an annual average of just 3.5 percent in the decade before that. With improving outlook from credit-rating agencies and confidence from foreign investors, investments are expected to continue to improve in the coming years. Investment was an integral source of growth among such East Asian economies as Malaysia, Thailand, China and Korea.

Figure 3. Gross Capital Formation as Share of GDP, 2000 to 2012

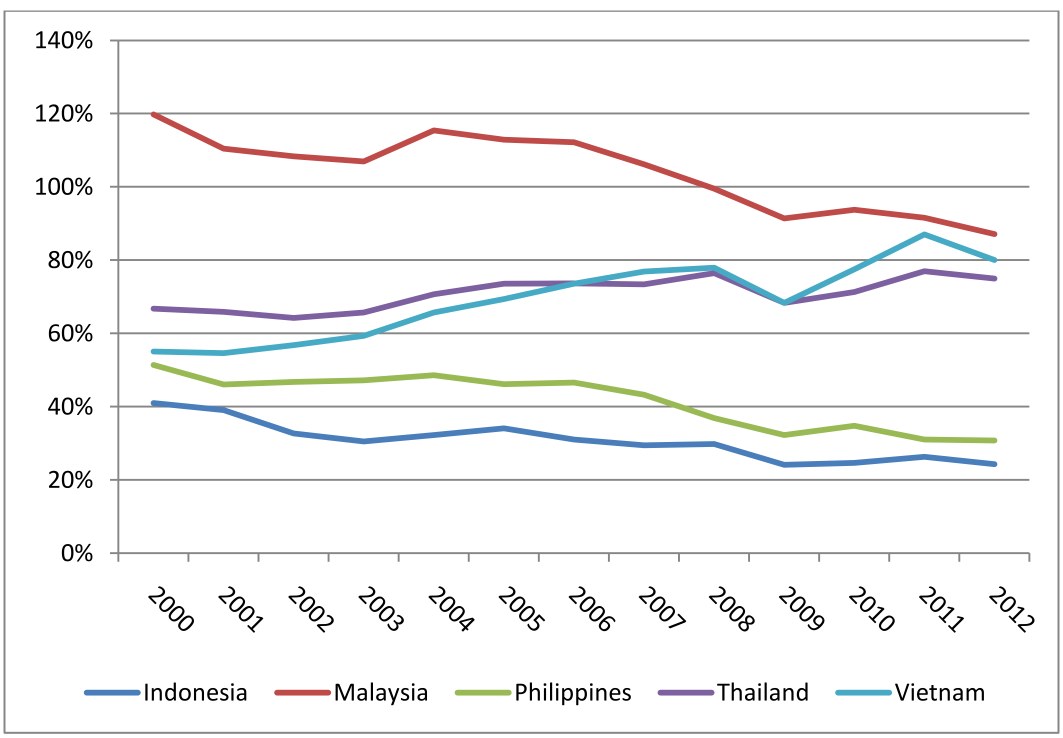


Source: World Development Indicators.

However, although investment has been growing significantly in the past four years, the Philippine economy is still consumption-driven compared to its ASEAN counterparts. In 2012, Gross Capital Formation accounts for 18 percent of the Philippines's GDP. This is much smaller compared to Indonesia's 36 percent, Thailand's 30 percent, Vietnam's 27 percent, and Malaysia's 26 percent. Since the last decade, the Philippines consistently posted the lowest capital formation as share of GDP among the ASEAN5 economies, as shown in Figure 3.

Another critical contributor to economic expansion and development that is fluctuating in growth is exports. This was a key ingredient in the growth of the high-income and upper middle income countries in East and Southeast Asia. Exports expand the domestic producers' markets, allowing them to increase production beyond what can be absorbed by the local economy. Among the same comparator countries, exports as share of GDP of the Philippines exceed only that of Indonesia. The Philippines' 31 percent in 2012 is much lower than Thailand's 75 percent, Vietnam's 80 percent, and Malaysia's 87 percent. This trend hardly changed from the previous decade, as shown in Figure 4.

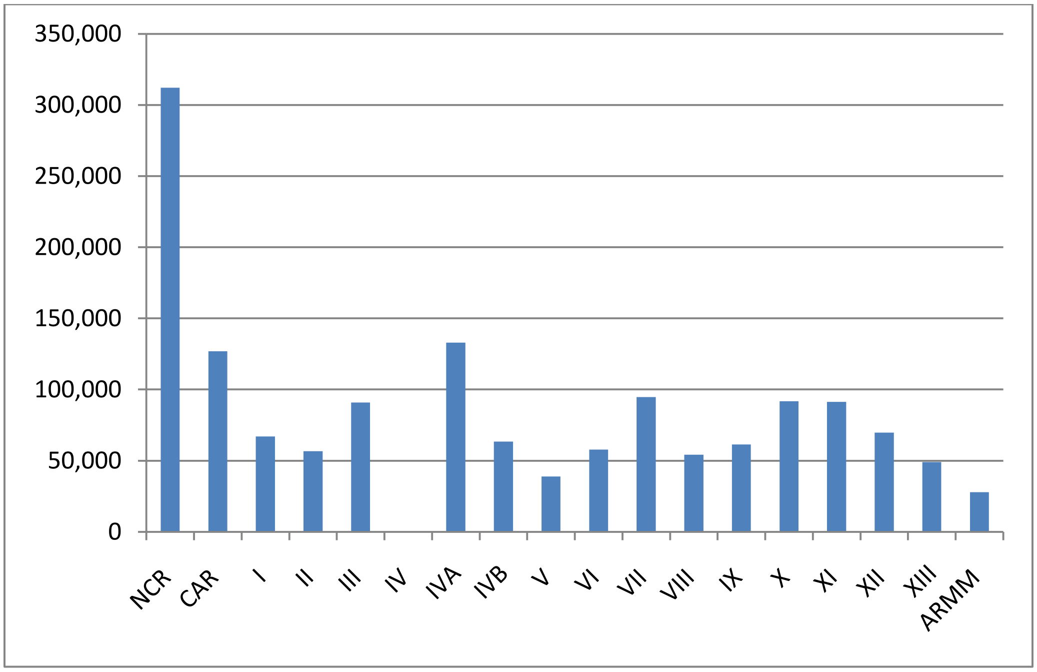
Figure 4. Exports as Share of GDP, 2000 to 2012



Source: World Development Indicators

Re-balancing growth – or ensuring that growth translates to higher incomes not just for a few – is also crucial in promoting competitiveness. Per capita Gross Regional Domestic Product (RGDP) shows the marked difference in income across regions, with NCR having per capita GDP more than 11 times greater than ARMM (see Figure 5). NCR also accounted for 36 percent of GDP but only 13 percent of population. In contrast, Mindanao contributed only 14 percent to GDP but has 24 percent of population.

Figure 5. Per Capital Gross Regional Domestic Product, 2012 in Current Prices



Source: National Statistical Coordination Board.

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