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The role of Filipino conglomerates in the nation's development

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COULD the country's small and medium companies be the engines of transformation that it needs to attain and sustain the 6.5-8 percent annual growth targeted in the Philippine Development Plan 2023-2028? I doubt it. They have neither the knowledge nor the financial muscle to do it.

There is another group of companies that could lead the way. These are the large conglomerates of the nation. They have much better knowledge of the economy and financial power. Yet, in general, they do not innovate or export. Instead, they are into non-tradable activities (real estate, banking, distribution, insurance, construction, telecommunications and food). They cater to a large domestic market by providing services that nobody denies are needed. There is nothing to criticize about specializing in non-tradables. The point is that while other nations have conglomerates and companies specializing in non-tradable activities, they also have conglomerates that innovate and export, like Toyota, Philips and BMW. No Filipino conglomerate is in this league. This matters because development requires "things" that non-tradable activities hardly provide and which ultimately lead to productivity gains.

These things are capital goods (machines) that have to be imported, and that developing countries can pay for only if they export and obtain dollars, euros or yen.

Economic transformation

The above is important for three reasons. First, development has always been a process of economic (and social) transformation, where workers move out of agriculture (the largest employer in poor countries and still representing 25 percent of total employment in the Philippines) into tradable industry and service activities. The essence of this transfer of resources is that productivity is higher in the latter two sectors than in the former, with the consequence that wages can increase. The transformation of the advanced economies in the 19th and 20th centuries was characterized by the reallocation of workers from agriculture into industry, in particular manufacturing.

There, the possibilities for learning and upgrading to more complex activities are great. However, this is not happening today in most developing nations. The Philippines never industrialized like its East and Southeast Asian counterparts. Many workers move out of agriculture into low-productivity services (e.g., restaurants, sales clerks). Unlike the golden era of manufacturing that developed countries enjoyed in the 20th century, growth in many developing countries comes from the service sector, from branches such as personal services, wholesale and retail trade, and what can be referred to as "food and fun" services, where productivity growth tends to be slow or masks declining quality.

Second, most Filipino conglomerates claim to be committed to the nation's development. They do so by claiming that they contribute to the attainment of the Sustainable Development Goals (SDGs) and the environment, social and governance (ESG) agenda. The reality is that neither the SDGs nor the ESG framework help developing countries close the enormous income and welfare gap that separates them from advanced economies. Nothing in these agendas, especially in the ESG, explicitly favors the kinds of investments that developing nations need to close this gap. The ESG agenda is disconnected from the criteria that favor the transformative investments that the Philippines needs. The SDGs are a list of 17 objectives with 250 targets, many of them vague and poorly formulated, such that no developing country will meet them. The Philippines needs a scorecard that favors the transformation of the economy. This is what will lead to higher wages.

Export basket

The third reason for discussing conglomerates is that developing nations need to import machinery for their development. These imports are paid in US dollars, euro or yen, not in pesos. This means that unless these nations export to earn these currencies, they will run a current account deficit (an accumulation of financial claims against the country), and sooner or later a crisis will follow. The need to avoid sustained deficits is the most significant constraint on growth for most developing nations, including the Philippines. The problem is that the Philippines is not an exporter like South Korea or Germany. The Philippines exports simple manufactures (e.g., assembled electronics) that hardly pay for its imports. Research shows that an important determinant of a country's long-run growth rate is the non-price characteristics of the export basket (and not price-competitiveness). These characteristics are quality, reliability, speed of delivery, distribution network, etc. Countries like Germany or South Korea export high-quality machinery, cars, electronic products or chemicals. Countries like the Philippines export agricultural products, natural resources or simple manufactures. Unless the export basket of the Philippines changes, it will be very difficult to increase and sustain a higher growth rate. This will perpetuate the dependence on OFW remittances and BPO call centers to avoid a current account deficit.

The non-tradable activities that Filipino conglomerates are into require foreign exchange that they themselves do not generate. These groups are therefore unable to push the country forward beyond the output that can be supported by the export capacity of others. I read recently that Integrated Micro-Electronics Inc. (the Ayala group) will partner with American company Zero Motorcycles to manufacture up to 18,000 e-motorcycles per year in the Philippines. Ayala's example needs to be replicated manyfold.

Advanced niches

I am not criticizing the conglomerates for specializing in non-tradable sectors. In a market economy, companies are free to decide what they do. Yet Filipino conglomerates do not feel pressure because they serve a growing domestic market. Growth is almost guaranteed to continue for some time as a result of positive labor force and productivity growth. But this situation will end, and when it does, the country will be left with an economy that will continue without being able to compete in international markets. The balance-of-payments constraint on growth will remain, as will the dependence on remittances. The wage gap with the advanced economies will not have been closed.

The Philippines lost the manufacturing train decades ago, and many think that services (tourism and the whole gamut of business processing outsourcing activities) will do it today. These activities can indeed provide many mid-level jobs and help the current account. Yet, it will be difficult to eventually become a high-income economy without getting into some advanced niches in both manufacturing and services. Specifically, while services do and will contribute to the economy, the Philippines needs a manufacturing base that innovates, absorbs the skilled employment that our universities generate, and competes in world markets. Agriculture still employs about 10 million workers who will not be absorbed by Accenture, JPMorgan or IBM.

Summing up, the nation's conglomerates need to lead the jump that the country needs to transform the economy and to attain and sustain 6.5-8 percent annual growth during the current administration and beyond. They are the only ones with enough size and financial power to do it, and they are the ones that can establish links with medium-sized firms that can be their suppliers. The conglomerates have to become exporters that compete in international markets with products that are more and more sophisticated. This is what the country lacks to attain and sustain growth in the next few decades.

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