

# POLICY BRIEF

GLOBALIZATION, ADJUSTMENT AND THE CHALLENGE OF INCLUSIVE GROWTH

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## GLOBALIZATION, ADJUSTMENT, AND EMPLOYMENT DRIVERS

### I. INTRODUCTION

**This study is a comparative analysis of the relative performance of two key industries in the Philippines during the period when the country liberalized trade. These industries are (1) the textile and garments industry, and (2) the information and communications technology (ICT)-based industries consisting of the electronics industry and the business process outsourcing (BPO) services sector.**

The study aims to account for the factors that affected the differential performance of these industries, and their efforts to upgrade in the face of stronger competition and the consequence and implications of these in terms of the attainment of the goal of inclusive growth and their role as employment drivers, respectively.

### II. Structural Changes of the Philippine Economy

The typical pattern of an industrializing economy is characterized by a declining share in agriculture accompanied by an increasing share in industry. In the case of the Philippines, the decline in the share of agriculture was offset by the increase in the share of the services sector—from 38.6% in the 1970s to 53.7% in 2008. The share of the industrial sector remained practically unchanged at 31.5% throughout the last 40 years.

manufacturing to GDP ratios in the East Asian region. Across the manufacturing sector, there are also structural changes. The food, beverage, and tobacco industry continues to dominate the manufacturing sector with its share rising over time. The share of the textile industry peaked in the '80s but fell in the succeeding decades. The garments industry grew in the '90s but declined afterwards. Notable was the spectacular growth in the share of the electronics sector. Its share in the GDP increased from 4.4% in 1970 to 11.6% in 2000.

How do we account for stagnation in the manufacturing sector? To a large extent, the poor performance in manufacturing can be traced to the stagnation in the garments and textile industry. Hence, our analysis will have to focus on developments in these sectors of the economy.

#### 2.1. Trade Liberalization

By far, the most important factor affecting the performance of the Philippine

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The share of manufacturing declined slightly from a quarter of the GDP in the 1970s to 22.3% in 2008, one of the lowest

**Table 1. Key Features of the Manufacturing Sector, 1995**

Code	Industry	% Foreign	% Exported	Effective Protection Rate (EPR)
311-2	Food Processing	36.9	16.2	32.4
313	Beverages	35.3	0.1	44.0
314	Tobacco	42.9	1.3	53.4
321	Textile	27.2	47.1	1.9
322	Garments	45.3	73.8	4.6
323	Leather Products	67.5	68.9	8.0
324	Footwear	38.7	52.2	0.2
331	Wood Products	12.2	33.8	7.5
332	Furniture	13.3	67.6	-0.1
341	Paper Products	48.3	10.0	13.6
353	Petroleum refining	100.0	1.4	20.1
355	Rubber Products	73.9	30.9	17.3
356	Plastic products	45.8	10.4	17.9
361	Ceramics	77.4	41.8	3.6
362	Glass Products	71.8	9.4	20.2
363	Cement	22.8	0	19.5
371	Iron and Steel	44.2	5.6	9.1
381	Fabricated metals	15.6	22.2	28.7
382	Machinery	69.9	78.7	0.4
383	Electronics	84.1	70.8	4.7
<b>3</b>	<b>Total</b>	<b>56.6</b>	<b>24.6</b>	<b>19.2</b>

Source: Hill (2003)

manufacturing sector was the policy of trade liberalization that began in the '80s and accelerated in the '90s and which considerably reduced the protection that manufacturing used to enjoy. At the same time, the manufacturing sector suffered from intense competition in the '90s from China and other developing economies. With the influx of substantial capital flows to the country, the peso experienced a nominal and real appreciation, hurting tradable goods sectors such as manufacturing by making imports cheaper in the domestic market and exports more expensive in the world market.

But why is it that some manufacturing subsectors fared worse than others? One possible explanation would be the uneven liberalization of trade within the manufacturing sector as shown in Table 1. By 1995, effective protection rates (EPR) are relatively high in the food processing, beverages, and tobacco but low in the

textiles and garments. The decline in EPR for textile was dramatic—from 90% in 1983 to 29% in 1988 to 1.9% in 2005. On the other hand, the decline in EPR for garments was reversed in the mid-1990s—from 3.1% in 1983 to -3.5% in 1988 to

**Table 2. Cost Structure of Different Philippine Industries 1999, in percent**

Code	Industry	Labor	Raw Materials	Fuels	Electricity	Interest expense	Indirect taxes	R&D
311-2	Food Processing	7.6	68.4	1.5	2.1	3.0	2.2	0.05
313	Beverages	8.8	53.3	1.1	1.9	1.7	12.9	0.07
314	Tobacco	2.8	30.6	0.1	0.4	2.1	24.8	0.04
321	Textile	21.2	50.9	1.1	4.2	2.7	1.8	0.03
322	Garments	25.7	52.0	0.9	2.0	1.8	1.0	0.02
323	Leather Products	26.0	57.0	1.4	2.0	0.4	0.6	0.01
324	Footwear	24.1	53.9	0.6	3.9	3.3	1.6	0.03
341	Paper Products	9.5	63.2	4.1	7.4	7.7	1.4	0.06
351	Industrial Chemicals	8.3	69.6	2.5	6.0	4.6	1.7	0.05
353	Petroleum refining	0.4	82.3	2.4	3.9	0.7	1.4	-
354	Misc. petro	7.1	72.4	1.8	1.4	5.4	0.6	0.02
355	Rubber Products	13.7	52.7	1.5	3.3	3.0	0.9	0.14
356	Plastic products	13.7	65.7	1.1	5.7	3.5	1.7	0.61
362	Glass Products	14.2	40.3	7.9	4.3	5.6	1.5	0.17
363	Cement	7.6	44.1	4.9	17.4	6.0	5.1	0.10
369	Other non metals	15.3	50.4	3.2	2.4	9.3	1.2	0.07
371	Iron and Steel	6.1	64.3	2.7	7.0	13.4	1.4	0.01
372	Non ferrous metals	3.6	74.8	0.6	2.7	7.4	1.0	-
381	Fabricated metals	12.8	73.2	1.2	2.2	1.0	1.0	0.03
382	Machinery	4.1	86.2	0.4	0.7	0.8	0.3	0.08
383	Electronics	8.0	76.2	0.4	3.8	1.9	0.4	0.14
384	Transport equipment	6.2	69.7	0.3	1.0	3.5	2.9	0.27
3xx	Professional equipment	23.9	62.6	0.1	3.0	0.3	0.9	0.26
	Average (in percent)	8.2	68.7	1.2	3.0	2.9	2.5	0.13
	<b>Total (billions of pesos)</b>	<b>114.9</b>	<b>959.5</b>	<b>16.9</b>	<b>41.3</b>	<b>40.5</b>	<b>34.9</b>	<b>1.8</b>

Source: 1999 Census of Establishment, preliminary data

4.6% in 1995. The EPRs in electronics are also low but this sector thrived during the period. This can be explained by the fact that the electronics industry is import-dependent and the low EPRs in imported electronic inputs allowed the electronics industry to remain competitive.

## 2.2. Subsectoral Performance and Differential Labor Costs

Another explanation can be found in the differences in labor costs. When labor costs constitute a large share in the total cost of an enterprise or industry, the own-wage elasticity of demand for labor will tend to be high. This implies that for any given wage increase, the negative effect on output and employment is higher in industries where labor costs constitute a larger share in the total cost of the industry. Hence, these industries will be more sensitive to any increase in the real wage.

Table 2 shows that labor costs constitute a large proportion of the total cost of textiles, garments, footwear, and furniture

(hence, own-wage elasticity of demand for labor tends to be high), but only a small component of food processing, machinery, and electronics. In particular, textile and garments employ mostly unskilled workers whose wages are affected primarily by minimum wage legislation.

Table 3 compares growth rates in nominal wages of full time workers in selected industries during the last 10 years. Wage growth was slowest for some electronics sub-industries (e.g., office, accounting, and computing machinery; and electrical machinery and apparatus), but was rapid and much higher than the average for the manufacturing sector in the textile and apparel industries.

The data suggests that the wages of skilled workers rose relative to the wages of unskilled workers and consequently, the wage gap between skilled and unskilled workers seemed to widen. What this implies is that the Philippines no longer has an advantage in producing labor-intensive goods and services that make use of low-cost, low-skilled workers and that to successfully compete in a globalizing environment, domestic firms are increasingly turning to skill-intensive manufacturing processes.

Table 4 shows that wage levels for both skilled and unskilled workers are well above the levels prevailing in Vietnam and Indonesia by 1999. In general wage levels are comparable to that of Thailand which has a per capita income that is twice that of the Philippines.

Competitiveness depends primarily on unit labor costs, which is defined as nominal wages, measured in dollars, divided by average labor productivity.

**Table 3. Median monthly wage rates of time-rate workers on full-time basis on selected industries, various years, (in PhP)**

Country	1997	1999	2002	2004	2006	Growth Rate
Manufacture of Textiles	5,439	6,175	8,356	7,817	9,725	70.5
Manufacture of Wearing Apparel	5,014	5,910	7,644	7,259	8,219	63.9
Manufacture of Office Accounting	5,625	5,975	7,757	7,832	8,338	48.2
Manufacture of electrical machinery, apparatus and computing machinery	6,341	6,993	9,141	8,445	8,599	35.6
Manufacture of Radio, TV and communication Equipment	5,669	5,853	9,092	8,035	9,118	60.8
All Manufacturing	5,714	6,330	8,564	7,801	9,058	58.5

**Table 4. Prevailing Wage Levels Across Selected Asian Countries, 1999, in US dollars industries, various years, (in PhP)**

Country	Min. Wage for Unskilled Labor (\$/day)	Unskilled Labor (\$/day)	Skilled Labor (\$/day)	Technicians (\$/month)	Engineers (\$/month)	Middle Management (\$/month)
Indonesia	0.70-2.8533	2.00 - 3.00	6.10	250	380	560
Malaysia	No minimum wage	7.97	13.28	578	1,395	1,992
Philippines	4.19-5.65	4.00-6.70	7.00-9.17	350-550	650-962	1,076-1,307
Taiwan (China)	28.50	37.50	51.50	1,378	1,568	2,225
Thailand	5.07-6.25	5.12-6.13	6.61-7.28	282-560	584-749	700-1,221
Vietnam	.78	1.29-1.37	2.15 - 2.38	100-185	195	220

Note: All data are as of mid-1996. Average wages are for workers in light manufacturing industries. Minimum wages in the Philippines include cost of living allowance and temporary living allowance.

Source: The Services Group, compiled from various publications and supplemented with firm-level interviews. Philippine data compiled from government sources

**Table 5. Unit Labor Costs of the Manufacturing Sector in Selected Asia Countries, 1986-1995**

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995
China	100	97	95	91	91	87	82	77	74	
Hong Kong (China)	100	91	95	95	94	82	76	79	78	67
India	100	85	77	63						
Indonesia	100	96	101	90	91	103	106	97	93	
Korea	100	110	117	146	158	172	180	180	181	177
Philippines	100	115	120	127	134	140	157	145		
Singapore	100	95	94	105	108	105	110	100	93	85
Sri Lanka	100	96	76	58	117	116	99	126	133	
Taiwan (China)	100	105	111	122	124	121	126	122	126	124
Thailand	100	106	87	83	88	99	104	100	90	
Japan	100	97	97	100	100	102	106	110	114	117
United States	100	97	93	92	92	92	91	90	87	82

Note: Entries are ratios of total annual compensation cost per employee to value added per employee, both constant producer prices and in domestic currencies, indexed to have 1986 as the base year.

Source: Godfrey (1997).

It can therefore be interpreted as the rate depreciation will cause unit labor costs to fall while an exchange rate appreciation and nominal wage increases will increase unit labor costs. Table 5 shows that from 1986 to 1992, unit labor costs in the Philippines were much higher and grew much more rapidly than those of selected countries. This is attributed to the large increases in

**Table 6. A.T. Kearney's Global Services Location Index, 2005 Rankings**

	OVER-ALL RANK	Business Environment (Rank)	Financial Attractiveness (Rank)	People Skills and Availability (Rank)
<b>Southeast Asia +2</b>				
Singapore	5	1	30	10
Malaysia	3	10	15	18
Thailand	6	19	8	26
India	1	23	6	3
China	2	28	9	7
Philippines	4	33	1	16
Indonesia	13	38	5	20
Vietnam	26	40	3	36
<b>Europe and Africa</b>				
Czech Republic	7	11	27	18
Egypt	12	35	4	25
Hungary	19	17	26	32
Poland	18	20	24	21
Russia	27	39	20	13
South Africa	32	24	21	34
<b>Latin America</b>				
Brazil	10	25	17	12
Chile	8	12	22	23
Mexico	17	27	19	16
<b>Developed Countries</b>				
Australia	29	4	34	8
Canada	9	3	33	6
Ireland	39	6	39	11
GLOBAL MEDIAN	11	22	20	17
ASIAN MEDIAN	5	26	7	17

From A.T. Kearney's Global Services Location Index study (2006). It ranks 40 countries according to three categories (weights in parenthesis): Financial structure (40%), Business environment (30%), and People and skill availability (30%).

nominal wages given to workers upon the assumption to power of President Corazon Aquino and in response to growing militancy in the labor sector. Subsequently, real wages fell and labor productivity improved modestly. Labor costs have been falling ever since particularly in the tradable goods sector including textile and apparel.

### III. Business Processing Outsourcing (BPO)

The Business Processing Outsourcing (BPO) sector has emerged as an important driver of growth and employment in the Philippines. From having a negligible

share of 0.075% of the GDP in 2000, its contribution has jumped to 3.59% in 2008. It generated over US\$6 billion revenue and employed 372,000 workers the past year.

The contact center subsector constantly captured the largest share of the market—67.5% in revenue and 61.0% in employment—for 2008. Part of this may be explained by the shifting of what are considered the low-end BPO, like contact centers and transcription services, to the Philippines from India, a service provider that is maturing to the high-end BPO or Knowledge Processing Outsourcing (KPO).

Another significant subsector next to contact center is the back-office non-voice BPO such as one that provides finance and accounting and human resource administration services. It grossed US\$827 million revenue and employed close to 69,000 workers in 2008. Moreover, during the same year, it posted the fastest growth in terms of revenue of almost 120% from the previous year and 72% additional employment. Other subsectors that the country is catching up to serve are Information Technology Outsourcing (ITO) and Engineering Services Outsourcing (ESO).

The marked expansion and success of the Philippine BPO industry can largely be attributed to what may be considered an enabling environment for BPO in the country. It possesses not only an IT-proficient and English speaking workforce but also strong support industries that pave the way for a more efficient and sustainable BPO operations. In 2005, A.T. Kearney ranked the Philippines as the fourth best global service location next to India,

China, and Malaysia (Table 6). The study utilizes three considerations to determine overall ranking: business environment, financial attractiveness, and people skills and availability. Among the 40 countries ranked, the Philippines outperformed all the other countries in terms of financial attractiveness but fared below average on business environment aspect.

The issues of labor piracy and migration appear to be the biggest weaknesses associated with BPO. Its human capital is threatened of depletion from attrition and more attractive money returns from overseas work. Intensified competition from other sites also poses a threat. Already, A.T. Kearney's rankings of Global Services Location Index reported the Philippines to lose four places—from 4th to 8th best global service location among 40 to 50 countries.

In response to the fast changing environment, the BPO sector should take advantage of the opportunities that arise along the way. The current trend towards building infrastructure outside Metro Manila supportive of the sector, such as IT parks and PEZA zones, needs to be sustained to enable BPO greater access to a larger pool of talents and resources in the provinces and at the same time, potentially reduce urban-centric migration and income inequality. Data security, being a primary consideration for the sector, requires firm implementation of data protection laws like the "Guideline 8" for Protection of Personal Data in Information and Telecommunication System in the Private Sector especially for capturing, retaining, and expanding the medical transcription services. The transition to servicing more of the high-value outsourcing market and tapping the

shared services/captives market ought to be facilitated by both the private and public sectors. The required skills for high-value services can be developed by ensuring a match between school curricula and industry requirements. The BPO firms, directly or through industry associations, must establish a strong linkage with the academe to address any mismatch between acquired and required skills. The Commission on Higher Education (CHED) and Technical Education and Skills Development Authority (TESDA) should take a lead role in closing the skills gap.

### IV. Some Conclusions

There are many reasons for the decline of the textile and garments industry in the Philippines: the macroeconomic and political instability in the early '80s that led to capital flight and high interest rates, the labor unrest and political strife in the late '80s, the power crisis in the early '90s, the exchange rate appreciation in the late 90's, and the end of the Multifiber Agreement in 2005. At a more fundamental level, the domestic textile industry collapsed under the weight of cheap imports from low-wage countries while the garment industry found itself unable to compete with these low-wage countries in the world market for low-skilled, labor-intensive garment manufactures.

The fact, however, that the electronics industry and more recently, the BPO industry, managed to thrive under the same set of circumstances suggest two things. First, the country can be competitive in both the domestic and export markets by promoting the development of industries that exploit its emerging comparative advantage, that is, industries that make more use of the country's relative

abundance of an educated and highly trainable work force. For the textiles and garments industries, in particular, it suggests that efforts should focus on competing by raising labor productivity rather than by reducing real wages, in shifting to the high-end segments of the industry and on competing on the basis of quality and timeliness in delivery rather than on the price.

The Philippines is well endowed with skills in sewing, especially fine embroidery, but is weak in other specialized skills such as pattern-making and -designing. There is also no integration with the upstream textile industry and this has affected adversely delivery time. Investments, particularly foreign direct investments, have fallen behind other industries. There is a need to create training facilities for garment design pattern-making and other advanced skills, assist firms in productivity raising measures, and encourage the formation of clusters where firms can share facilities, information, and skills.

Second, the differential performance of the two industries brings to the fore the crucial importance of infrastructure support. Policies adopted in the early '90's to eliminate barriers to entry and promote competition in the telecommunications industry created an efficient telecommunications infrastructure that gave birth to a vibrant business process outsourcing industry. Furthermore, the elimination of rent controls and financial sector reforms that reduced the cost of borrowing precipitated a building boom that reduced rental costs. The establishment of export processing zones located near relatively efficient airports favored as well the rapid growth of electronics exports. In stark contrast, the high cost of electricity

exacerbated the inefficiencies of the textile sector, an energy-intensive activity at the finishing stages. Meanwhile, congestion in our major seaports and the relatively high costs of port services helped erode the competitiveness of the garments sector.

As the country strives to be more competitive through an emphasis on quality and timeliness in delivery, and ability to adapt quickly to rapid changes in consumer preferences, what kind of system of industrial relations would be appropriate? In the choice of a system, two things would have to be taken into account. First, it has to be in line with the emerging trend towards more flexible production techniques. Second, it must be consistent with our specific conditions and our cultural values.

To survive under globalization necessitates a continuous process of adjustment by domestic firms to the vagaries of changing consumer preferences in international markets and interminable changes in production processes brought about by the application of new knowledge. Recent advances in transportation, communications, and computers and the globalization of production and markets have made it imperative to replace the old system of mass production with

more flexible production methods that emphasize quality and variety rather than standardized uniform products. The shift towards more flexible production methods has important implications for industrial relations. The kinds of workers needed are those who have the skill and motivation to take on different tasks and to spot mistakes and correct them, and who have the initiative and willingness to share their knowledge and contribute to designing and maintaining flexible, consumer-oriented production processes geared towards continuous improvements to increase quality and reduce costs. Accordingly, these workers ought to be highly motivated, better skilled, cooperative, and able to communicate and work well with others.

How can firms bring about a highly skilled and motivated workforce concerned with the well-being of the company? First of all, effort, loyalty, and commitment tend to be higher among workers who perceive their employers to be fair in terms of the firm's compensation policies, to be willing to share in the surplus during good times, and who are honest about the true financial state of the enterprise. Secondly, an implicit guarantee of job security similar to the Japanese system of lifetime employment may help firms to generate a

skilled and highly motivated workforce. This is because the firm can attract the best and brightest workers, who are highly motivated, well-educated and therefore easier to train. Moreover, if the firm is reasonably confident that its workers will not leave then it has the incentive to invest in their training. The training raises the workers' skills and productivity, allowing the firm to pay relatively higher wages. This in turn encourages workers to stay.

Thirdly, because exit is often not a feasible option for many workers, voice becomes extremely important. For many workers, policies and decisions are judged not so much in terms of the outcome but more in terms of the process that went into it. Decisions might be considered fair regardless of what they are so long as the process that went into it is perceived as fair. For instance, a worker who has been disciplined after a formal hearing before a committee that includes worker representatives may consider the decision as fair than if he received the same punishment from management without a formal hearing. Finally, the need arises for firms to provide continuous training for their work force. Firms will provide training voluntarily when they are able to recover the costs particularly when turnover rates are high.

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