Philippine Economy & Policy Review: Manufacturing and Foreign Investment

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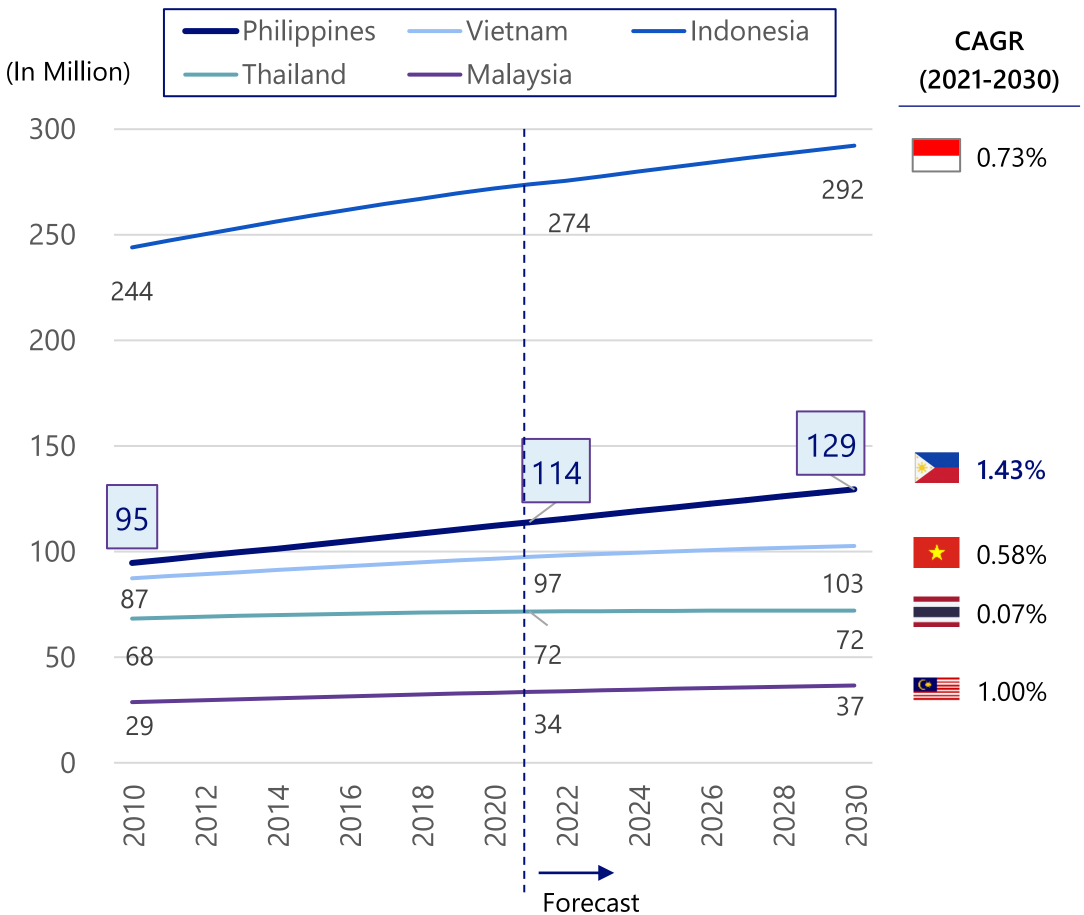
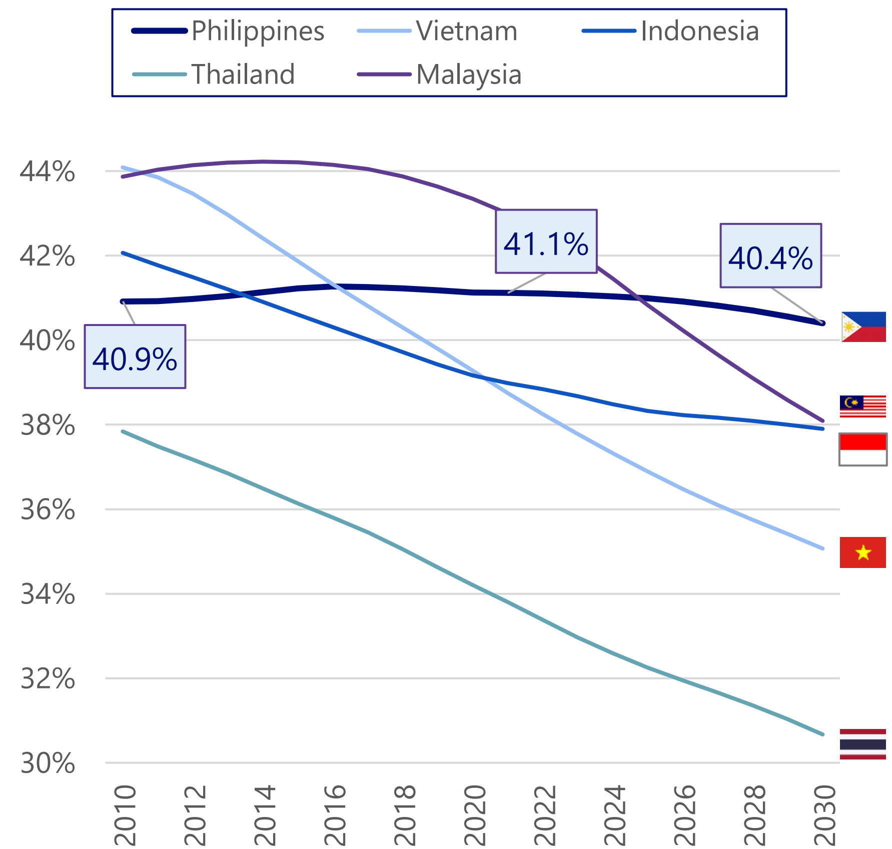
1. Macroeconomic Indicators / PDP Overview

Philippine population continues to grow at higher rate than other major ASEAN countries, with retaining high proportion of younger working-age population.

Population (in Million)



Proportion of younger working-age (age: 15-39) population

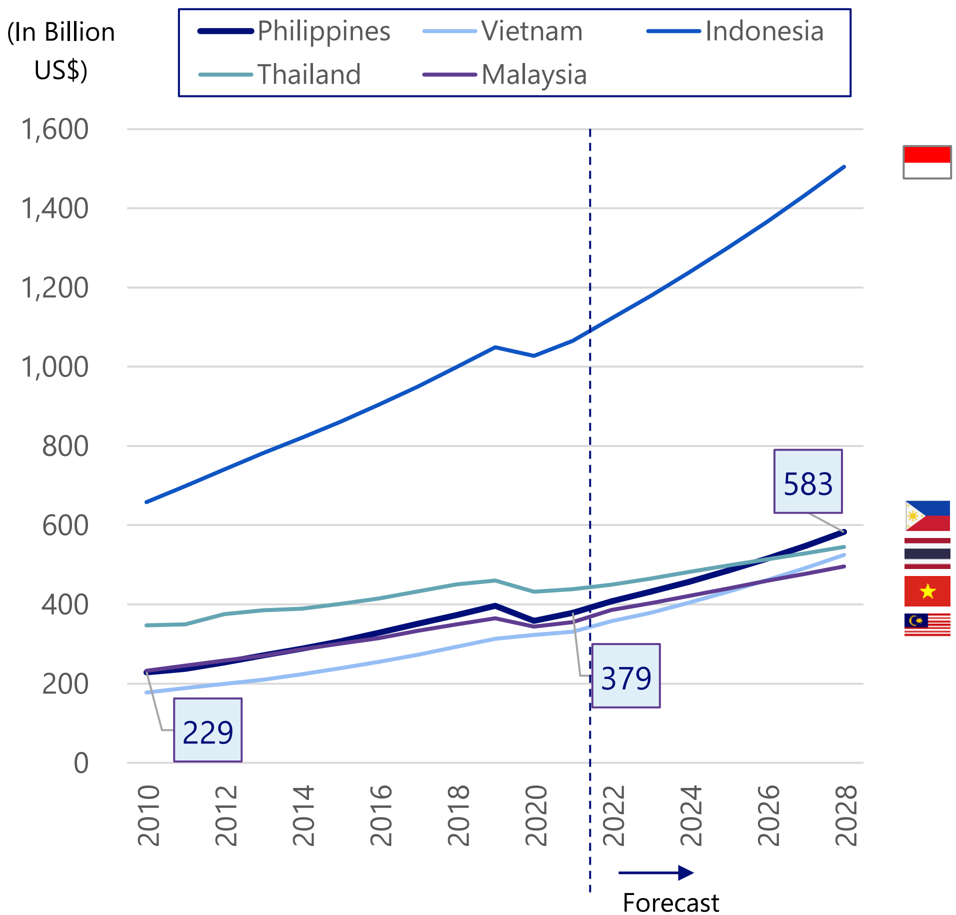


Note: Each year as of July 1st

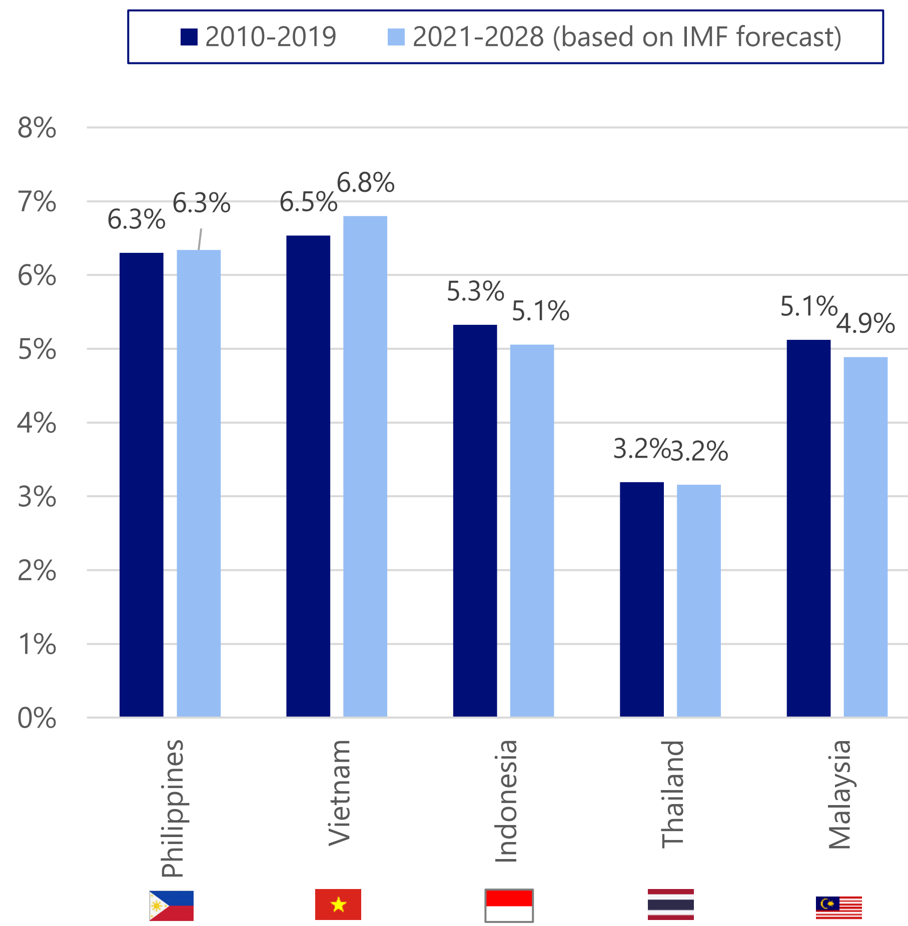
Source: United Nations "World Population Prospects 2022"

Philippine GDP continues to expand at CAGR of 6.3% to reach 580 billion USD in 2028, which will be the 2nd highest among the major ASEAN economies.

Real GDP (constant 2015 US$, in Billion)



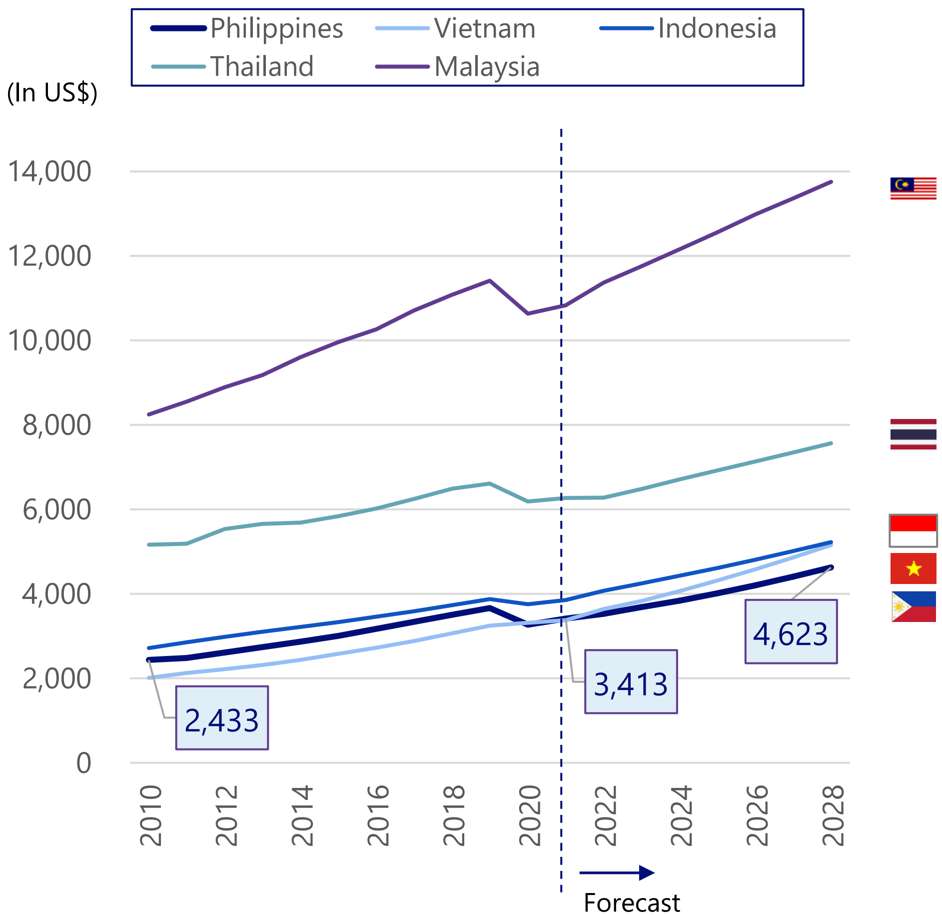
CAGR of Real GDP



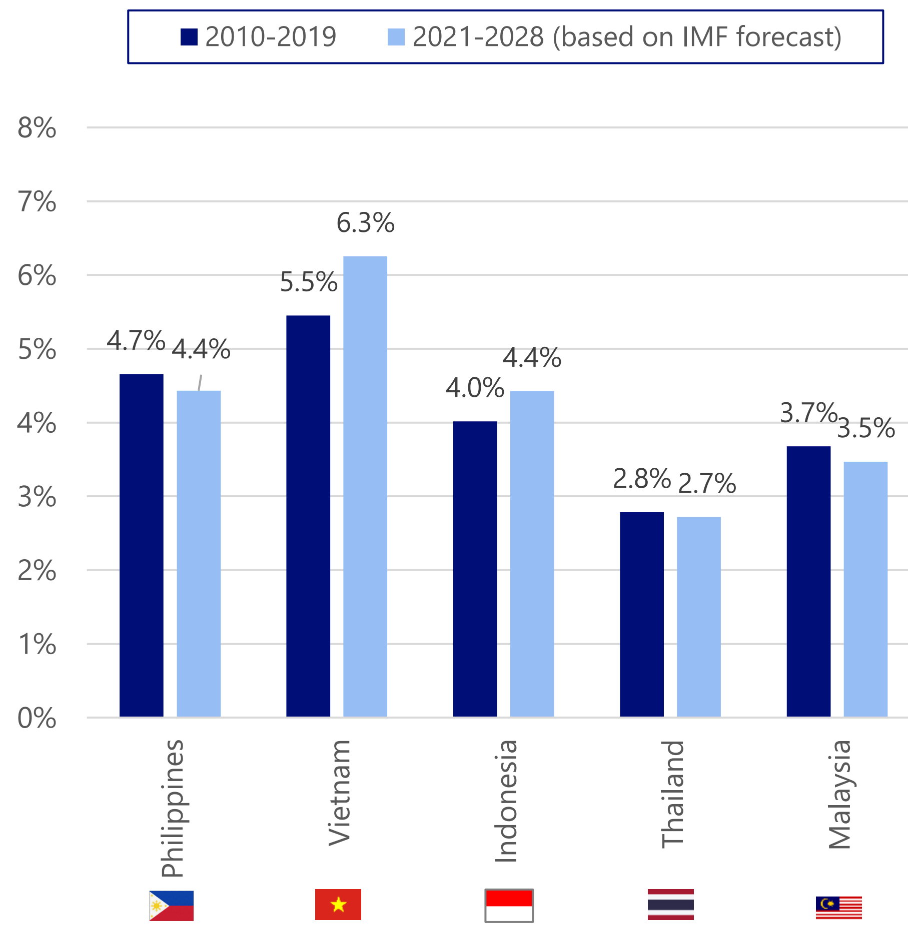
Source: NRI, based on World Bank "World Development Indicators" and IMF "World Economic Outlook (April 2023)"

Philippine GDP per capita is expected to grow at CAGR of 4.4%, but still fall behind the other major ASEAN economies.

GDP per capita (constant 2015 US$)

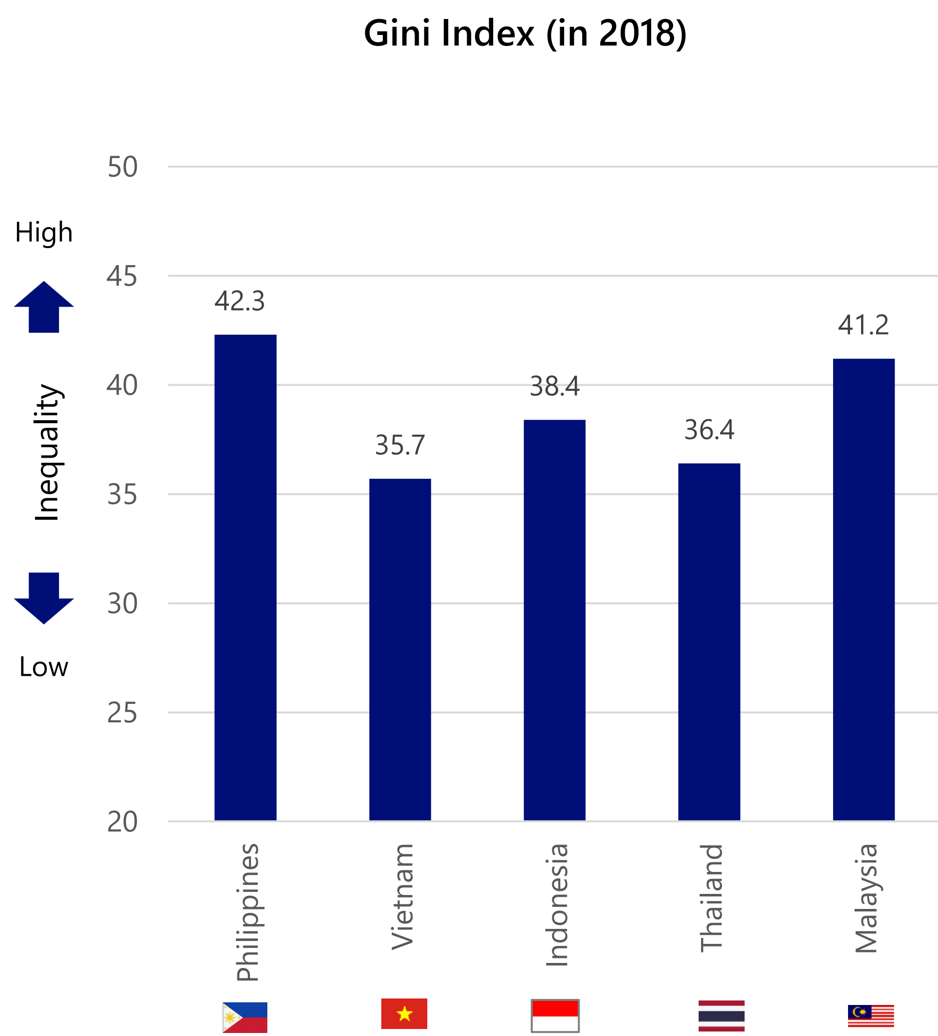


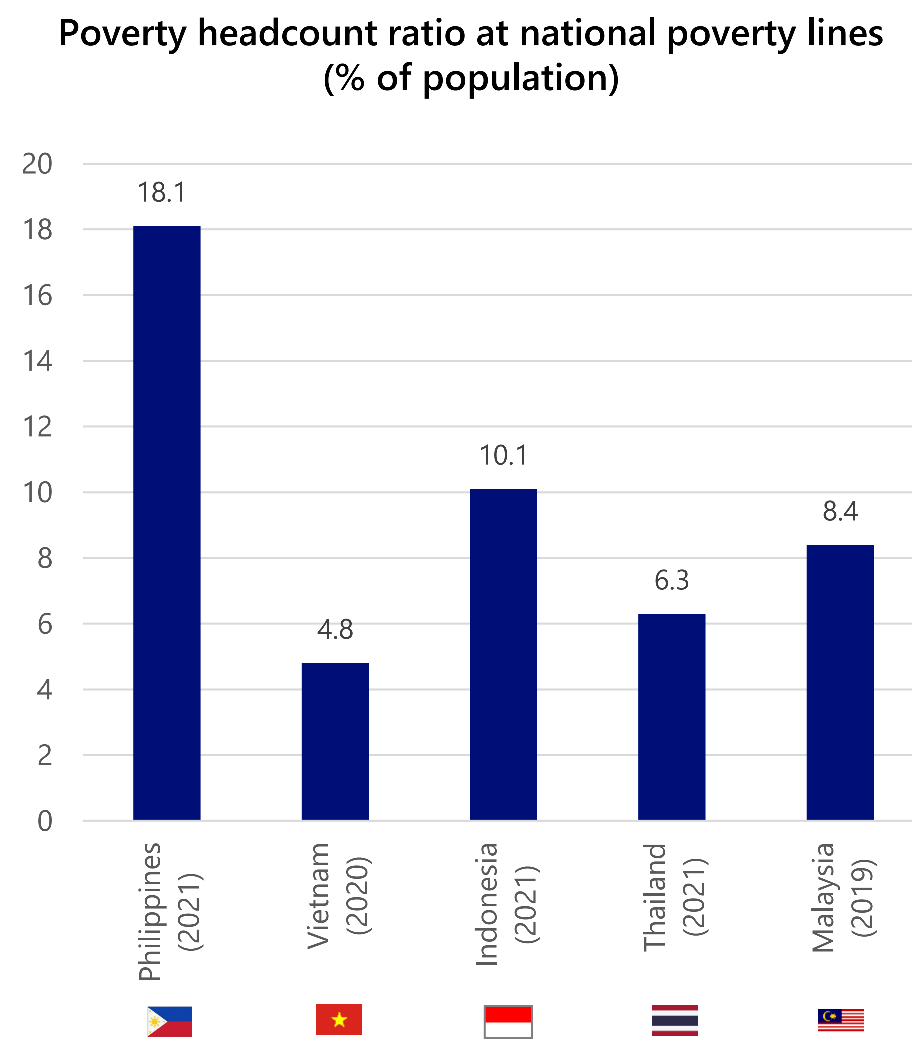
CAGR of GDP per capita



Source: NRI, based on World Bank "World Development Indicators" and IMF "World Economic Outlook (April 2023)"

Philippines has the highest rates of income inequality and poverty ratio in major ASEAN economies.





Source: World Bank "World Development Indicators"

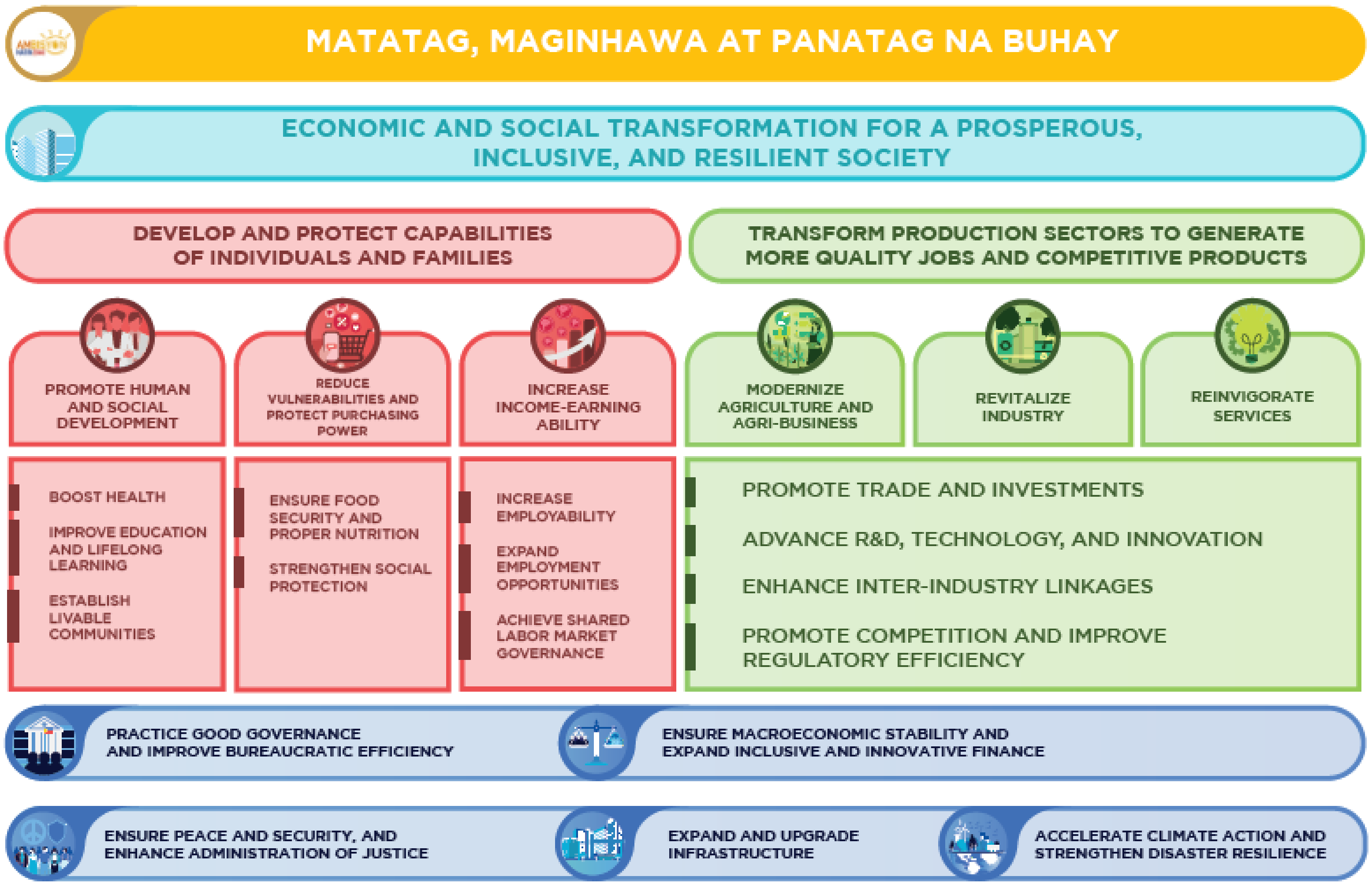
The current PDP targets high levels of economic growth, putting emphasis on creating more and better-quality jobs and reducing poverty.

Goals and Targets

- Maintain annual economic growth rate between **6.0 to 7.0% in 2023** and **between 6.5 to 8.0% from 2024 to 2028.**
- **Transform the production sectors toward generating more and better-quality jobs**, and enabling the competitiveness of enterprises in domestic and international markets.
- **Create more and better-quality jobs**. By 2028, the target unemployment rate is within 4.0–5.0%.
- **Reduce poverty incidence to 9% by 2028.**
- Food and overall inflation will be kept to within 2.0 to 4.0 percent.
- Ensure fiscal discipline, to reduce the national government deficit to GDP ratio to 3.0% and the outstanding government debt GDP ratio to 51% by 2028.

Source: Philippines Development Plan

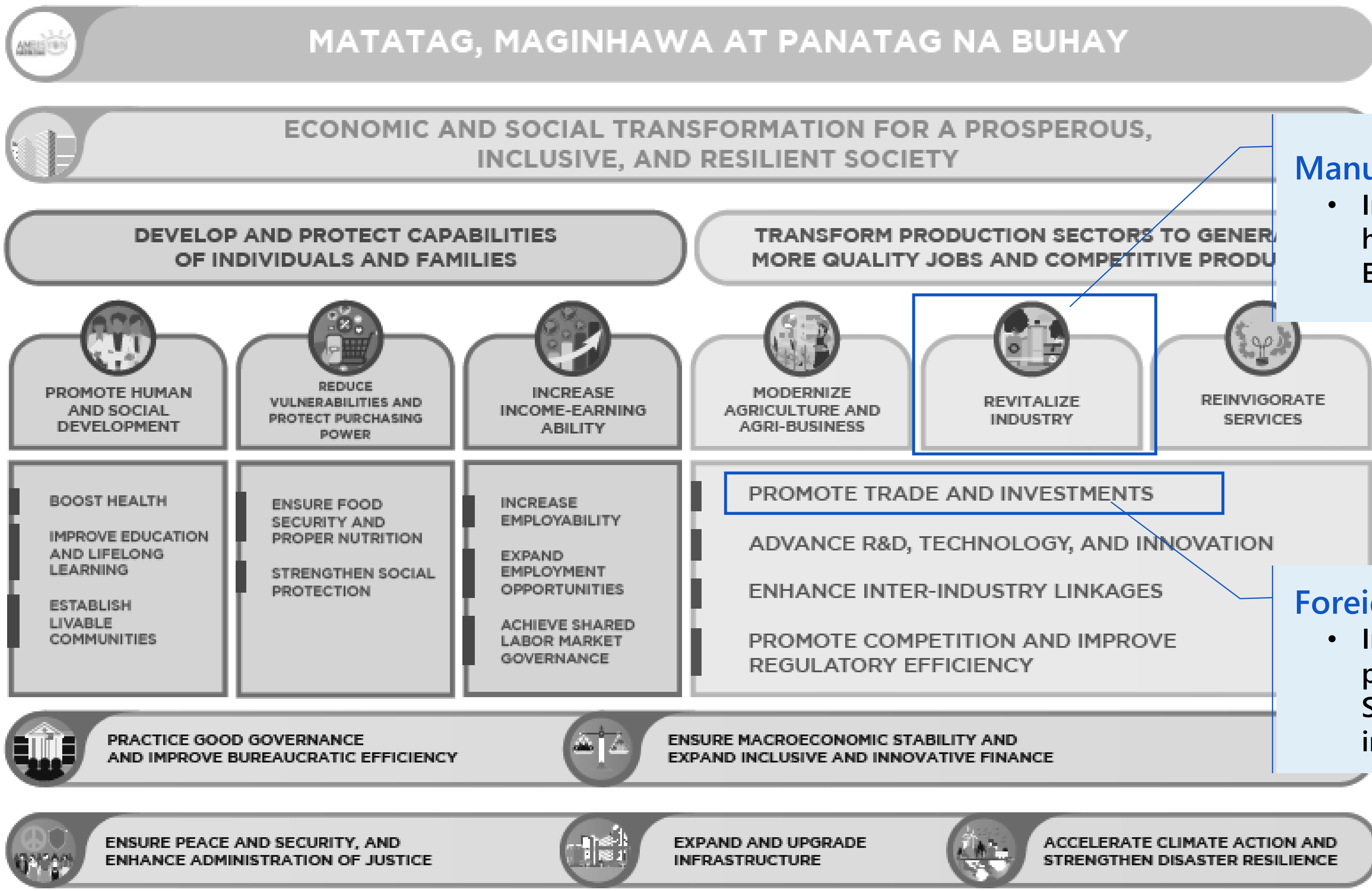
The PDP’s strategies are organized to achieve economic and social transformation for a prosperous, inclusive, and resilient society



Source: Philippines Development Plan

Focus of this session

This session focuses on Manufacturing and Foreign Investment, which are both important elements for achieving economic and social goals



Manufacturing
- Important for Creation of high-quality jobs and Expansion of middle-class

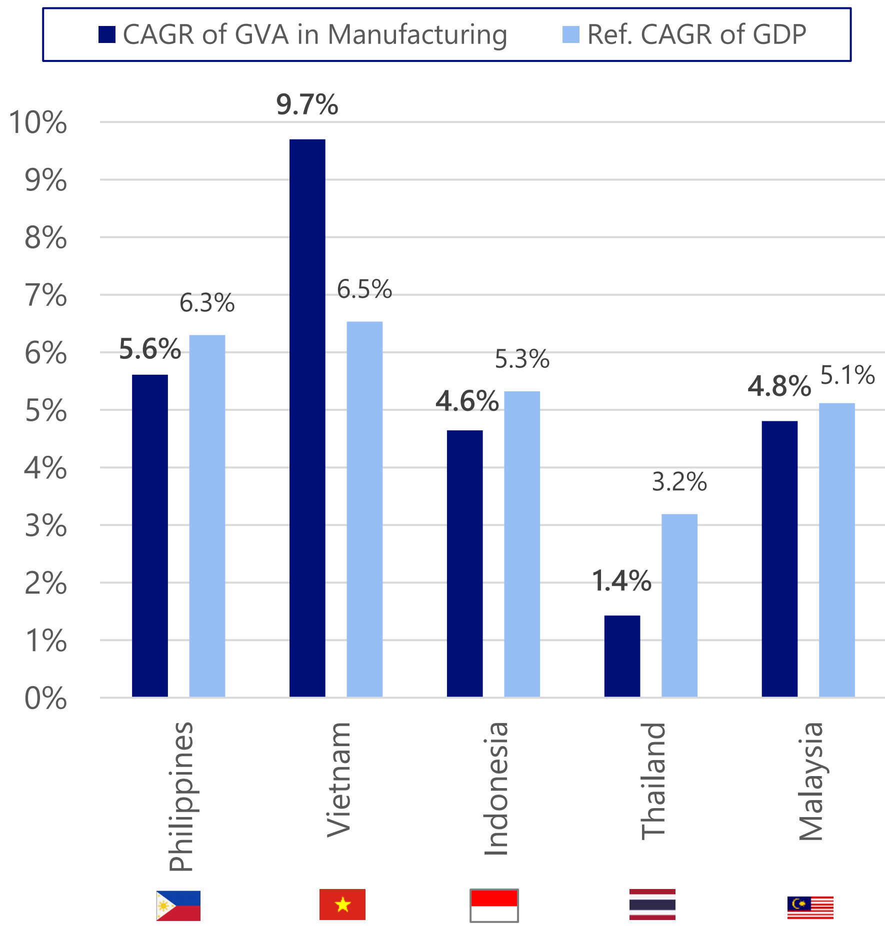
Foreign Investment
- Important for Increased productivity and Sophistication of industrial structure

Source: Philippines Development Plan

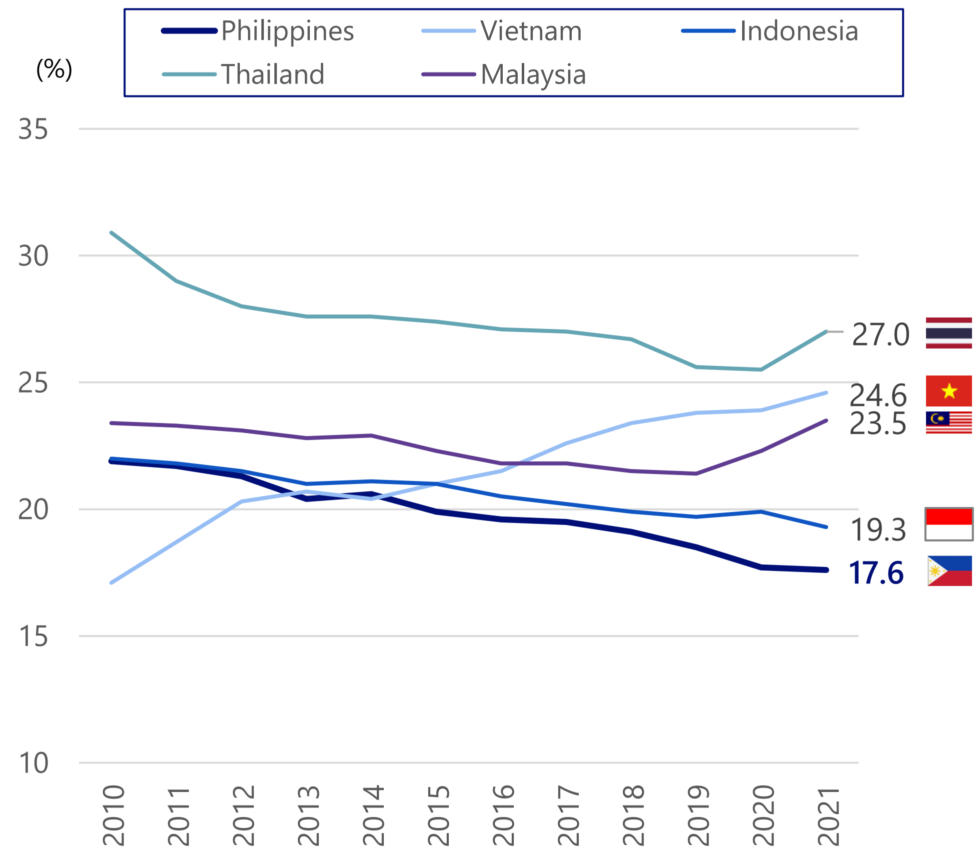
2. Manufacturing

Philippine GVA in Manufacturing is growing at a high rate (over 5% annually), but its share of GDP is stagnant at less than 20%, the lowest among major ASEAN countries.

CAGR of GVA in Manufacturing (2010-2019)



GVA in Manufacturing as % of GDP

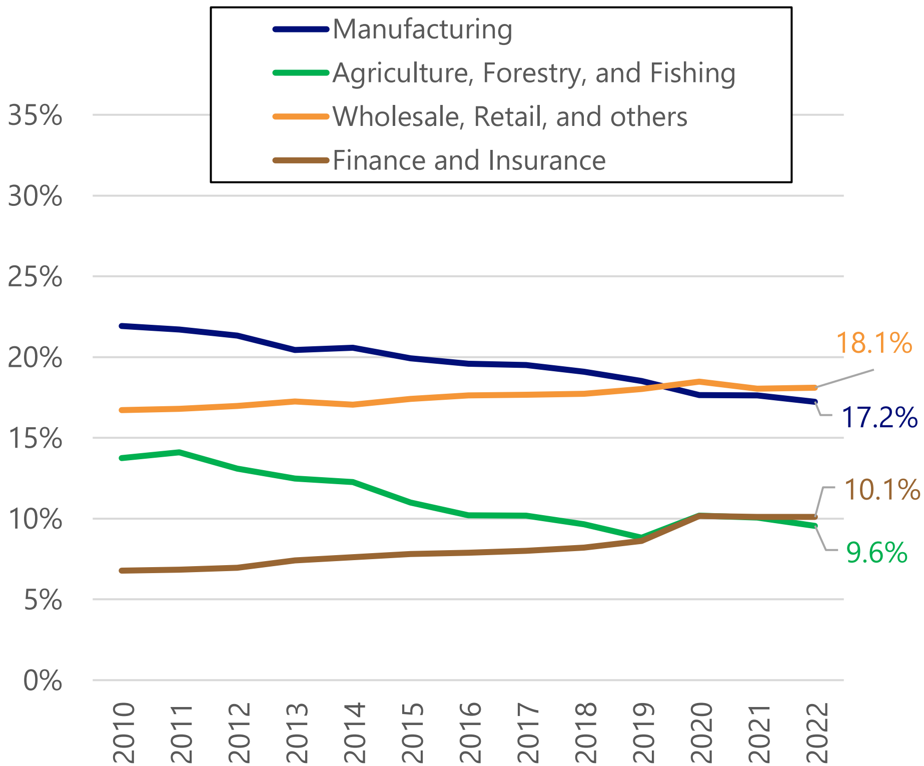


Source: World Bank "World Development Indicators"

Manufacturing sector's share of GDP continues to decline as the services sector (finance and insurance, wholesale and retail, etc.) has grown at a higher rate.

GVA in major industries as % of GDP

Share of manufacturing is declining, while shares of finance/insurance and Wholesale/Retail are on the rise



Note: "Wholesale, Retail, and others" include Sale and repair of motor vehicles and motorcycles

GVA change from previous year

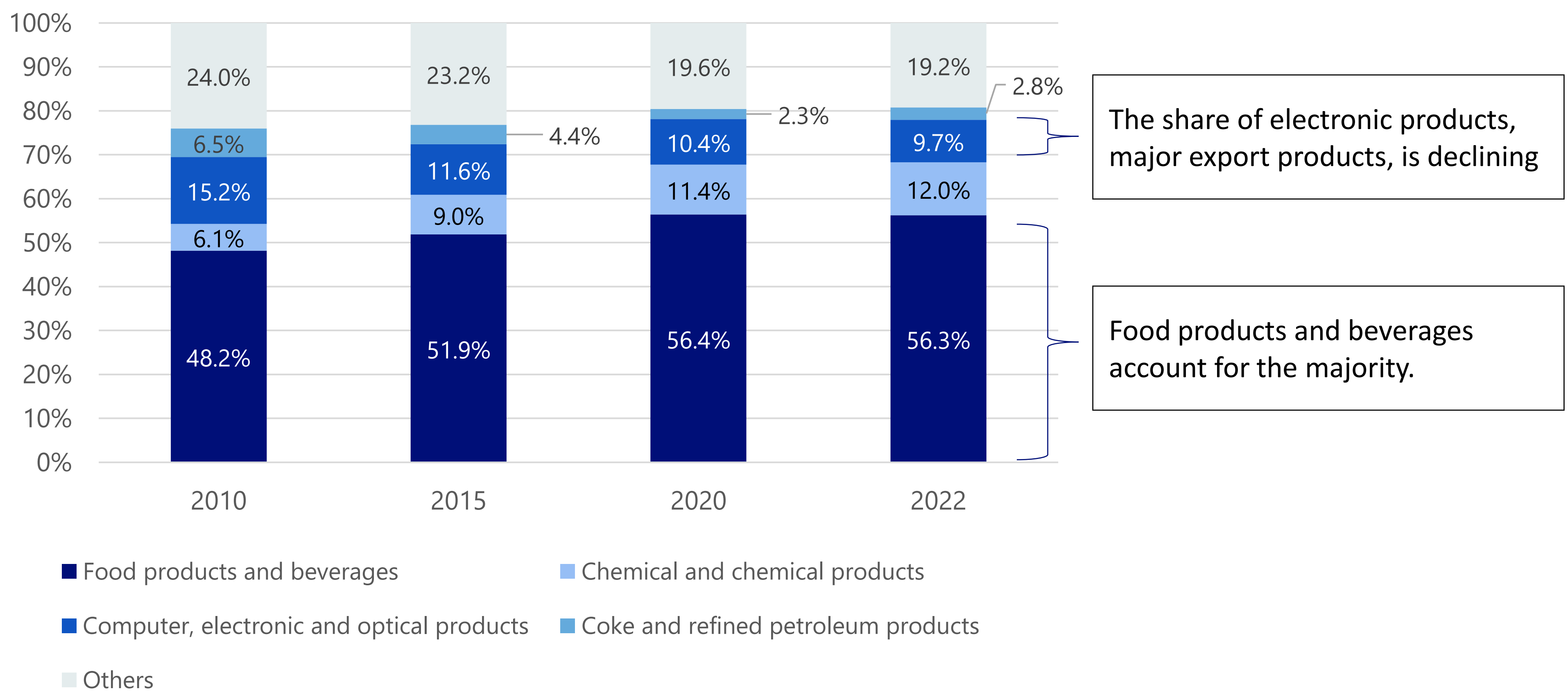
Manufacturing grows 5% in 2022, but services (wholesale/retail, finance/insurance) grow more

Industry	GVA change from previous year (%) 2020	2021	2022
Manufacturing	**-9.8**	**8.8**	5.0
Agriculture, Forestry, and Fishing	-0.2	-0.3	0.5
Wholesale, Retail and others	-6.1	4.2	**8.7**
Finance and Insurance	5.6	4.7	7.2
(ref) GDP	-9.5	5.7	7.6

Source: Philippine Statistics Authority

Food products and beverages account for the majority, while the share of electronic products, major export products, is only about 10% and has been declining in recent years.

Breakdown of GVA in manufacturing

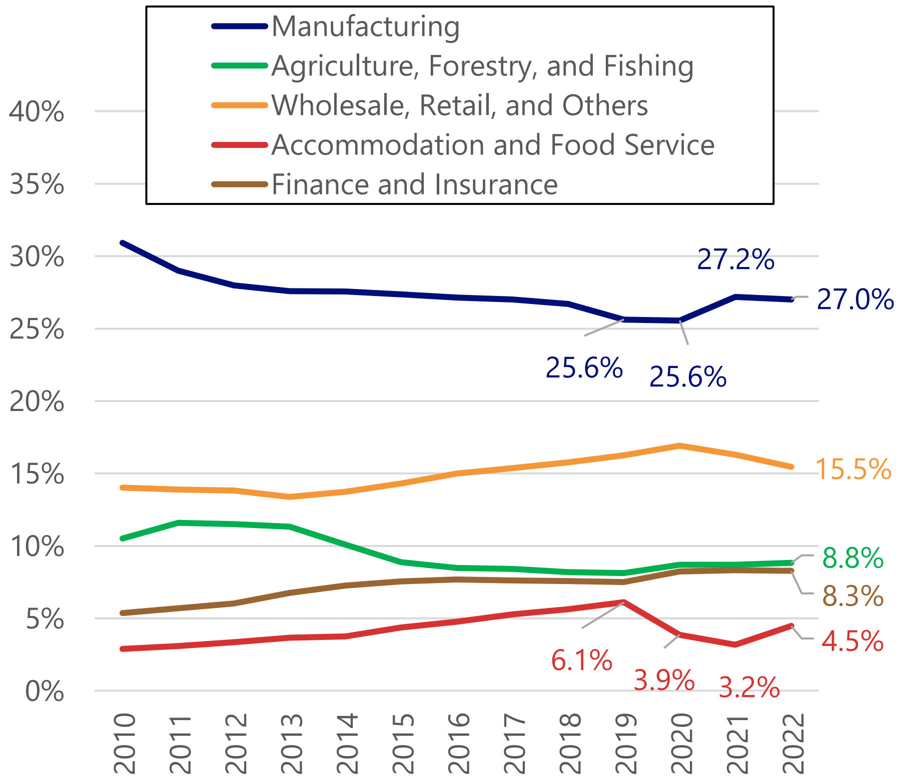


Source: Philippine Statistics Authority

The share of manufacturing increased partly due to the significant decline in the share of tourism sector (accommodation and food services) during the pandemic.

GVA in major industries as % of GDP

Share of Accommodation and Food Services decreased significantly due to the pandemic, while share of manufacturing steadily increased



Note: "Wholesale, Retail, and others" include Sale and repair of motor vehicles and motorcycles

GVA change from previous year

Accommodation and Food Services recovered in 2022, while the growth in the manufacturing sector was slow

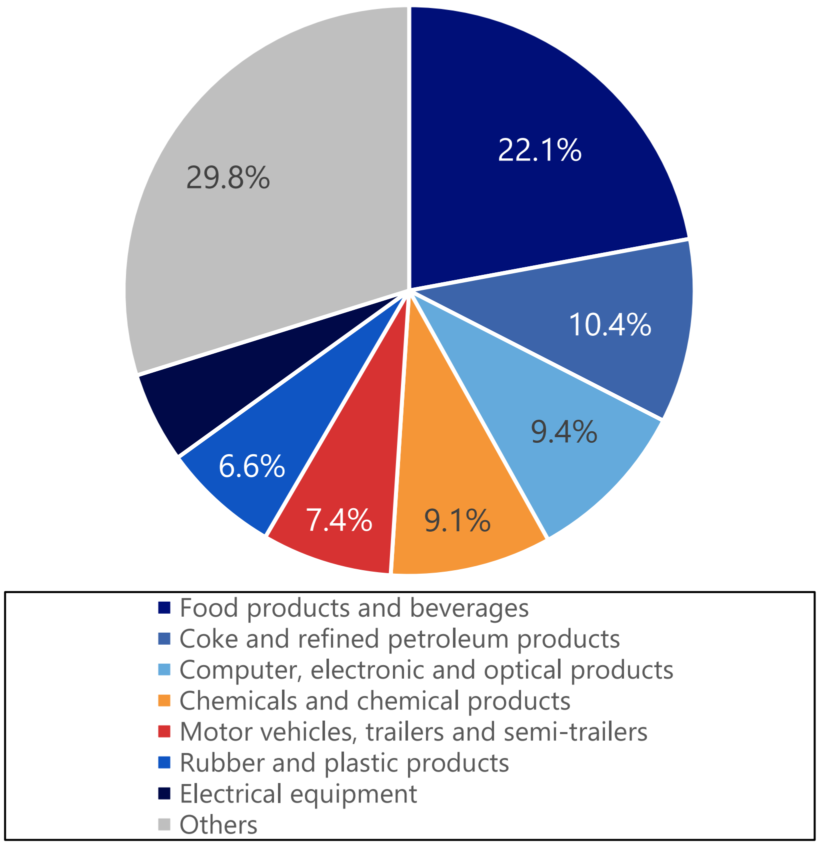
Industry	GVA change from previous year (%) 2020	2021	2022
Manufacturing	-5.5	4.9	0.4
Agriculture, Forestry, and Fishing	-3.3	2.3	2.5
Wholesale, Retail and others	-3.1	1.6	3.1
Accommodation and Food Services	**-37.5**	**-14.2**	**39.3**
Finance and Insurance	5.2	5.5	0.9
(ref) GDP	-6.1	1.5	2.6

Source: Thailand Office of the National Economic and Social Development Council

In Thailand, various export products account for a high proportion, while in the Philippines, electronic products (main exports) account for less than 10%.

Breakdown of GVA in manufacturing [Thailand]

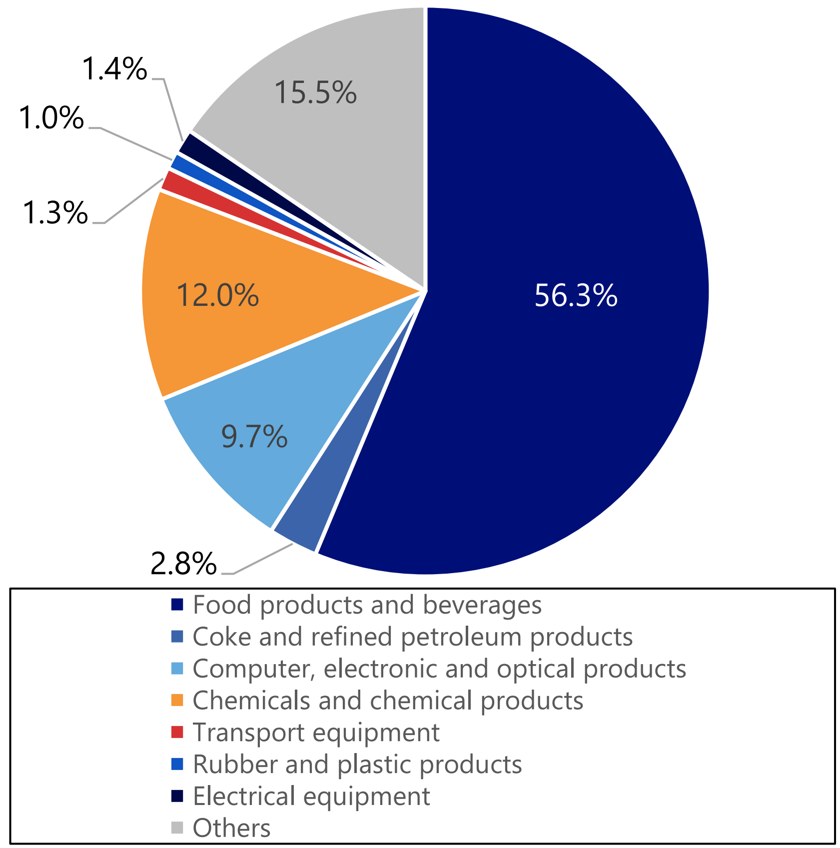
Export products (electrical and electronics, automobiles, etc.) account for a high proportion



Source: Thailand Office of the National Economic and Social Development Council

Breakdown of GVA in manufacturing [Philippines]

Food and beverages account for the majority, while Electronics (main exports) account for only less than 10%.



Source: Philippine Statistics Authority

Thailand promotes the "Thailand 4.0" policy to advance its industries, and is actively attracting foreign investment in the key industries such as electronics and EV.

Manufacturing Promotion Policy

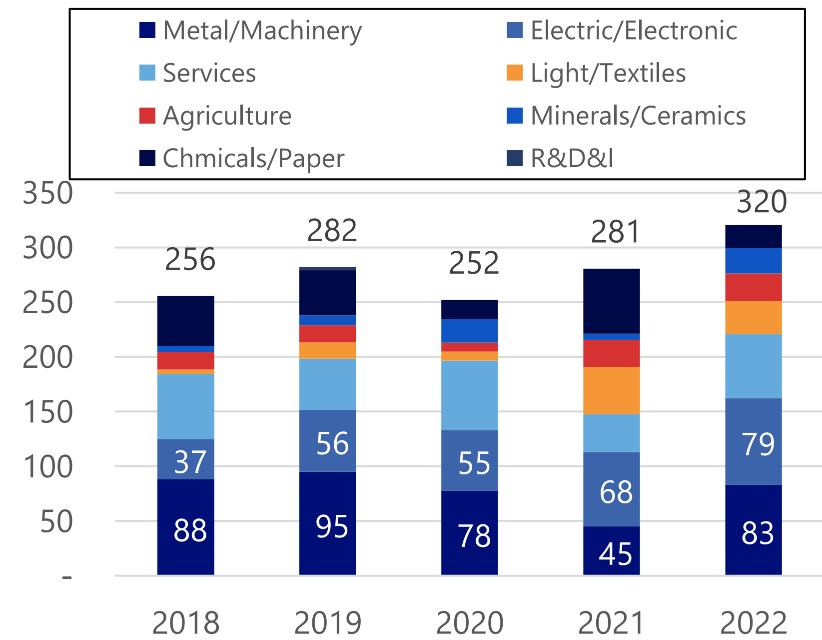
- Since 2015, Thailand has promoted the **"Thailand 4.0"** policy to realize Industry 4.0, focusing on the below priority industries
- Designate the **Eastern Economic Corridor (EEC)** as a place to strengthen priority industries through **infrastructure development and foreign investment**

Category	Priority Industries in "Thailand 4.0"
Short/ Medium -term	• Next-Generation Automotive • Smart Electronics • Affluent Medical and Wellness Tourism • Agricultural and Biotechnology • Food for the Future
Long-term	• Automation and Robotics • Medical Hub • Aviation and Logistics • Bio fuels and Biochemical • Digital Economy

Approved Foreign Investments

- Foreign investments approved by BOI has been increasing recently, reaching **320 billion baht (approx. 500 billion peso)** in '22
- Driven by **electronics** and **next-generation automobiles (electric vehicles)**, which are priority industries in Thailand 4.0.

(Unit; Billion baht)

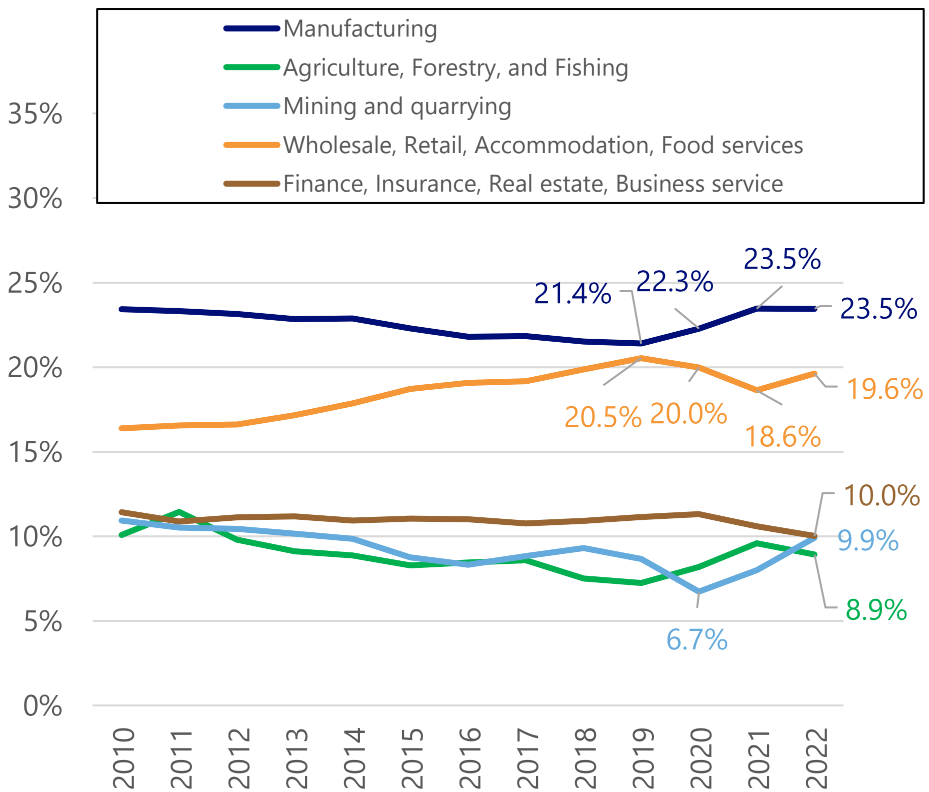


Source: Board of Investment of Thailand

The increase in the share of manufacturing can be attributed not only to the pandemic, but to the sustained growth of the manufacturing sector.

GVA in major industries as % of GDP

Share of Mining and Service industries decreased due to the pandemic, while share of manufacturing steadily increased



GVA change from previous year

GVA in Malaysia's manufacturing sector, unlike in Thailand, continued to increase significantly in 2022

Industry	GVA change from previous year (%) 2020	2021	2022
Manufacturing	-2.6	**9.5**	**8.1**
Agriculture, Forestry, and Fishing	-2.2	-0.5	0.1
Wholesale, Retail and others	**-10.6**	1.3	3.4
Wholesale, Retail, Accommodation, Food Services	**-9.5**	-0.1	**15.9**
Finance, Insurance, Real estate, Business service	-4.9	2.2	**8.1**
(ref) GDP	-5.6	3.2	8.7

Source: Department of Statistics Malaysia

Malaysia promotes the "Industry4WD" policy to advance its industries, and is actively attracting foreign investment, especially in the electronics sector.

Manufacturing Promotion Policy

- Malaysia has promoted the **"Industry4WRD"** policy since 2018 to realize Industry 4.0
- Focusing on the **advancement electronics and machinery**, as well as promotion of new fields such as medical care and aerospace

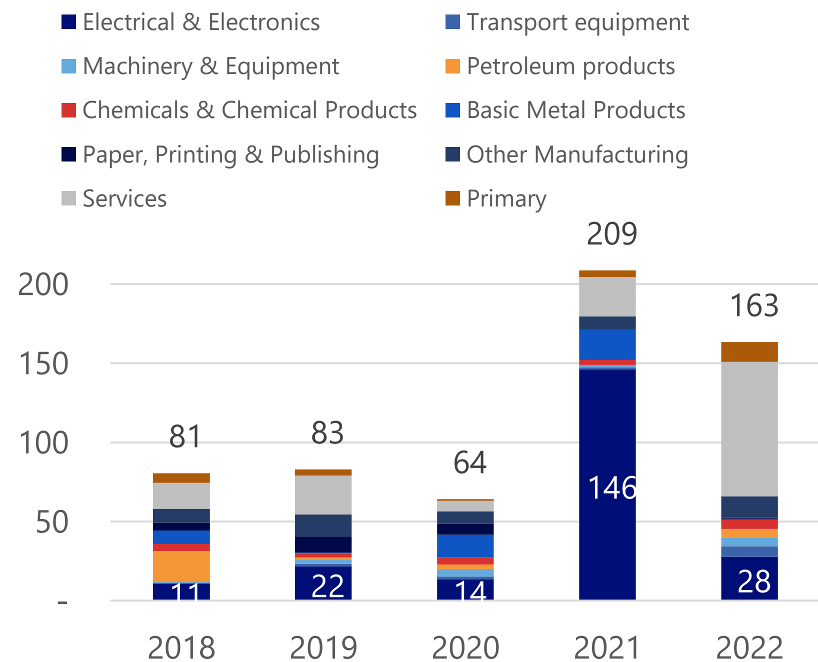
5 Focus Areas

Electrical & Electronics	The leading industry	Contributing to the country's exports and employment
Machinery & Equipment	The Key areas for growth	focusing on high value-added and high technology M&E
Chemical	The catalytic industry	due to the availability of oil and gas as a feedstock
Medical Devices	The wide-range industry	engineering support and electronics
Aerospace	The strategic sector	high growth potential and technological development programs

Approved Foreign Investments

- Foreign investments approved by MIDA has increased significantly in the last 2 years, reaching **163 billion ringgit (approx. 2 trillion peso)** in '22
- Investment in **electrical and electronic components, particularly semiconductors**, has been large

(Unit: Billion ringgit)



Source: MITI(Ministry of International Trade and Industry of Malaysia), MIDA(Malaysian Investment Development Authority)

(Ref) Top export items in Thailand, Malaysia, and Philippines

Thailand and Malaysia have a greater diversity of export products and larger export value than the Philippines.

Top export items in Thailand (2021)

Main exports: Machinery, Electric/Electronics, Vehicles

Item (HS: 2 digits)	Value (M USD)	Share
[84] Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	45,527	16.8%
[85] Electrical machinery and equipment and parts thereof; sound recorders and reproducers; television image and sound recorders and reproducers, parts and accessories of such articles	40,681	15.0%
[87] Vehicles; other than railway or tramway rolling stock, and parts and accessories thereof	32,258	11.9%
[40] Rubber and articles thereof	20,072	7.4%
[39] Plastics and articles thereof	15,737	5.8%

*** Total exports as % of GDP: 53.6%**

Top export items in Malaysia (2021)

Main exports: Electric/Electronics, Fuels, Machinery

Item (HS: 2 digits)	Value (M USD)	Share
[85] Electrical machinery and equipment and parts thereof; sound recorders and reproducers; television image and sound recorders and reproducers, parts and accessories of such articles	102,890	34.4%
[27] Mineral fuels, mineral oils and products of their distillation; bituminous substances; mineral waxes	37,333	12.5%
[84] Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	25,104	8.4%
[15] Animal or vegetable fats and oils and their cleavage products; prepared animal fats; animal or vegetable waxes	19,642	6.6%
[40] Rubber and articles thereof	16,765	5.6%

*** Total exports as % of GDP: 80.3%**

Top export items in Philippines (2021)

Main exports: Electric/Electronics (more than 50%)

Item (HS: 2 digits)	Value (M USD)	Share
[85] Electrical machinery and equipment and parts thereof; sound recorders and reproducers; television image and sound recorders and reproducers, parts and accessories of such articles	34,669	51.0%
[84] Nuclear reactors, boilers, machinery and mechanical appliances; parts thereof	8,667	12.8%
[74] Copper and articles thereof	2,382	3.5%
[90] Optical, photographic, cinematographic, measuring, checking, medical or surgical instruments and apparatus; parts and accessories	2,015	3.0%
[08] Fruit and nuts, edible; peel of citrus fruit or melons	1,755	2.6%

*** Total exports as % of GDP: 17.2%**

Source: ASEANstats

To strengthen manufacturing industries, the Philippines need to implement appealing policies to compete with the other ASEAN economies in attracting foreign investment.

Current Policy to promote manufacturing

- Attracting foreign investment through investment incentives by investment promotion agencies such as PEZA and BOI, which has led to the expansion of the electronic industry
- Promoting the automotive industry, which have high production ripple effect and can create high added value and jobs
  - Comprehensive Automotive Resurgence Strategy program: CARS (2016 - present)
    - Provide fiscal support to the enrolled manufacturers on condition that they achieve certain targets (production of 200k units, local procurement ratio of 50%) in 6 years (* 5-year extension was approved in 2023)
  - EV Incentive Strategy: EVIS (under development)
    - Provide the similar support (time-bound, performance-based support) as CARS to promote EV production

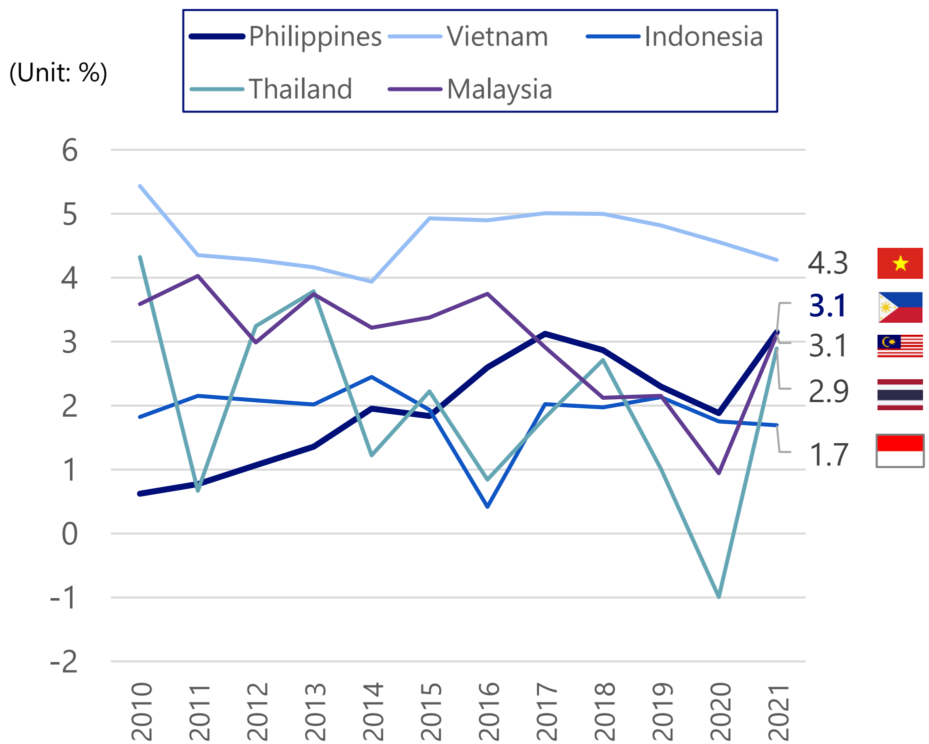
Issues

- To strengthen manufacturing industries such as electronics and automobiles, Philippines need to attract more foreign investment
  - **Is the Philippines more attractive than the competitors (Malaysia, Thailand, Indonesia, Vietnam)?**
  - **What kind of policies should be implemented to attract more foreign investment?**

3. Foreign Investment

Philippine FDI to GDP ratio has been around 1~3%, in the middle of major ASEAN countries. However, investment attractiveness is the lowest, especially in terms of the institutional framework (transparency, public governance, etc).

FDI (Foreign Direct Investment) inflow as % of GDP



Source: NRI, based on World Bank and ASEANstats

Ranking of Global Opportunity Index (2023, Among 124 countries）

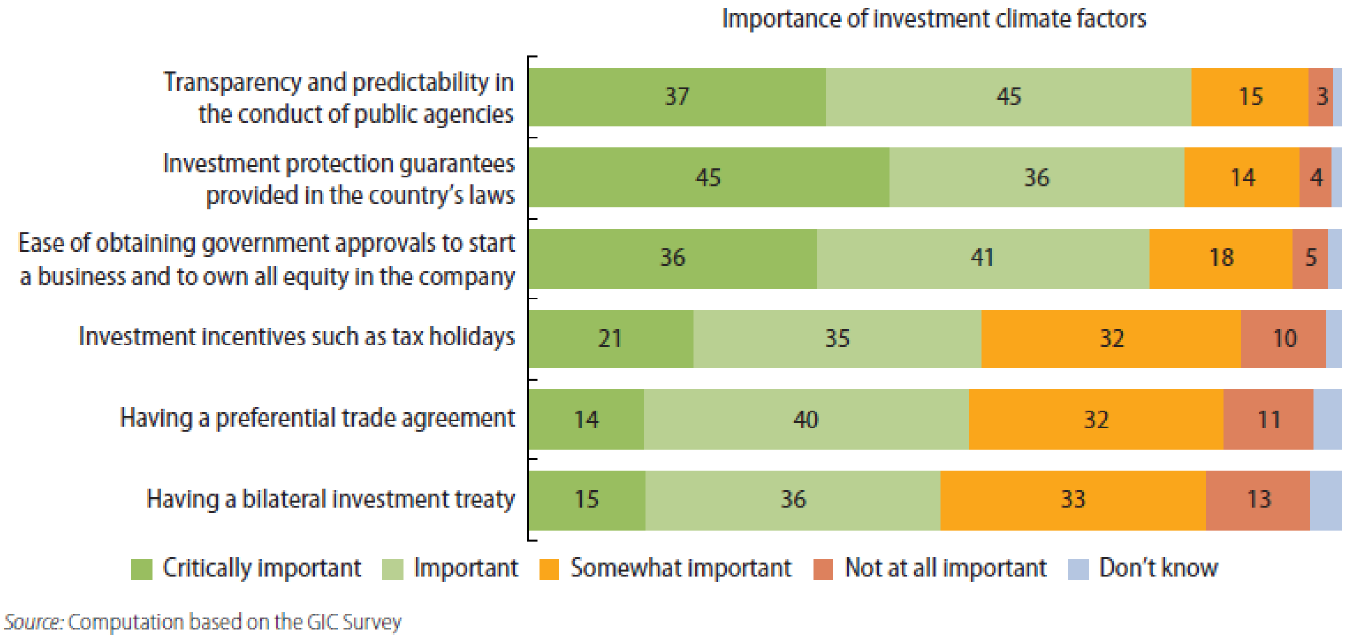
Index	Philippines	Vietnam	Indonesia	Thailand	Malaysia
Total*	**86**	**68**	**55**	**33**	**27**
Business Perception	84	72	54	19	27
Economic Fundamentals	72	42	39	23	30
Financial Services	92	63	68	32	24
Institutional Framework	96	92	53	45	22
International Standards & Policy	73	72	59	58	48

* "Total" is a composite index from 5 categories: business perception, economic fundamentals, financial services, institutional framework, and international standards and policy.

Source: Milken Institute

According to the World Bank report, investors put weight on predictability and efficiency in the implementation of investment-related laws and regulations.

Importance of investment climate factors



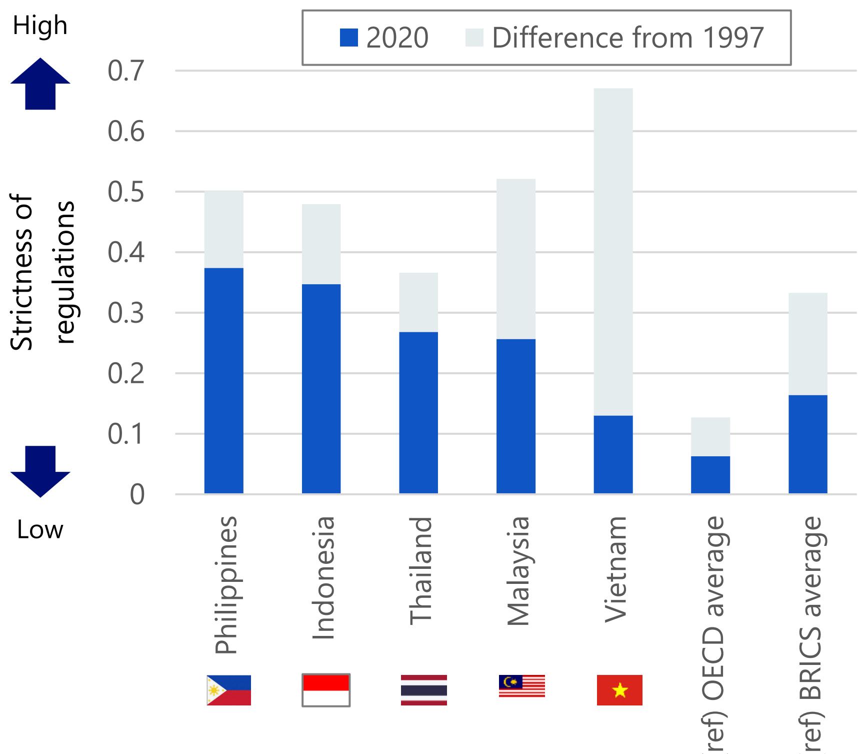
- Investors rate the "**transparency and predictability** of public agency conduct" and "the **ease of doing business**" as important determinants of their locational decisions
- Inefficient bureaucracies, opaque regulations, complex procedures, and high transaction costs can undermine competitiveness

Clear regulations, simple procedures, and transparent and efficient operation are important to attract foreign investment

Source of chart: World Bank "Global Investment Competitiveness Report 2017/2018 - Foreign Investor Perspectives and Policy Implications"

Philippine FDI restrictions are the strictest among the major ASEAN countries. They are especially strict in the primary and tertiary (service) industries.

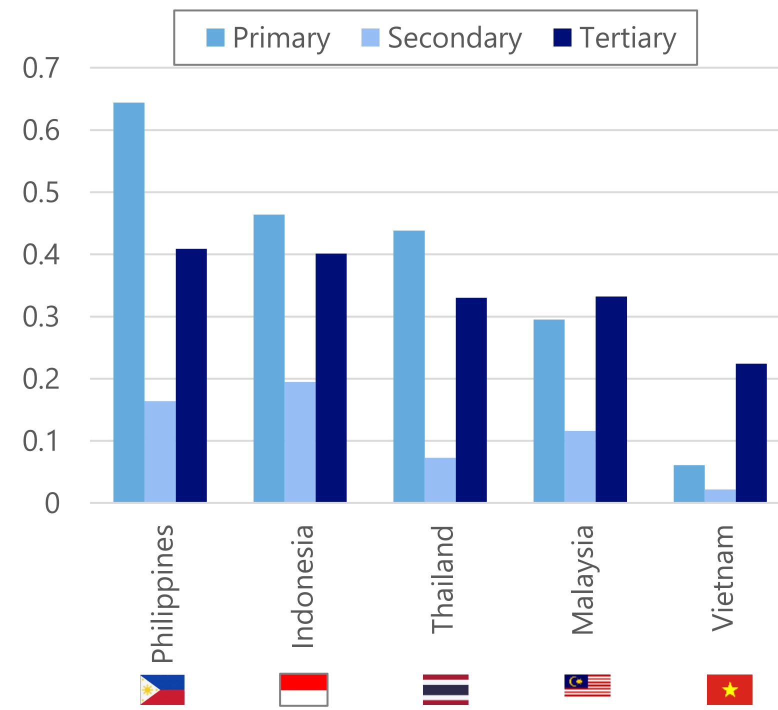
FDI Regulatory Restrictiveness Index (In 2020, and difference from 1997)



Note: FDI Regulatory Restrictiveness Index evaluate the following 4 elements in all industries: 1) Foreign equity restrictions, 2) Screening & approval, 3) Restrictions on key personnel, and 4) Other operational restrictions

Source: OECD

FDI Regulatory Restrictiveness Index by Industry (2020)

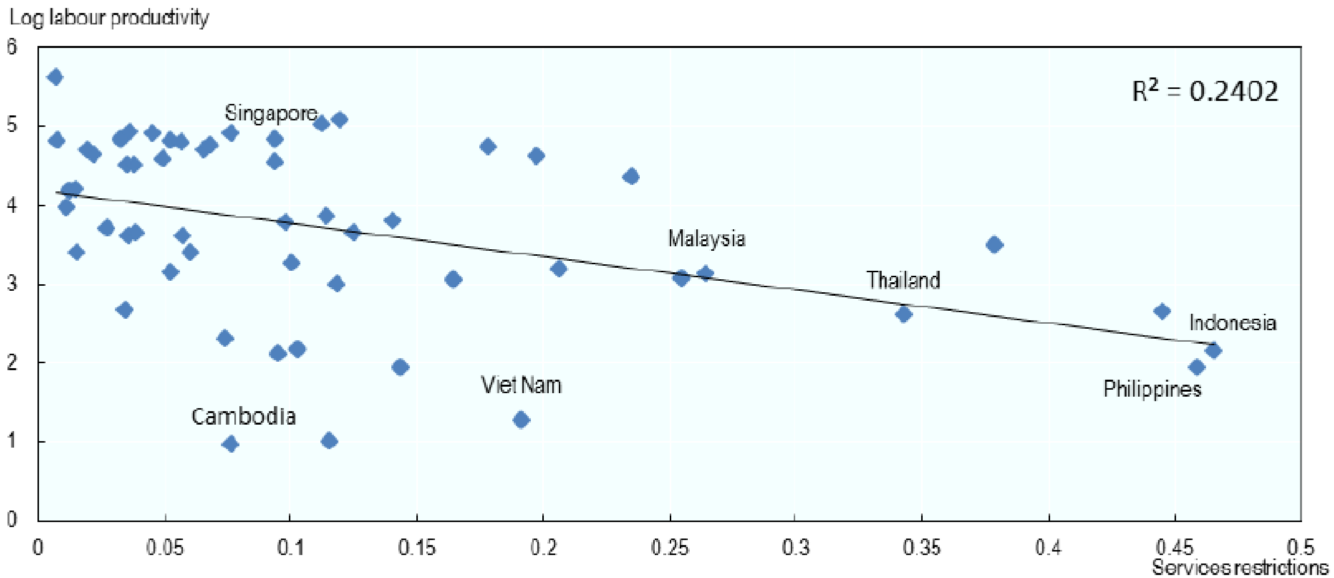


Note: Mining & Quarrying is included in Primary.

Source: OECD

According to the OECD analysis, FDI liberalization in the service sector is important to increase the productivity.

Relations between FDI restrictions in services and Labor productivity



Note: Labour productivity is defined as value added per person employed in 1000 USD, in constant prices. Labour productivity data are not available for Brunei Darussalam, Lao PDR, and Myanmar.
Source: Authors' calculations based on OECD FDI Regulatory Restrictiveness Index and World Bank's World Development Indicators.

- FDI restrictions constrain competition and contestability in service sectors and act as a **barrier to raising service productivity levels**
- This also **prevents manufacturers' access to high quality services** – particularly telecommunications, transport and specialized business services

FDI liberalization and promoting competition, particularly in the service sector, is important to increase the productivity in overall industries

Source of chart: OECD "OECD Investment Policy Review of Southeast Asia"

As the policies to promote foreign investment have been formulated, the issue is how to ensure transparent, predictable, and efficient implementation of the policies.

■ Current Policy to promote foreign investment

- **Simplification and streamlining of investment incentives** under the CREATE (Corporate Recovery and Tax Incentives for Enterprises) Act
- **Establishment of IIPCC (Inter-Agency Investment Promotion Coordination Committee)** under the amended Foreign Investment Act
  - ➢ IIPCC is tasked with integrating the promotion activities to encourage foreign investment and formulating medium-term and long-term plan called "Foreign Investment Promotion and Marketing Plan (FIPMP)"
- **Easing of restrictions on foreign investment**
  - Retail Trade Liberalization Act eased requirements for foreign companies to operate retail businesses
  - Amended Foreign Investment Act eased requirements for paid-in capital of foreign companies
  - Amended Public Service Act clarified the definition of "Public Utility" in which foreign ownership is limited to 40% or less -> Foreign investment on telecommunication, railway, highway, transport, etc. was liberalized
  - Foreign investment on renewable energy (excluding hydropower) was liberalized in Nov 2022

■ Issues

- Formulated policies seem good, but what is more important is to ensure **transparent, predictable and efficient implementation** of policies

About the Author

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Josh joined NRI Manila in 2022. He has rich experience in public sector projects and has been involved in market researches in the Philippines.

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