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# Leveraging Service Sector Growth in the Philippines

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## ABSTRACT

The Philippines is often referred to as a country from which export of services rather than manufactured goods is the principal engine for economic growth, as the share of the service sector in gross domestic product has exceeded that of the industry sector since the mid-1980s. Three major opportunities for leveraging service sector growth stands out. One is expanding the scale and scope of the export and domestic markets for information technology-business process outsourcing and other modern services in urban areas. Second is expanding tourism to foster economic development across social groups and regions including poor and remote rural areas. Third is enhancing the domestic prospects for Filipino technical, managerial, and entrepreneurial talent so they will work in the Philippines rather than overseas. To take advantage of those opportunities, there is a need for concerted efforts to improve infrastructure; logistics; broadband connections; the power supply; and education, healthcare, financial, legal, and public administration services and more generally the overall business environment for foreign investors and local entrepreneurs.



Keywords: services, growth, Philippines, Asia, business process outsourcing, information technology, migration, diaspora, tourism, innovation, knowledge economy

JEL classification: F22, L80, O14.

# I. INTRODUCTION

In recent years, it has become popular to argue that service industries such as information technology-business process outsourcing (IT-BPO) and tourism can serve as principal drivers to achieving sustainable and inclusive economic growth for the Philippines and for other developing countries (Ghani 2010, Pasadilla 2006). Some economic analysts, however, are skeptical of this notion and assert that the industry and agriculture sectors are equally or more important (Usui 2012), while others claim that developing IT-BPO and other modern service industries has so far been limited in many parts of the world. How will IT-BPO and tourism evolve in the Philippines in the 2010s and beyond? In addition, what are the prospects for migration and its impact on exporting services? This study examines the dynamics of the development of the service sector in the Philippines in a historical and comparative review based on a synthesis of secondary information and interviews.

A substantive analysis of service sector development is, however, constrained by the weakness of the data. In recent years, the Bangko Sentral ng Pilipinas (BSP, the Philippine central bank) and industry associations have made efforts to improve the reporting of basic revenue and employment data. Nevertheless, the data lack details on revenue, employment, and investments per business line and on export or domestic markets and do not include information on individual firms. Moreover, data on the impact of information and communication technology (ICT) and BPO production and consumption are incomplete. One particular knowledge gap is the lack of information on the impact of developing export services on different social groups and on productivity. Several reports have been issued on growth trends in the industry, but its impact on economic growth and on social groups is typically not a principal focus. Much of the information on these topics consists of general observations, some of which are based on anecdotal information.

Data on tourism are also weak although they are covered in a special national satellite account. Similarly, there is little regularly published information on the impact of migration beyond general data on the number of migrants and the BSP's reporting on remittances from Filipinos working overseas.

# II. THE PHILIPPINE ECONOMY AND SERVICE SECTOR DEVELOPMENT

## A. Economic Development

The performance of the Philippine economy has improved in recent years. The gross domestic product (GDP) grew by 7% in 2012 and is currently projected to grow at 6% or more in 2013 and 2014 (ADB 2013). Among its strengths are its rich natural and human resources, yet the historical records show that the country's performance has lagged behind many of its East and Southeast Asian neighbors as reflected in its inadequate infrastructure, its low domestic investment rates, the comparatively modest growth in foreign investment and trade, the slow pace of upgrading technology and alleviating poverty, and weaknesses in governance. In recent years, however, there has been marked improvement in governance, macroeconomic balance, and overall competitiveness rankings (WEF 2013b). The economy has profited from growth and has benefited from increases in overseas workers' remittances and from exports of services, but overall advancements in manufacturing have continued to be minimal compared with the People's Republic of China (PRC); the Republic of Korea; and Taipei,China, for example. Also, most of the decline in agriculture as a share of GDP and of employment has been absorbed by the expansion of the service sector in major urban areas rather than by manufacturing.

Furthermore, the country is characterized by major disparities in economic development. Some are very wealthy, and there is a growing urban middle class, but many parts of the country are still economically disadvantaged. Much of the economy is dominated by a few oligopolies while the development of small and medium-sized enterprises (SMEs) has been constrained by a lack of financing and by red tape (World Bank and IFC 2013).

For several decades, the Philippines has lagged behind East Asian and most Southeast Asian economies in overall GDP performance as well as in life expectancy, poverty alleviation, improvements in education, infrastructure investment, the diffusion of ICT, and other development indicators. In the 2000s, GDP growth accelerated reaching an average of 4.9% from 2000 to 2010, which is close to the Association of Southeast Asian Nations (ASEAN) average. This growth was partly fueled by remittances from Filipinos working overseas and by export earnings from the semiconductor and electronics industry, and more recently by IT services and BPO exports and by tourism. The semiconductor and electronics industry has largely focused on assembling imported components, and export earnings vary substantially due to sharp fluctuations in external demand. Moreover, manufacturing as well as agriculture and mining have been characterized by low wages and value added per employee compared with IT-BPO and other modern services.

While GDP growth has improved, the economy has not generated enough new jobs, especially for unskilled workers and those living in rural areas. This is reflected in the national unemployment rate of 7.0%–7.5% from 2007 to 2012 and the underemployment rate of 19.8%–22.6% in the same time period (Bureau of Labor and Employment Statistics 2011–2013). The proportion of the population living in poverty was 34.9% in 1985, 22.4% in 2000, and 22.6% in 2006 (Ravallion and Chen 2008).

Urban-centered economic growth and the lack of employment opportunities in rural areas and smaller towns have resulted in substantial internal migration. For several decades, economic development has been concentrated in the industry and service sectors in a few metropolitan areas, the prime example being the Greater Metro Manila area which now accounts for almost a fourth of the country's total population and an even greater proportion of it exports and GDP.

The Philippine Development Plan 2011–2016 identified the key constraints to overall economic growth as low investment and slow technological progress due to inadequate infrastructure and weaknesses in institutions. The inefficient transport network and unreliable power supply are cited as among the most significant constraints. The percentage of paved roads to total roads remains one of the lowest in the region, and the quality of port, air, and railroad infrastructure needs to be improved. The government acknowledges the urgent need to tackle weaknesses in ICT and infrastructure, institutional frameworks, governance, and the overall business climate (ADB 2013, NEDA 2011). Economic development is still marked by slow progress in reducing poverty and income inequality, by over-reliance on volatile electronics export earnings and on remittances, and by stagnation in the manufacturing industry and agriculture sectors. There is, however, no doubt that the Philippines is rich in talent and that the impetus to tackle these weaknesses and to build on strengths has begun to grow in recent years as. These facts are exemplified by improvements in credit ratings and international competitiveness ranking (WEF 2013b), and advancements in terms of national economic development plans, the launch of various schemes for an ICT-empowered "Smart Philippines," and specific plans to boost the development of the IT-BPO and tourism industries (NEDA 2011, Melchor 2013).

## B. Service Sector Development

The share of the service sector in GDP has exceeded that of the industry sector since the mid-1980s growing from 36% to 55% in 2010, and the sector's share in total employment increased from 40% in 1990 to 52% in 2010. The service sector share of GDP has continued to increase in recent years. It rose from 54.1% in 2006 to 57.1% in 2012 (Table 1). By 2011, services employed 19.4 million people which is more than agriculture and manufacturing industry combined (Table 2). Export-oriented services were especially significant as the ratio of service sector exports to total sector revenue was 12% in 2009. This is comparable to that of India and significantly higher than that of Indonesia, but low if compared with Hong Kong, China; Malaysia; Singapore; and Thailand (World Bank 2013a).

The large service sector indicates that the growth in the agriculture and manufacturing industry sectors has been slow. In fact, the overall growth performance of the service sector in the Philippines has been moderate due to limited growth in the domestic market and in external demand, low investment in infrastructure, education and other public goods, and the inadequate overall business climate. Yet the performances of the different parts of the service sector vary significantly.

The Philippines stands out because of the large number of Filipinos working overseas. Remittances from overseas workers corresponded to 9%–10% of GDP from 2003 to 2012 making the Philippines one of the most remittance-dependent economies and largest recipients in the world. Added together, IT-BPO services export revenue, tourism, and remittances accounted for over 22% of GDP, or over 30% of the country's foreign exchange earnings in 2011 (BSP 2013b, 2013c). This has major direct and indirect implications for the labor market. As of 2011, export-oriented services combining tourism and BPO directly employed more than 4 million workers and indirectly employed about 10 million assuming an employment multiplier of 2.5%. Adding overseas workers, the number of Filipinos directly employed in exporting services can be estimated at more than 10 million from 2010 onwards (Table 3).

## Table 1: Gross Domestic Product by Sector, 2004–2012

| Sector/Industry | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | | **% of GDP** (current prices) | | | | |
| Agriculture | 13.3 | 12.7 | 12.4 | 12.5 | 13.2 | 13.1 | 12.3 | 12.8 | 11.9 |
| Industry | 33.8 | 33.8 | 33.5 | 33.1 | 32.9 | 31.7 | 32.7 | 31.4 | 31.1 |
| Manufacturing | 24.0 | 24.1 | 23.6 | 22.7 | 22.8 | 21.3 | 21.4 | 21.0 | 20.5 |
| Services | 52.9 | 53.5 | 54.1 | 54.5 | 53.9 | 55.2 | 55.1 | 55.8 | 57.1 |
| Transportation, storage and communication | 7.7 | 7.8 | 7.60 | 7.5 | 7.1 | 7.0 | 6.5 | 6.4 | 6.5 |
| Trade and repair of motor vehicles, motorcycles, personal and household goods | 16.0 | 16.4 | 16.8 | 17.1 | 17.1 | 16.9 | 17.4 | 17.42 | 17.7 |
| Financial intermediation | 5.5 | 5.9 | 6.3 | 6.5 | 6.5 | 6.8 | 6.9 | 7.03 | 7.2 |
| Real estate, renting and business activities | 9.6 | 9.9 | 10.1 | 10.2 | 10.6 | 11.02 | 10.9 | 11.46 | 11.9 |
| Public administration and defense; compulsory social security | 4.4 | 4.1 | 4.2 | 3.9 | 3.7 | 4.03 | 4.1 | 4.03 | 4.1 |
| Other services | 9.8 | 9.4 | 9.2 | 9.3 | 9.0 | 9.45 | 9.3 | 9.43 | 9.7 |
| Gross Domestic Product | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| | | | | | **Annual growth rates in %** (constant prices) | | | | |
| Agriculture | 4.3 | 2.2 | 3.6 | 4.7 | 3.2 | –0.7 | –0.2 | 2.7 | 2.7 |
| Industry | 5.2 | 4.2 | 4.6 | 5.8 | 4.8 | –1.9 | 11.6 | 2.3 | 6.5 |
| Manufacturing | 5.2 | 5.0 | 4.1 | 3.6 | 4.3 | –4.8 | 11.2 | 4.7 | 5.4 |
| Services | 8.3 | 5.8 | 6.0 | 7.6 | 4.0 | 3.4 | 7.2 | 5.1 | 7.4 |
| Transportation, Storage and Communication | 12.1 | 7.1 | 4.3 | 8.4 | 3.9 | –0.1 | 1.0 | 4.3 | 9.1 |
| Trade and repair of motor vehicles, motorcycles, personal and household goods | 7.4 | 5.9 | 6.0 | 8.6 | 1.4 | 1.4 | 8.4 | 3.3 | 7.5 |
| Financial intermediation | 7.0 | 10.6 | 11.9 | 10.2 | 1.8 | 5.5 | 10.1 | 5.2 | 7.8 |
| Real estate, renting and business activities | 9.6 | 6.8 | 6.5 | 7.9 | 9.0 | 4.1 | 7.5 | 9.3 | 7.9 |
| Public administration and defense; compulsory social security | 7.5 | 0.6 | 3.5 | 1.4 | 2.0 | 6.1 | 5.8 | 0.3 | 3.3 |
| Other services | 6.5 | 3.5 | 4.8 | 6.1 | 6.0 | 6.5 | 8.4 | 6.6 | 7.2 |

Sources: NSCB (2012) and BSP (2013d).

## Table 2: Employment and Employment Growth by Sector, 1998–2010

| Indicator | 1998 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|
| **Number employed** (million) | | | | | | | | |
| Total employed | 26.6 | 31.3 | 32.0 | 33.0 | 33.6 | 34.1 | 35.1 | 35.9 |
| Agriculture | 10.1 | 11.3 | 11.5 | 11.8 | 11.8 | 12.0 | 12.0 | 11.9 |
| Industry | 4.5 | 5.0 | 5.0 | 5.0 | 5.1 | 5.0 | 5.1 | 5.4 |
| Manufacturing | 2.7 | 3.1 | 3.1 | 3.1 | 3.1 | 2.9 | 2.9 | 3.0 |
| Services | 12.0 | 15.1 | 15.5 | 16.1 | 16.7 | 17.0 | 17.9 | 18.6 |
| **Employment** (% in total) | | | | | | | | |
| Agriculture | 37.9 | 36.0 | 35.9 | 35.8 | 35.1 | 35.3 | 34.4 | 33.0 |
| Industry | 17.1 | 15.9 | 15.6 | 15.2 | 15.3 | 14.8 | 14.5 | 15.1 |
| Manufacturing | 10.2 | 9.7 | 9.6 | 9.3 | 9.1 | 8.6 | 8.3 | 8.4 |
| Services | 45.0 | 48.1 | 48.4 | 49.0 | 49.6 | 49.9 | 51.1 | 51.9 |
| **Employment growth** (%) | | | | | | | | |
| Agriculture | | 0.4 | 2.2 | 2.6 | –0.2 | 2.1 | 0.1 | –1.6 |
| Industry | | 3.0 | 0.6 | –0.2 | 2.3 | –1.4 | 0.9 | 6.1 |
| Manufacturing | | 0.6 | 0.6 | –0.4 | 0.4 | –4.7 | –1.1 | 4.5 |
| Services | | 3.5 | 2.8 | 4.0 | 3.1 | 2.2 | 5.4 | 3.9 |

Source: NSCB (2012).

**Table 3: Employment by Sector and by Service Type, 2008–2011('000)**

| Sector/Industry | 2008 | 2009 | 2010 | 2011p |
|---|---|---|---|---|
| **All sectors** | 34,089 | 35,061 | 36,035 | 37,192 |
| Agriculture | 12,030 | 12,043 | 11,936 | 12,256 |
| Industry | 5,048 | 5,093 | 5,399 | 5,530 |
| Manufacturing | 2,926 | 2,894 | 3,033 | 3,080 |
| Services | 17,011 | 17,925 | 18,700 | 19,406 |
| Wholesale and retail trade; repair of motor vehicles, motorcycles, and personal and household goods | 6,446 | 6,736 | 7,040 | 7,400 |
| Hotels and restaurants | 953 | 1,010 | 1,063 | 1,119 |
| Transport, storage, and communications | 2,590 | 2,679 | 2,723 | 2,775 |
| Financial intermediation | 368 | 369 | 400 | 434 |
| Real estate, renting, and business activities | 953 | 1,064 | 1,146 | 1,257 |
| Public administration and defense, compulsory social security | 1,676 | 1,749 | 1,847 | 1,873 |
| Education | 1,071 | 1,138 | 1,176 | 1,199 |
| Healthcare and social Work | 392 | 421 | 451 | 452 |
| Other community, social, and personal service activities | 833 | 877 | 914 | 934 |
| Private households with employed persons | 1,729 | 1,880 | 1,926 | 1,950 |
| Extra-territorial organizations and bodies | 1 | 2 | 2 | 2 |
| **Filipinos overseas, tourism, and information technology-business process outsourcing (IT-BPO) exports** | | | | |
| Filipinos overseas (majority employed in services) | 8,188 | 8,559 | 9,453 | 10,456 |
| Tourism | 3,415 | 3,547 | 3,694 | 3,823 |
| IT-BPO services | 372 | 442 | 557 | 626 |

p = preliminary.

Notes: Details may not add up to totals due to rounding. Industry classification is based on the 1994 Philippine Standard Industrial Classification.

Sources: NSCB (2012); BLES (2011–2013); BPAP (2012); Department of Tourism (2013); POEA (2013).

## III. INFORMATION TECHNOLOGY SERVICES AND BUSINESS PROCESS OUTSOURCING

### A. Growth and Structural Change

The Philippines is a prime example of a country that successfully developed a sizeable BPO export industry in the 2000s (Table 4). It has outperformed most countries in industry growth emerging as the largest BPO center in the developing world after India and appears poised to become a major exporter of IT services as well. As of 2012, IT services and BPO combined generated $13 billion in export revenue and directly employed 777,000 people (BPAP 2009–2013).

Compared with India, the IT software and service industry and much of the BPO industry is younger in the Philippines, and the scope for establishing a large high-end software and engineering service industry is limited by the fact that the country is smaller than India in terms of its domestic market and the pool of skilled human resources available. The IT-BPO industry in the Philippines was initially largely focused on basic call centers and lower-end non-voice, back-office services. Subsequently, the industry has also expanded significantly in higher-end call center services, non-voice BPO, knowledge process outsourcing, IT software and services, and engineering service outsourcing. The industry has major growth potential at both the lower and higher ends of the value chain as the country is still in the early stages of developing a major IT-BPO industry in rapidly growing areas like human resource management, healthcare, tourism, and a wide range of higher-end banking, finance, insurance, and accounting services (BPAP 2012).

The trajectories for IT-BPO development in the Philippines differ from those in most other Asian countries. Industry growth has largely been driven by exports as the domestic market has been small compared to larger, higher-income Asian economies. Unlike in India and in many other places where IT services have been comparatively more important, the initial growth of the industry in the Philippines was in exports of low-end BPO services such as basic call centers. Compared to the PRC, India, and higher-income economies, the Philippines has limited capacity for high-end science and technology and industrial development although it does have a sizeable number of highly qualified people in engineering, medicine, accounting, creative industries, and other services (Mitra 2013b).

**Table 4: Information Technology Services-Business Process Outsourcing Industry Export Revenues and Employment in the Philippines, 2004–2012**
($ million and number of employees)

| Type | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011p | 2012p |
|---|---|---|---|---|---|---|---|---|---|
| **A. Voice business process outsourcing** (BPO) | | | | | | | | | |
| Contact centers | 1,024 | 1,792 | 2,360 | 3,600 | 4,100 | 5,000 | 6,100 | 7,400 | 8,700 |
| **B. Non-voice BPO and IT** | | | | | | | | | |
| Back office | 120 | 180 | 288 | 398 | 827 | 1,118 | 1,660 | 2,058 | – |
| Transcription | 72 | 70 | 109 | 137 | 182 | 187 | 202 | 277 | – |
| Animation | 52 | 74 | 97 | 105 | 120 | 120 | 142 | 128 | 132 |
| Information technology outsourcing | 170 | 204 | 272 | 423 | 601 | 568 | 725 | 993 | 1,160 |
| Engineering service outsourcing | 34 | 48 | 68 | 152 | 228 | 228 | 163 | 172 | 206 |
| Digital content/game development | 3 | 7 | 13 | 1 | 3 | 4.5 | 7 | 8 | – |
| Subtotal non-voice revenue | 451 | 583 | 847 | 1,216 | 1,961 | 2,225 | 2,899 | 3,636 | 4,500 |
| Total revenue | 1,475 | *2,375* | 3,207 | 4,816 | 6,061 | 7,225.3 | 8,999.0 | 11,036 | 13,200 |
| | | | | | | | | | |
| **Employment** (full-time) | | | | | | | | | |
| A. Voice | 64,000 | 112,000 | 160,000 | 198,000 | 227,000 | 280,000 | 344,000 | 416,000 | 497,000 |
| B. Non-voice | 36,500 | 51,250 | 75,575 | 100,953 | 144,965 | 162,164 | 181,182 | 221,929 | 273,000 |
| Total direct employment | 100,500 | 163,250 | 235,575 | 298,953 | 371,965 | 442,164 | 557,127 | 638,000 | 777,000 |

– = data not available, IT-BPO = information technology-business process outsourcing, p = provisional estimates.

Note: Digital content was added to back-office in 2007 and was replaced by game development starting in 2007.

Source: BPAP (2009–2013 and 2012) based on data from Animation Council of the Philippines Inc. Contact Center Association of the Philippines, Gaming Development Association of the Philippines, Medical Transcription Industry Association of the Philippines, and Philippine Software Industry Association.

## B. Drivers and Constraints

External demand and the large pool of low-cost human resources with English-language skills and higher education, attractive fiscal incentives for foreign investors and the rapid expansion of industrial parks and their akin have been the key factors enabling the extraordinarily rapid BPO industry growth in the Philippines since the early 2000s. These factors do not, however, explain it sufficiently or why the industry did not take off until recently. Other countries have also had these strengths but have failed to develop the industry as rapidly as the Philippines has done. It is, therefore, essential to examine a wide range of factors in greater detail, namely human resources, finances, infrastructure, technology, and legal and regulatory developments as well as cultural affinities and social mores. The specific roles of government; foreign companies and indigenous entrepreneurs; industry associations; civil society; individual champions; the Philippine diaspora; local and international commercial, consulting, and financial networks as

well as timing and competition are also important. In short, to understand how the IT-BPO industry developed, the dynamics of a wide range of factors driving and constraining growth locally, regionally, nationally, and internationally must be analyzed (Mitra forthcoming).

The country's principal strength is its large, educated workforce with strong English-language capabilities and a reputation for being flexible, adaptable to both Asian and Western cultures, productive, loyal, and dedicated with key strengths in attention to detail and the ability to communicate and work with a positive and enthusiastic attitude and to take initiative. Filipinos speak idiomatic American English better than Indians and many other Asians, and their accents are more neutral. The workforce is familiar with multiple cultures (American, Chinese, Japanese, Malay, and Spanish) and has a proven ability to respond to changing customer demands and to deliver quality at low cost. The industry has also benefited from traditionally close business and other relationships with the United States (US), from developments in India and dynamic East Asian economies, and from its diaspora and other international networks. In addition, there is limited competition for the skilled workforce within the country due to a shortage of other employment opportunities for educated youth.

Access to foreign know-how and capital has enabled the rapid development of the IT-BPO service industry. Foreign equity investments in the industry rose from $329 million in 2005, to $1.8 billion in 2008, to $4.4 billion in 2010, and to $5.4 billion in 2011. In contrast, indigenous private equity investment amounted to $163 million in 2005, $132 million in 2008, $107 million in 2010, and $391 million in 2011 (BSP 2013a). For multinational corporations wishing to expand operations in the Philippines, financing has typically not been a principal impediment, but the availability of venture capital funding for SMEs or for venture and/or angel investments has, however, been comparatively more limited than in India. Indigenous firms are yet to become major investors in the service export industry; the business is currently dominated by foreign companies. The telecommunication industry is older and is owned by foreign as well as local business interests. Telecommunications and the electric power supply are mostly controlled by large oligopolies, and costs for services have so far been higher than in most other Asian economies (JFC 2011).

Access to quality telecommunication and other infrastructure plus real estate and conducive working and living environments are typically central issues facilitating IT-BPO industry growth. While most of the country lags behind in broadband connectivity and in the diffusion of computers and software, much of the industry requirements in terms of infrastructure are met in major cities and industrial parks or their akin. This proves that the IT-BPO export industry (unlike many types of manufacturing) can develop rapidly even when most of a country lacks effective modern infrastructure.

Government vision, policies, and institutions have facilitated industry development, but as in India, they have not been the prime owners or drivers of industry growth. Nevertheless, the government has indeed had an impact on its development through a wide range of policies, investments, and other interventions especially establishing Cyber Parks (Techno Parks, IT Parks, Eco Zones) offering fiscal incentives (corporate income tax holiday for 4–8 years), upgrading infrastructure, investing in training and education programs, and enacting legal and regulatory reforms (Box 1).

**Box 1: Government Support for Information Technology-Business Process Outsourcing Industry Development in the Philippines**

**Principal National Visions, Strategic Plans, and Programs**

- Medium-Term Philippine Development Plan, 2004–2010 and 2011–2016
- Roadmap 2010 and Roadmap 2016 for information technology-business process outsourcing (IT-BPO) industry development formulated by the Business Processing Association of the Philippines in consultation with a wide range corporate and government agencies
- The Philippine Digital Strategy 2011–2016 launched by the Commission on Information and Communication Technology in 2011
- National Broadband Plan 2016
- Philippine IT-BPO Brand Management Plan
- Government Information and Communication Technology Office flagship public–private partnership projects presented in 2012
- The Smarter Philippines flagship program launched by the Department of Science and Technology in 2013; key elements include Smarter Government, Smarter Economy, Smarter Mobility, Smarter Environment, Smarter Living, and Smarter Cities

**Cyber Parks and Development of "Next Wave" Cities**

- Rapid expansion of Cyber Parks (Techno Parks, IT Parks, Eco Zones)—typically developed in partnership with the private IT-BPO or real estate firms and offering office space, reliable connectivity and energy supply, and flexible tax exception rules—in Metro Manila and its peri-urban areas, Cebu; and subsequently also in other parts of the country.
- The Philippine Cyber Corridor Initiative and the Next Wave Cities Initiative—special efforts to promote the development of the IT-BPO industry in areas other than Metro Manila and Cebu.
- Philippine Economic Zone Authority industrial parks and economic zones with fiscal and non-fiscal incentives for private investors: 217 economic zones in operation and 103 under development with more than 60% recognized as IT parks/centers.

**Fiscal Incentives**

- Income tax holiday initially for 4 years extendable to 8 years if further investment and other requirements are fulfilled
- Special 5% tax rate on gross income in lieu of all national and local taxes after the lapse of the tax holiday (for IT park/economic zone locators)
- Tax and duty exemption on imported capital equipment (for IT park/economic zone locators); duty-free importation of capital equipment (for Board of Investment registered firms under Executive Order 528)
- Exemption from wharf fees and export taxes, duties, imposts, and fees
- Exemption from 12% value-added tax on allowable local purchases of goods and services such as telecommunications, power, and water (for IT park/special economic zone locators)
- Additional deduction of 50% of total worker training costs under the special 5% gross income regime

**Non-Fiscal Incentives**

- Unrestricted use of consigned equipment
- Liberal rules for employing foreign nationals and granting special investor resident visas

Sources: Author's compilation based on various government and industry association reports and the *Official Gazette of Executive Orders* issued by the Government of the Philippines; BPAP 2007.

## C. Impact

The IT-BPO services export industry has grown rapidly compared with other parts of the economy. As a share of GDP, its revenue rose from less than 1% in the early 2000s to 1.5% in 2004 and to 5.5% in 2012, and its share of total exports (goods and services combined) increased from less than 1% in 2000 to 3% in 2004 and to 19 % in 2012. Its share of employment is, however, significantly less than its share of GDP or of foreign trade. Nevertheless, the share of the country's total employment directly employed in the industry has risen from less than 0.1% in the early 2000s, to 0.3% in 2004 and to 2.1% in 2012 (Table 5).

Most of the IT-BPO industry has traditionally been located in Metro Manila followed by Cebu. The Metro Manila area accounted for 75 percent of all employment and more than 82 percent of total revenues in the industry in the Philippines as of 2012. The industry accounted for 12% of regional GDP and directly employed more than 0.6 million persons in the Metro Manila area as of 2013 (Mitra forthcoming). While much of the industry continue to be located in Metro Manila, it has also begun to develop rapidly in the Cebu area, and in so called next wave cities, many of which offering special advantages in terms of access to human resources, low costs, taxation and other incentives.

While the IT-BPO industry had only a limited impact on the economy in the 1990s, it is now a significant factor in the country's economic development. The industry's share of GDP and exports has risen sharply. Also, it has become a major generator of new job opportunities as direct full-time employment in the industry has risen from 100,000 in 2004 to 777,000 in 2012. Furthermore, in addition to direct employment, it is estimated that the industry generated 1.9 million indirect employment opportunities in 2012, that is, assuming an employment multiplier of 2.5 which is rather conservative; multiplier estimates for India typically range from 3 to 4 (Table 5) (Mitra forthcoming).

The expansion of the industry, coupled with more use of ICT, has had significant implications in terms of the level and composition of consumption and investment especially in the Metro Manila and Cebu areas. Direct and indirect impact include creation of employment, providing income and other benefits for employees, and earnings for the corporate sector, the latter including major foreign IT-BPO firms as well as indigenously owned telecommunication and real estate conglomerates. It has had positive impact on the local economy in terms of revitalizing retail sales, real estate, education, travel, and tourism, but has also entailed so called creative destruction whereby some jobs and old business practices become obsolete. More important, however, are the long-term implications for building competency and institutions and the potential to foster greater use of IT-BPO services across all sectors, geographies and social groups in the country. Among other things, the expanded role of ICT-related services has played a central role in transforming entrepreneurship, supply chains and fostering the development of production, trade, finance, and knowledge networks. In addition the success in developing a major BPO export sector has helped to improve the perception of the country internationally (Mitra forthcoming).

Due to the complexity of issues involved, and the lack of data and survey material, it is difficult to explicitly verify the various impacts of the IT-BPO service industry have; nevertheless, the following have been observed.

- Expansion has enabled new livelihood opportunities within and across social groups, but significant regional, ethnic, and income disparities remain. Although much of the impact has been on the middle class, direct and indirect impact on lower-income groups has also been significant especially in terms of new jobs in the formal and informal sectors.

- The higher pay offered has generated new income opportunities for high-, middle-, and low-income groups but has also increased prices and the cost of living and appears to have contributed to the widening of income disparities.

- The industry has directly and indirectly generated significant amounts of additional tax revenue despite the fact that much of it has been granted tax holidays.

- The accumulation of new private wealth has expanded corporate social responsibility programs and other philanthropic activities targeted at underprivileged groups (Mitra forthcoming).

While the rapid growth of the industry may have caused stress and disrupted family lifestyles, social and economic structures, and labor markets, positive socioeconomic impacts of industry expansion include the empowerment of entrepreneurs and of middle- and low-income groups and intergenerational effects in terms of job and educational aspirations. Furthermore it has given rise to a new set of issues relating to disaster management, privacy, and cyber security.

**Table 5: Information Technology Services-Business Process Outsourcing Revenue and Employment Growth in the Philippines, 2004–2020**

| Year | 2004 | 2009 | 2010 | 2011[p] | 2012[p] | 2016[a] | 2020[b] |
|---|---|---|---|---|---|---|---|
| Revenue from IT-BPO export industry | | | | | | | |
| Revenue ($ billion) | 1.5 | 7.2 | 9.0 | 11.0 | 13.0 | 25.0 | 45.0 |
| Revenue-to-GDP (%) | 1.6 | 4.2 | 4.5 | 4.9 | 5.5 | 7.8 | 9.8 |
| Revenue-to-total export of goods and services (%) | 3.4 | 14.6 | 13.7 | 17.2 | 18.8 | – | – |
| Employment impact of IT-BPO export industry | | | | | | | |
| Direct employment (million) | 0.1 | 0.4 | 0.5 | 0.6 | 0.8 | 1.3 | 1.8 |
| Indirect employment (million) | 0.3 | 1.1 | 1.3 | 1.6 | 1.9 | 3.2 | 4.5 |
| Total employment (million) | 0.4 | 1.5 | 1.8 | 2.2 | 2.6 | 4.5 | 6.3 |
| Direct employment, share of country's total employment (%) | 0.3 | 1.3 | 1.6 | 1.7 | 2.1 | – | – |
| Total employment, share of country's total employment ((%) | 1.0 | 4.1 | 4.9 | 5.9 | 7.1 | – | – |

– = data not available, IT-BPO = information technology-business process outsourcing.

a = BPAP high-end road map projection for 2016 BPAP (2012), b = Mitra forthcoming mid-point scenario for 2020, p = provisional estimates.

Note: Indirect employment calculated based on an assumed employment multiplier of 2.5 as per BPAP (2012 and 2013).

Source: Author's estimates based on BPAP (2009–2013, 2012 and 2013), NSCB (2012), and Mitra (2013a).

## D. Opportunities and Challenges

The Cabinet-level Department of Science and Technology stated in 2012 that the government's goal was that the ICT industry as a whole would generate $50 billion in revenue by 2016 of which IT-BPO services would account for $25 billion–$27 billion and all other ICT (including telecommunications and electronic hardware) would be $23 billion–$28 billion. This implies that ICT would account for 18% of GDP in 2016 if the $50 billion target is reached (Ibrahim 2013).

The Philippine IT-BPO Road Map 2011–2016 launched by the Business Processing Association of the Philippines (BPAP) in 2011 suggested that annual export revenues from IT-BPO and global in-house center services could more than double from $9 billion in 2010 to $25 billion in 2016. However, the association also stressed that this will require the industry to accelerate the development of talent and to obtain stronger government support. If it succeeds,

the IT-BPO industry could employ up to 1.3 million and account for 8% of GDP by 2016. In addition to direct employment, it is estimated that the industry will produce 3.2 million indirect employment opportunities by 2016 (BPAP 2012, 2013). Furthermore, research in line with these growth assumptions shows that IT-BPO industry revenue could reach $50 billion by 2020, $45 billion in exports and $5 billion in domestic markets. The number of persons directly employed in the IT-BPO export industry would thus increase from 0.8 million in 2012 to 1.8 million in 2020 (Mitra 2013a).

According to BPAP, the Philippine Software Industry Association and other industry association partners of BPAP, the IT-BPO industry is poised to continue to grow rapidly in voice and non-voice BPO as well as in IT software and services. This is reflected in the fact that BPAP was renamed the Information and Technology and Business Process Outsourcing Association of the Philippines in 2013. Nevertheless, multiple factors will constrain growth prospects, the most important one being the quantity and quality of technical, managerial, and entrepreneurial talent. The industry, government, and academia must make concerted efforts to expand the scale and scope of educational and training programs. The BPAP road map identified five priorities for the association: (i) setting standards and accreditation to ensure a better match between the skills of graduates and industry requirements; (ii) more aggressive internal marketing of job prospects for the local talent pool; (iii) strengthening awareness of the value proposition in IT, voice, and non-voice BPO services in existing and new markets; (iv) advocating for high-impact public policies; and (v) strengthening public–private partnerships to fund key initiatives such as development of industrial hubs and work–study training programs (BPAP 2012).

The country appears to be ready to increase its global market share of low- and higher-end voice and non-voice BPO services in the short and medium terms as manifested in the surge of investments in BPO in the 2010s. Both IT services and the BPO industry can continue growing in line with global developments in outsourcing and offshoring. In the long term, though, it may no longer be viable to increase market share due to changes in demand, commoditization, lower profit margins, and intense international competition. These developments along with the emergence of new technologies, business models, and opportunities will demand a major transformation and adaptation of the industry in the country.

The challenges for the Philippines in this decade are interrelated. First, it is essential to ensure that the country's overall economic, social, and political environment and investment climate are favorable for sustaining inclusive ICT and for developing ICT-enabled services, for fostering a knowledge economy, and for leveraging global technology developments. Second and more specific to the IT-BPO industry, it is essential to (i) effectively respond to changes in demand and competition in developing services; (ii) give utmost priority to developing technical, managerial, and entrepreneurial talent; (iii) develop multiple avenues for financing; (iv) improve infrastructure and living conditions; and (v) improve the legal and regulatory environment. Moreover, strong efforts are needed to foster foreign and local investment, entrepreneurship, and networks in different international and local geographic areas (Box 2) (Mitra 2013a).

## Box 2: Factors Hampering Local Entrepreneurship in the Philippines

**Markets and Competition**

- There is a lack of financial resources, influential contracts, and competition from a wide range of foreign companies in India, the Philippines, and elsewhere.
- Historically, the scale and scope of the domestic market has been limited in terms of households, the private sector, and government procurement.

**Human Resources, Entrepreneurial Traditions and Talent Drain**

- There are large numbers of potentially capable entrepreneurs, but their willingness to adopt the mindset needed for success in establishing start-ups and scaling up small and medium-sized enterprises (SMEs) in the IT-BPO industry is limited, though the Filipino-Chinese community has more robust entrepreneurial traditions than most other groups in the country. It will take considerable time to change the overall mindset so that more people consider the IT-BPO industry as an entrepreneurial career.
- There is entrepreneurial dynamism but also a reluctance to take risks and insufficient efforts to improve quality and reliability.
- Technical, managerial, and entrepreneurial talent often choose to work overseas rather than in the Philippines with only a few returning. There is also an internal talent drain as foreign subsidiaries in the Philippines attract the best talents because they pay better salaries and generally are considered to be more attractive employers which makes it harder for local firms to attract and retain high caliber talent. On the other hand, the fact that multinational corporations attract local talent can be viewed as positive as they train and mentor people, some of whom eventually decide to work for local firms.

**Finance and Infrastructure**

- Start-ups and SMEs often find it harder to raise capital than established and larger firms do. Few are willing to risk limited private savings to cover even basic start-up costs such as hiring staff, computer equipment, connectivity, and electricity.
- The high cost and poor quality of energy, broadband, and other infrastructure affects start-ups and SMEs more than established and larger firms.

**Technological Capabilities**

- The understanding and practical knowledge of the use of ICT is often weak despite the fact that effective use of ICT is currently a must in many forms of entrepreneurship.

**Risk Mitigation**

- The Philippines is one of the world's most natural disaster-prone countries and is also perceived by some as having significant political risks. This calls not only for rigorous contingency planning but also entails significant costs for IT-BPO and other industries. Large firms—multinational corporations in particular—have the resources needed to mitigate risks, but it is harder for start-ups and local SMEs to do so. Also, multinational corporations have major advantages as they have global service delivery capabilities so they can shift work to other locations quickly, if required.

**Government, Vested Interest Groups, Personal Patronage, and the Political Economy**

- Much of the industry sector (also the government, the business community, and civil society) has been characterized by personal patronage as wealth is concentrated in a few families, and large companies or oligopolies dominate the economy. Private conglomerates control the banking, international commerce, retail sales, real estate, transportation, petroleum and electric power, and telecommunication industries. The Philippines is basically a market economy in which the government, the private sector, the church, and nongovernment organizations are all major participants. Many argue that the concentration of power coupled with a cumbersome legal and regulatory system and bureaucratic red tape have made it hard for start-ups and SMEs to break in and to compete with large established firms.
- Public sector weaknesses in terms of effectiveness, transparency, and accountability for corruption and in terms of red tape have hampered start-ups and SMEs. Compared with larger firms, smaller firms often find it difficult to comply with taxation and with other government requirements, so some choose to operate in the grey sector as they find it hard to cope with red tape.
- The enforcement, accountability, and transparency of government policies, projects, laws, and regulations are weak, both centrally and locally. Enacting new legislation and regulatory frameworks is a lengthy process.

**Economic Nationalism**

- The "Philippines first" ideology that is part of the constitution constrains possibilities for foreign firms and professionals to work in the Philippines. It limits the role of foreign direct investment; the Philippines has lagged behind its neighbors in attracting it.

Sources: World Bank and IFC (2013); WEF (2013b); Arangkada Philippines (2010); author's compilation based on interviews with foreign chambers of commerce and industry associations.

## IV. TOURISM

### A. Growth, Trends, and Impact

Compared to the young IT-BPO industry, the tourism industry has a long history in the Philippines. Tourism has traditionally been the largest source of service revenues in many developing countries, but in the Philippines, the growth of the industry has been moderate, and in recent years the IT-BPO industry has overtaken it in earnings though not in number of employees. Tourism did rather well in the 1970s and early 1980s, but then growth began to slump; in fact tourism's share of GDP at 5-6% and of total employment at 10% was relatively stable from 2004 to 2011 (Table 6). Growth has, however, been more substantial from the mid-2000s and onwards as international tourist arrivals grew from 1.9 million in 2003 to 4.2 million in 2012 and are targeted to reach 5.5 million in 2013 (DOT 2013).

Employment in tourism has been growing at a moderate rate compared with most other ASEAN countries, but the industry employed 3.8 million workers in 2011 which was twice the number in public administration and defense, more than three times the number in education, and nine times more than in the banking-finance-insurance industry. Although tourism is more widely distributed in the country than IT-BPO, skill and remuneration levels are typically lower.

**Table 6: Selected Indicators for Tourism Development in the Philippines, 2004–2012**

| | | Tourism Share of Country's | | International Visitor Arrivals (Number arrived) | | | Tourism Receipts[a] | |
|---|---|---|---|---|---|---|---|---|
| Year | Tourism Share of GDP[a] (%) | Total Employment[a] (%) | Domestic Tourism (Number millions) | Number Tourists (millions) | Growth Rate (%) | Share of Global Arrivals (%) | Growth Rate (%) | Share of Total Exports (%) |
| 2004 | 5.87 | 9.7 | 13,1 | 2,3 | 20.1 | 0.30 | 30.7 | 4.3 |
| 2005 | 5.87 | 9.7 | 15,4 | 2,6 | 14.5 | 0.33 | 12.3 | 3.9 |
| 2006 | 5.83 | 9.8 | 16,5 | 2,8 | 8.4 | 0.34 | 23.1 | 4.7 |
| 2007 | 5.87 | 10.0 | 19,7 | 3,1 | 8.7 | 0.34 | 7.4 | 4.1 |
| 2008 | 5.74 | 10.0 | 17,3 | 3,1 | 1.5 | 0.34 | –17.9 | 3.5 |
| 2009 | 5.52 | 10.1 | 17,6 | 3,0 | –3.9 | 0.34 | –7.9 | 3,9 |
| 2010 | 5.72 | 10.2 | 21,8 | 3,5 | 16.7 | 0.37 | 11.4 | 4,1 |
| 2011 | 5.76 | 10.3 | 26,2 | 3,9 | 11.3 | 0.40 | 20.2 | 4,0 |
| 2012 | – | – | – | 4,3 | 10,5 | – | – | – |

– = data not available. A = domestic and international tourism combined.

Source: NSCB (2012), DOT (2013) and WEF (2013a)

In 2012, the Philippines attracted 4.3 million international tourists compared with 3.1 million in 2007 and 2 million in 2000. Domestic tourism reached 22 million on 2011 compared to 11 million in 2011. Between 1995 and 2010, the annual average growth of international arrivals was 4.7% while between 2005 and 2010 the average annual rate of growth in the domestic market was 3.3% (DOT 2012). These growth rates are quite low compared with competing countries such as Indonesia, Malaysia, Thailand, and Viet Nam (WEF 2012). While growing more rapidly in recent years, the Philippines continues to lag behind Indonesia, Singapore, and Thailand in the number of international tourist arrivals and international tourism receipts per capita (Table 7).

**Table 7: Selected Tourism and Economic Indicators for Association of Southeast Asian Nations Members, 2011**

| Economy | TTCI Rank/139 Countries | International Tourist Arrivals | | International Tourism Receipts | | | Population (Million) | GDP per Capita ($) |
|---|---|---|---|---|---|---|---|---|
| | | Thousands | Per 100 Population | $ Million | % of GDP | $ per Capita | | |
| Brunei Darussalam | 67 | 214* | 51.7 | 254** | 1.8** | 613.5** | 0.4 | 29,852 |
| Cambodia | 109 | 2,882 | 19.3 | 1,683 | 15.0 | 112.6 | 15.0 | 753 |
| Indonesia | 74 | 7,650 | 3.2 | 7,952 | 1.1 | 33.5 | 237.6 | 2,981 |
| Lao PDR | – | 1,670* | 25.9 | 382* | 6.8* | 59.3* | 6.4 | 1,004 |
| Malaysia | 35 | 24,714 | 87.5 | 18,259 | 7.7 | 646.3 | 28.3 | 8,418 |
| Myanmar | – | 391 | 0.6 | 73* | 0.2* | 1.2* | 61.2 | 742 |
| Philippines | 94 | 3,917 | 4.2 | 2,783 | 1.7* | 29.6 | 94.0 | 2,123 |
| Singapore | 10 | 10,390 | 200.4 | 17,990 | 7.9 | 3,470.3 | 5.2 | 43,865 |
| Thailand | 41 | 19,098 | 29.9 | 26,256 | 8.2 | 411.0 | 63.9 | 4,992 |
| Viet Nam | 80 | 6,014 | 6.8 | 5,620 | 5.4 | 63.7 | 88.3 | 1,174 |
| ASEAN | – | 76,940* | 12.8 | 68,639* | 4.6* | 114.4* | 600.2 | 3,117 |

* = 2010, ** = 2009, – = data not available, ASEAN = Association of Southeast Asian Nations, GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic, TTCI = travel and tourism competiveness index of the World Economic Forum.

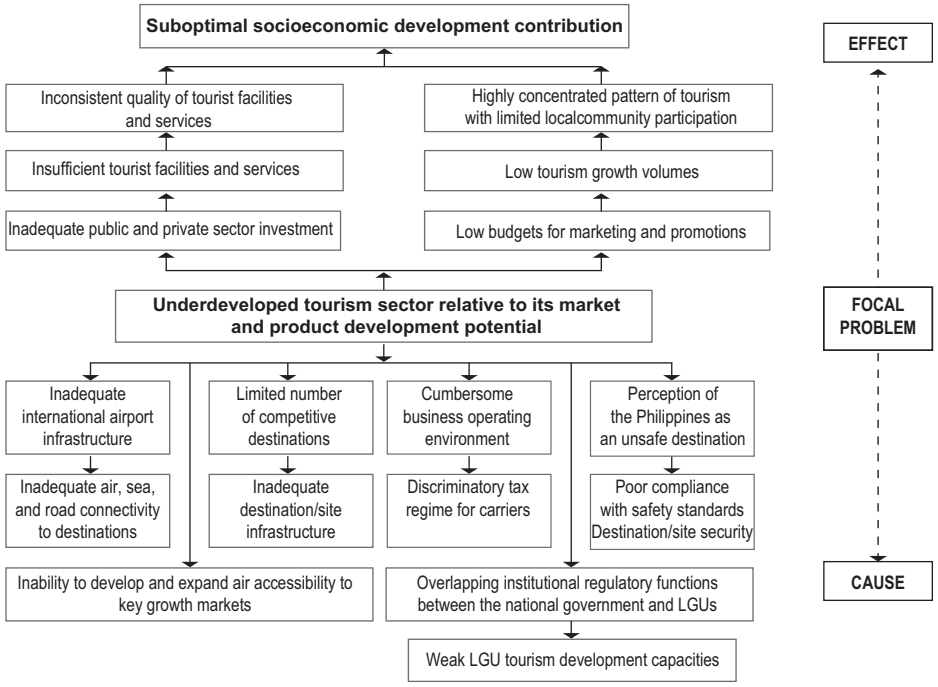
Source: Adopted from WEF (2012).

## B. Drivers and Constraints

The Philippines destination potential for tourists is not confined to in its principal cities but includes as large number of locations in its vast archipelago. The people are generally friendly, cosmopolitan, and proficient in English. Despite these attributes, growth has been uneven and constrained by deficient infrastructure and other weaknesses. While tourism is less demanding in terms of educated human resources and high remuneration levels, developing the industry is demanding as it requires not only hotels but also adequate physical and institutional infrastructure and access to major sources of funding and to marketing and sales networks. Also, tourism has limited growth potential and also has risks of undesirable developments such as disrupting traditional value systems and life styles and burdening the environment.

The Philippines has traditionally ranked poorly in the World Economic Forum annual survey on travel and tourism, which calculates a country's competitiveness index based on three criteria: regulatory framework; business environment and infrastructure; and human, cultural, and natural resources. The 2009 report ranked the Philippines lowest among its ASEAN neighbors in terms of number of airlines with flights from the country and the availability of good air connections to overseas markets. It also lagged behind in the quality of roads and the ground transportation network, and restrictions on foreign ownership of companies and property rights remain a handicap in attracting tourism investment, especially by international chains. The time and cost needed to start a tourism enterprise also deserve attention. The 2011 survey covered 139 countries; the Philippines ranked 98th in regulatory framework constraints; 94th in business environment constraints; and 75th in human, cultural, and natural resource constraints. From an overall position of 86th from 2007 to 2009, the country fell to 94th out of 139 countries and 18th out of 26 in Asia and the Pacific in 2011. According to the survey released in 2013, however, the conditions in the Philippines have improved significantly as it ranked the country 16th in the region, and 82nd overall (WEF 2009, 2011, 2012, 2013a). The following figure shows the Department of Tourism's diagnosis of why the industry is underdeveloped.

**Figure 1: Why Tourism is Underdeveloped in the Philippines**




LGU = local government unit.

Source: DOT (2012).

## C. Opportunities, Policies, and Other Challenges

Tourism has long been a high priority for the government and is considered central for social and economic development and employment in all provinces. Plans to develop tourism are included in the Medium-Term Economic Development Plan for 2011–2016 of the National Economic Development Authority and in the Department of Tourism's draft National Tourism Development Plan 2012.

The draft plan aims to increase international arrivals from 3.5 million in 2010 to 10 million in 2016, while domestic travel is projected to increase from 28 million to 35 million in the same period. In all, the share of tourism in GDP is projected to grow from 5.8% in 2010 to 8.1% in 2016, and employment is expected to rise from 3.7 million to 6.5 million, of which up to 740,000 will be from the poorer sections of the population (DOT 2012).

The plan further seeks to leverage the country's comparative advantage in natural resources, its position and proximity to major growth markets, and its well-known cosmopolitan and friendly culture. It highlights prospects for invigorated growth in the new tourism law and the open skies policy and by addressing (i) limited international and domestic market access and connectivity; (ii) noncompetitive tourist destinations and products; and (iii) weak public sector tourism governance and human resource development policies and practices.

Achieving the Philippine government's ambitious tourism growth targets for 2011–2016 will require forceful action. To tackle the main bottlenecks and barriers, the national plan outlines the development and marketing of competitive tourist products and destinations;

improving market access, connectivity, and destination infrastructure; and improving the institutional, governance, and human resource capabilities for tourism (DOT 2012). Substantive progress has been made in recent years, but much remains to be done to tap the development potential of tourism.

## V. OVERSEAS WORKERS AND THE PHILIPPINE DIASPORA

### A. Growth and Structural Change

Recently, the major avenue for Filipinos to "export" services has been by working overseas rather than by delivering services from the Philippines. In fact, more than 10% of all Filipinos work overseas as permanent, temporary, or irregular migrants, (Table 8) and their remittances have long been larger than the country's commercial service exports. The number of overseas Filipinos (workers, students, emigrants, and others) has continued to increase since the 1960s and reached more than 10 million in 2011. More than 2 million Filipinos have migrated to the US, 0.5 million to Canada, and several hundred thousands live in Australia and Japan. For overseas workers, the Middle East has been a prime destination followed by the PRC and other Asian countries.

Most overseas Filipinos work in services. They have a wide variety of occupations including medical doctors; nurses; physical therapists; accountants; engineers; architects; seafarers; caregivers; physiotherapists; IT professionals and other technicians; teachers; journalists; artists; travel, restaurant, and hotel employees; and domestic helpers. The number of Filipinos working overseas has not only grown but has also changed structurally. While significant numbers work in low-end service jobs such as domestic helpers and general laborers, there has been a rapid expansion in the number with higher education and professional skills. In fact, official data on Filipinos who emigrated in 2011 show that 40% had college or post-graduate educations (Table 9). In the US, the Philippines ranks first in supplying nurses and second in medical doctors after India. Also, many Filipinos work in engineering, teaching, research, business management, and liberal arts in North America, Europe, and Asia.

### B. Drivers and Constraints

Multiple factors explain why so many Filipinos have opted to work overseas. Broadly speaking, they are related to demand from other countries that can offer employment and comparatively high pay combined with high population growth and with a lack of attractive opportunities in the Philippines due to the modest growth of both the industry and service sectors. This, in addition to their strengths in cultural adaptability and professional talent, has resulted in a large number of Filipinos opting to work overseas, mostly in the service sector.

In addition, the Philippine government has been proactive in enabling Filipinos to work overseas. Since the enactment of the Labor Code in 1974, the government has set up public agencies to facilitate finding overseas jobs, and it has negotiated bilateral labor agreements to ease the movement of workers and to protect their rights in host countries. Efforts to counter the brain drain, or more broadly the talent drain, have, however, been unpretentious.

**Table 8: Estimates of Numbers of Filipinos Overseas, 2000–2011**

| Year | Permanent | Temporary | Irregular | Total stock |
|---|---|---|---|---|
| 2000 | 2,551,549 | 2,991,125 | 1,840,448 | 7,383,122 |
| 2001 | 2,736,528 | 3,049,622 | 1,625,936 | 7,412,086 |
| 2002 | 2,807,356 | 3,167,978 | 1,607,170 | 7,582,504 |
| 2003 | 2,865,412 | 3,385,001 | 1,512,765 | 7,763,178 |
| 2004 | 3,204,326 | 2,899,620 | 1,039,191 | 7,143,137 |
| 2005 | 3,407,967 | 2,943,151 | 626,389 | 6,977,507 |
| 2006 | 3,568,388 | 3,093,921 | 621,713 | 7,284,022 |
| 2007 | 3,693,015 | 3,413,079 | 648,169 | 7,754,263 |
| 2008 | 3,907,842 | 3,626,259 | 653,609 | 8,187,710 |
| 2009 | 4,056,940 | 3,864,068 | 658,370 | 8,579,378 |
| 2010 | 4,423,680 | 4,324,388 | 704,916 | 9,452,984 |
| 2011 | 4,867,645 | 4,513,171 | 1,074,972 | 10,455,788 |

Note: Permanent: an immigrant, dual citizen, or legal permanent resident abroad whose stay does not depend on a work contract. Temporary: a person whose stay overseas is employment related and who is expected to return at the end of the work contract. Irregular: a person not properly documented or without a valid residence or work permit or who overstays in a foreign country.

Source: Philippine Overseas Employment Administration (2013).

**Table 9: Number of Registered Filipino Emigrants by Educational Attainment prior to Emigrating**

| Educational Attainment | 1988 | 2000 | 2008 | 2009 | 2010 | 2011 | 1998–2011 | Share in 2011 (%) | Average Annual Growth in 1998–2011 (%) |
|---|---|---|---|---|---|---|---|---|---|
| Not of school age | 5,514 | 3,175 | 4,842 | 5,813 | 7,061 | 6,658 | 112,384 | 8.0 | 8.0 |
| No formal education | 459 | 331 | 105 | 92 | 83 | 64 | 10,324 | 0.1 | –9.5 |
| Elementary | 8,847 | 6,308 | 8,907 | 9,986 | 10,969 | 10,359 | 195,467 | 12.4 | 6.2 |
| Elementary graduate | 3,012 | 1,864 | 2,314 | 2,395 | 2,194 | 2,152 | 61,121 | 2.6 | 1.2 |
| High school | 7,291 | 6,475 | 8,216 | 9,218 | 9,428 | 9,260 | 185,297 | 11.1 | 4.5 |
| High school graduate | 5,724 | 6,398 | 8,251 | 8,702 | 8,299 | 8,401 | 174,322 | 10.1 | 3.2 |
| Vocational | 839 | 854 | 970 | 1,273 | 1,421 | 1,363 | 24,432 | 1.6 | 5.7 |
| Vocational graduate | 1,415 | 2,300 | 3,368 | 4,092 | 4,534 | 4,531 | 62,310 | 5.4 | 8.6 |
| College | 8,451 | 8,069 | 11,852 | 13,668 | 14,365 | 13,809 | 239,635 | 16.6 | 5.8 |
| College graduate | 15,614 | 13,619 | 19,264 | 21,794 | 24,834 | 24,193 | 408,011 | 29.0 | 7.7 |
| Post graduate level | 527 | 1,088 | 1,100 | 1,071 | 1,188 | 1,010 | 21,444 | 1.2 | 5.8 |
| Post graduate | 327 | 518 | 1,564 | 1,476 | 1,586 | 1,484 | 21,483 | 1.8 | 10.4 |
| Non-formal education | – | 23 | 31 | 46 | 17 | 13 | 1,573 | 0.0 | – |
| Not reported/No response | – | 9 | 16 | 92 | 96 | 113 | 843 | 0.1 | 29.3 |
| Total | 58,020 | 51,031 | 70,800 | 79,718 | 86,075 | 83,410 | 1,518,646 | 100.0 | 6.0 |

– = data not available.

Source: CFO (2012).

## C. Impact

Filipino remittances to their native country have been significant in absolute terms and as a ratio of GDP and of other economic indicators. They have been a major source of foreign exchange earnings and hence in the balance of payments. Remittances recorded and routed through banks rose from about $2 billion in 1990 to $6 billion in 2000 and to $21 billion in 2001. As of 2012 they stood at $23 billion compared to $2 billion in foreign direct investment. Recorded remittances were 5.2% of GDP in 1996 compared with 9%–10% from 2003 to 2012. Remittances have increased rather steadily despite the global financial crisis in 2008 although at a slower rate than in the pre-crisis years (BSP 2013b).

The absolute magnitude of remittances to the Philippines is larger than in any other ASEAN country. The Philippines was the world's third largest recorded remittance recipient in

absolute terms after India and the PRC in 2012. Moreover, the remittance-to-GDP ratio for the Philippines has been as high as 9%–10% compared with 1% and 3% in the PRC and India, respectively which is also far greater than other ASEAN countries (World Bank 2013b). Also, partly because the Philippine diaspora is large and spread worldwide, remittance inflows have been rather more stable than other international financial flows (BSP 2013b)

The fact that remittances have a major impact on the economy is widely acknowledged although most have been channeled to consumption rather than to direct investment with the prime exception of real estate. Remittances have been a major source of foreign exchange earnings and contribute markedly to the current account surplus in addition to being a significant factor in consumption expenditures in the country.

While individuals and their families benefit financially from Filipinos working overseas, there are also undesirable implications such as weakening family ties. Thus on the one hand, the Philippines is a major exporter of human capital that benefits from workers' remittances, but on the other hand, it can be perceived as a country that is losing potentially valuable talent.

### D. Opportunities and Challenges

The improved performance of the Philippine economy as illustrated by rapid BPO industry growth and changes in the external job market (economic slowdown and migration and work permit restrictions) have moderated the trend to seek employment overseas, and it has also become more difficult for certain categories of workers to emigrate. Thus, for example, a significant number of business management, IT, engineering, and healthcare graduates now seek employment in the IT-BPO industry in the Philippines.

The continued rapid growth in IT-BPO, tourism, and other service industries both in terms of exports and of services directed at local needs will result in more job opportunities in the country and will reduce the incentive to go overseas. Moreover, it could trigger an increase in the number of Filipinos opting to return to work or to invest in their native county. Such a development could prove to be very beneficial for the modern service sector.

Redirecting past trends in migrating talent will, however, require major improvements in the Philippine economy so that it can offer more employment and higher pay. Furthermore, the education system has to be reoriented so that it produces what is needed in the country rather than what is in demand overseas. Also, the government and the private sector need to make greater efforts to retain useful talent and to entice those working overseas to invest and work at home as that could improve prospects for developing the IT-BPO industry, tourism, and other services.

## VI. CONCLUSIONS

Typically, sustainable, inclusive social and economic development is based on developing both the goods-producing (agriculture, mining, construction and manufacturing), and service sectors and the interface between them because services like education, healthcare, banking, legal systems, ICT, and logistics are fundamentally important for goods-producing sectors and vice versa. The principal issue is not whether to focus on services or on goods production but rather on why, when and what type of services and goods in the context of shifting patterns of comparative advantage that in turn depend on changes in demand, skill sets, natural resources

and other factor endowments, technology, government policies, and other developments. This implies a need for vision and pragmatic approaches.

While potentially useful, a traditional analysis of broad categories of services such as modern versus traditional has major limitations. One reason for this are the changes that modern and traditional services undergo over time, e.g., in education, healthcare, financial services, and public administration. ICT has been a major factor in the revolutionary changes in these and other services whereby certain modes become obsolete while new ones come to the fore in line with the notion of creative destruction (Schumpeter 1950). There is a need to give priority to new modern services (IT, BPO, the Internet and other) and to use them to revitalize the delivery of both modern and traditional services. Furthermore, it is useful to distinguish between services for export and those for the domestic market and to note that advancements in transportation and logistics and the escalating ICT revolution make both goods and services more tradable within and across countries. Becoming more tradable implies that services can grow substantially even when domestic demand is weak.

Traditional services interact with modern ones; for example, the IT-BPO industry is highly dependent on the education system for human capital while an effective education system is becoming increasingly dependent on ICT. Similarly, there is substantial interdependence between ICT and the development of engineering and other science and technology based services manufacturing and other goods production, transportation, tourism, real estate, banking, finance and insurance industry, creative industries, business services, public administration and national security among other sectors. Although the successful development of the IT-BPO industry depends on the status of other sectors, it also has major implications for their development. In short, a well-developed IT-BPO industry can both empower and be a catalyst for transforming other parts of the economy.

Simultaneously developing both the IT-BPO and tourism industries can help create a better overall business environment that could further spur their development. Expanding the scale and scope of IT-BPO exports and tourism can also improve country branding and can help to increase air traffic and to develop hotels, real estate, retail businesses, and creative industries.

The experience of the Philippines points to the need to embark on multipronged development with a pragmatic focus on several services and goods-producing sectors. Concerted efforts to strengthen education, training and institutional capabilities coupled with effective application of ICT will develop new business models and entrepreneurship and will transform supply chains and production, trade, finance, and knowledge networks. While not a panacea for economic development the Philippines has major opportunities to expand the scale and scope of ICT and ICT-enabled services. ICT related development can have a special strategic role as they can leverage development in the economy as a whole in terms of innovation, productivity, and competitiveness and governance (Mitra 2013a).

Analyzing the growth and the impact of developments in ICT, tourism, and other services needs to be extended beyond revenue and employment and beyond a traditional analysis of forward and backward links or multipliers. It is critical to consider the importance of growth and structural changes in the IT-BPO industry that have major, economy-wide implications for building competency and using new ICT applications, both of which generally have not been sufficiently understood (Mitra forthcoming).

The traditional agriculture and manufacturing sectors continues to be important in the Philippines (and in most other countries), but the service sector accounts for a major part of employment, GDP, and exports. Reconstituted traditional services as well as modern services (and goods production) are central to poverty alleviation and also for the economy to develop beyond the middle-income level. The advancement of most countries from low- to middle-income status required the government, the private sector, and other stakeholders to diversify and move up the value chain in both the industry and service sectors. In this context, it is essential to focus on education, research, innovation, entrepreneurship, ICT, and other technological and skill developments.

In sum, the government and the business and academic communities acknowledge that the Philippines has considerable scope for advancement in several areas and for fostering both intra- and inter-sector links and for transforming the supply chain within the country and internationally. Realizing those opportunities will require coherent strategies as well as the forceful implementation of appropriate actions in the agriculture, industry, and service sectors on one hand and in technology, governance, and other institutional aspects on the other.

Three major opportunities for leveraging service sector growth stand out. One is expanding the scale and scope of export and domestic market development for IT-BPO, telecommunications, and other modern services. This implies a unique window of historical opportunities for developing the Philippine economy. Leveraging ICT and ICT-enabled services is necessary to generate new income and jobs, to foster inter-sector links, and to be more productive and competitive. Second is to successfully develop the tourism industry to foster economic development across a wider social groups and regions, including poor and remote rural areas. Third is the need to enhance the prospects for Filipino technical, managerial, and entrepreneurial talent to work in the Philippines rather than overseas.

There is a need for forceful action and for flexible, timely responses by all stakeholders—government, academia, industry associations, foreign investors, and local entrepreneurs—to opportunities and challenges in the IT-BPO export industry, international tourism, and the development of the domestic market. Those efforts along with efforts to further develop education, healthcare, banking and finance, telecommunications, energy, physical infrastructure and the agriculture and industry sectors can substantially enhance prospects to achieve sustainable and inclusive growth within the country and to develop international interfaces, all of which would help the Philippines to catch up in economic development and to become a knowledge economy.

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**Leveraging Service Sector Growth in the Philippines**

This paper examines the potential to leverage service sector growth in the Philippine economy. It points to opportunities and challenges to expand the scale and scope of information technology-business process outsourcing and tourism, and the prospects for Filipino technical, managerial, and entrepreneurial talent so they will work in the Philippines rather than overseas. It stresses the need for revitalization of a wide range of service and goods-producing industries and the interface between them.

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