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Comment on “Exploring the prospects of services-led development in the Philippines”

Mead Over*

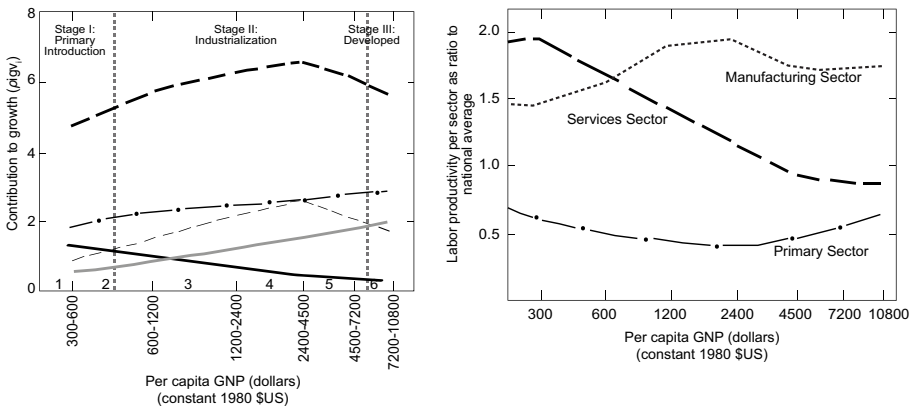
Center for Global Development

Dr. Serafica’s comprehensive and insightful paper offers hope that, by designing and implementing policies that raise not only employment, but also productivity and wages in the service sector, the Philippines government can increase average per capita income even in the absence of consumer-punishing, rent enabling, import substitution. Such policies, if they are effective, would generate “services-led development.”

The idea that services could lead development is rather new. The received wisdom from the earliest students of economics was that only growth of the manufacturing sector would generate the “externalities” that could jump-start economic growth. Perhaps it is useful to review the reasoning that led early students of growth to that conclusion.

Among the classic growth models developed a decade after the second world war, the stages of growth theory advanced by Chenery [1960] stands out for its relative success at predicting patterns of economic development over the subsequent 60 years. Chenery’s model posits three successive “stages” of economic growth: (1) primary production, (2) industrialization, and (3) developed (see Figure 1, Panel a).

FIGURE 1. Syrquin's model of service sector growth contribution and value-added per worker in a country's income evolution



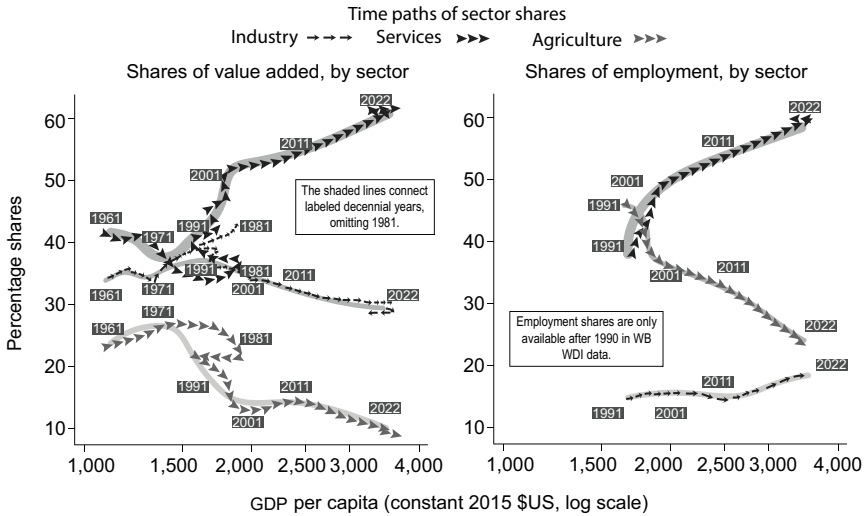
Source: Syrquin [1988].

Note: Multiplying the per capita GNP labels on the horizontal axes by 2.88 converts from 1980 USD to 2015 USD used in the rest of these comments.

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According to this theory, a precondition for an economy to transition from dependency on primary production to development, is for its manufacturing sector to serve as the engine of growth throughout the intermediate “industrialization” stage.¹ After growing to dominate the other two sectors in both value added and employment, the manufacturing sector, according to the theory, generates both intermediate and final demand for services. Transition to the “developed” third stage occurs after the service sector’s contributions to GDP growth exceeds those of the other two sectors. This dynamic causes the service sector to expand until it contributes more to growth and employs more workers than either of the other sectors. This pattern has been evident in the Philippines since 1991, as seen in Figure 2.

FIGURE 2. Sector shares vs. GDP per capita over time



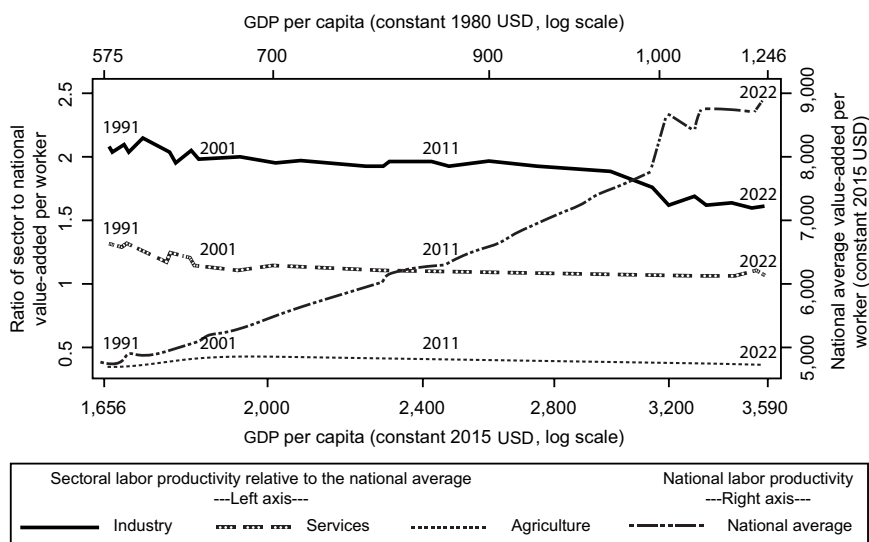
Source: World Bank’s WDI databank, accessed November 5, 2024; Years 1960 to 2022.
 Note: The service sector shares of value-added and employment have grown remarkably in the Philippines since 1991, both now exceeding 60 percent, without an intermediate industrialization stage as postulated by Chenery/Syrquin models.

However, despite the service sector’s growing dominance as a contributor to growth and as a source of employment, Chenery [1960] saw the value-added per service sector worker declining, falling farther and farther behind the manufacturing sector (Figure 1, Panel b). Notwithstanding Baumol’s subsequent

¹ Manufacturing has been the engine of growth” largely because manufactured goods are tradeable, providing domestic manufacturing firms with unlimited markets and thus enabling economies to scale. By contrast, traditional services were predominantly limited to domestic markets, creating less opportunity for expansive growth. Manufacturing sector workers have also benefited from standardized technology, allowing less-skilled labor to work with capital equipment which increases their productivity and wages. In addition to these beneficial externalities from sales to foreign customers, manufacturing firms can create local demand for intermediate goods and local supply to domestic firms, stimulating growth through these “forward linkages.”

comment that the lower bound on service sector productivity would be determined by the wages service sector workers might earn if they switched to the higher paid manufacturing sector, World Bank data on value added per worker in the Philippines displays a pattern like that predicted by Chenery and Syrquin. As shown in Figure 3, while Filipino GDP per capita has increased from USD 1,600 to USD 3,600 in 2015 USD (equivalent to an increase from USD 575 to USD 1,246 in 1980 USD) and national labor productivity has increased from USD 4,770 to USD 8,730 in 2015 USD, labor productivity in the Philippines service sector has continued to decline relative to nationwide labor productivity.

FIGURE 3. Labor productivity of Filipino workers, 1991 to 2020



Note: For compatibility with Figure 1, the top axis converts the 2015 USD to 1980 USD at a ratio of 2.88:1.

As Serafica [2024] notes, the Filipino service sector is absorbing an increasing share of the nation’s labor force, but service worker productivity remains well below the similarly declining productivity of workers in the manufacturing sector. If this pattern persists, the Filipino service sector may continue to grow without enriching the economy.

In almost all countries over the last 50 or more years, agriculture’s shares of GDP and employment have steadily declined, manufacturing’s share has peaked at mid-income levels and then given way to service. Yet, as Serafica’s [2024] paper highlights, the Philippines deviates from this path, passing directly from dominance of the primary sectors to dominance of the service sector, without the benefit of the manufacturing sector’s impact on growth and the consequent increase in per capita incomes it has typically entailed.

Dani Rodrik, writing with Rohan Sandhu [2024] and Joseph Stiglitz [2024], argues that the global economy has outgrown the manufacturing-led development

model. According to these and other authors cited by Serafica, the “window” for manufacturing-led growth may have closed. This conjecture might be tested using aggregate data or, instead, by applying quasi-experimental impact evaluation methods to purposefully collected experimental evidence.

With aggregate data one could attempt to apply vector auto-regression methods to separately identify the causal impacts of the service sector and the manufacturing sector on national growth. A brief review of any existing literature on this topic could support Serafica’s recommendations for future research. Furthermore, Yap and Turla’s [2024] paper exploring the application of complexity methods to the analysis of industrial policy, which uses VAR methods to estimate the impact of lagged sectoral performance on subsequent growth, could include the service as well as the manufacturing sectors among the determinants of growth. Since the critical issue for services-led development is whether the growth of particular components of the service sector could generate high paying jobs, with high value added, the research could use indices of these service jobs as dependent variables. Furthermore, in her paper, Serafica presents data on several different decompositions of the Filipino service sector which could be used to find the sector jobs with the highest value added. By constructing a table with entries defined as the quotient of Table 9 (gross value added) and Table 10 (number of employees), one could also learn the parts of the service sector where workers are the most productive.²

Acknowledging that the mechanisms for achieving sector-led growth are not fully understood, Rodrik and Sandhu [2024] suggest a second more granular empirical approach. The Philippine government, perhaps with assistance from a partner institution³ could conduct policy research, using either experimental or quasi-experimental methods, on a sample of service sector firms and test whether or under what conditions specific interventions generate high productivity jobs. This kind of study could apply the same intervention to small service sector firms in different sub-sectors in order to distinguish the impact on key outcome variables, by sub-sector. Or, the study could apply the same intervention to a sample of small manufacturing sector firms as well as to service sector firms, to test whether the intervention elicits high value job creation in one sector more than the other. Among the impacts hopefully caused by the experimental policy could be: (a) the increase in labor productivity and value-added per worker, (b) the increase in exports of tradeable services; and (c) an increase in forward linkages in either sector.

² Also see Autor and Price [2013] which breaks down service sector jobs into those with more or less potential for automation. Workers who can partner with AI systems may be more productive and, therefore, more highly paid.

³ Candidate partners include, for example, the Philippines Institute for Development Studies (PIDS), a multilateral development bank, the International Initiative for Impact Evaluation or the Abdul Latif Jameel Poverty Action Lab (J-PAL).

The experimental approach to policy design has its supporters and detractors. Rodrik and Sandu [2024] support policy experiments and provides a useful list of 20 published experiments, which, they suggest, might improve firm performance in the service as well as the manufacturing sectors. However, a paper dated a few months earlier by Rodrik and Stiglitz [2024] cautions that policies should not be guided solely by experiments. “China explicitly experimented by trying new policy arrangements in some provinces before launching them elsewhere. As these experiences show, learning from policy successes and failures is possible even when policy makers’ causal inference standards fall short of RCTs or other econometric techniques of “evidence-based policy making” [Rodrik and Stiglitz 2004]. As an archipelagic nation, the Philippines could leverage its diverse regions to conduct localized policy trials, which could yield valuable insights without requiring the constitutional changes highlighted by Serafica as impediments to some otherwise promising policy reforms or the monetary budget and political capital often required to conduct a well-powered randomized controlled trial.

While both the aggregate statistical analysis and the granular impact evaluation method are beyond the scope of Serafica’s paper, she could include comments on these and other relevant empirical approaches which Filipino policy makers could use to guide their choice of policies to implement on a larger scale. The challenge to industrial policy in the Philippines is to continue increasing the size of the service sector while exploring policies which offer higher value-added and thus higher wages to service sector employees. Policy experiments like those proposed by Rodrik and Sandhu (op. cit.) could generate excitement and political momentum for services-led growth and inform strategies that address low-productivity domestic services, which is essential to maintaining social cohesion. While experiments may be micro in scale, they offer an invaluable foundation for data-driven development, particularly in navigating the unique constraints of the Philippine economy.

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Recognized in the international community of professional economic associations and a founding member of the Federation of ASEAN Economic Associations (FAEA), the PES continuously provides a venue for open and free discussions of a wide range of policy issues through its conference and symposia.

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