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Exploring the prospects of services-led development for the Philippines

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The growing importance of the services sector has prompted an examination of possible pathways to maximize its impact, particularly on the quality of economic growth. Some emphasize promoting job creation and exports in the sector, in addition to ensuring that the services requirements of the rest of the economy are met. Others argue that the potential for services-led development depends on being able to replicate the features of industrialization by leveraging trade, technology, training, and targeting. There are also proponents of more active strategies on the demand side of labor markets. This paper discusses the interrelated issues the country must address in pursuing economic transformation through services. Priority actions include boosting productivity, expanding services outside the National Capital Region, implementing structural reform, strengthening exports of digital services, accelerating digitalization, and increasing innovation. For the Philippines, harnessing services to achieve broad-based and inclusive growth should be the essence of services-led development.

JEL classification: L80, L88
Keywords: services, development, exports, digital trade, structural reform, Philippines

1. Introduction

The services sector comprises a diverse range of activities such as transport and storage, financial services, research and development, health, and entertainment. Specific services are used for production, while others are crucial for human capital development. Services can also be characterized in terms of the nature of demand (intermediate input vs. final consumption), purpose (consumer vs. business services), or the form of provision (market/private vs. public provision) [Schetkatt and Youmani 2003].

Over time, services tend to play an increasingly bigger role in the economy in terms of both value-added and employment. Demand-side and supply-side factors contribute to the growing share of services in the economy (Schetkatt and

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Youmani [2003]; Cuadrado-Roura [2016]). These include shifts in the structure of final demand due to rising incomes, rural to urban migration, higher female labor force participation, and demographic changes which influence the structure of household expenditure. Increasing use of services by the goods sector and other service industries drives the demand for services as well. Growing international trade in services from lower trade barriers and government demand for services also explains the growth of the services sector. On the supply side, possible factors include productivity differentials between manufacturing and services, the provision of non-market services by the government, and advancements in information and communications technology (ICT) which drive the development of new services.

The impact of the expansion of the services sector depends on which services are growing [Maroto Sanchez 2010]. A primary objective for economic transformation is to move to high-productivity services or improve productivity in services that support other industries [te Velde 2017]. Experts suggest boosting the services sector as a complementary, if not alternative, development path as the space for manufacturing-led development is increasingly becoming constrained for developing countries. The next section presents some of the strategies that have been proposed, followed by an overview of the Philippine services sector. The critical issues and priorities for action in pursuing services-led economic development are then discussed. The paper concludes with a summary of the key messages and final remarks.

2. Harnessing services for economic transformation

2.1. Understand how specific services shape economic transformation

For Khanna et al. [2016], a key step in the formulation of strategies is understanding the three main effects of services expansion: (i) direct impacts on employment, exports, and GDP; (ii) indirect impacts on jobs and output through backward linkages with upstream sectors; and (iii) second-order effects for example productivity effects on downstream sectors through forward linkages. Table 1 maps out the roles of different services in economic transformation in terms of their possible direct, indirect, and knock-on effects. For example, hotel and accommodation related to tourism could be a source of export revenues and jobs. Professional services need skilled workers and enhance firm-level productivity, while transport and storage may have limited backward linkages yet have significant downstream effects especially in the goods sector.

TABLE 1. Services and economic transformation: conceptual pathways

Subsector	Direct effects			Indirect effects (static and dynamic)	Induced/ Productivity Effects
	Jobs (skilled, medium, or low-skilled workers)	Exports	GDP		
Wholesale and retail	Important for less to medium skills	Less important for most developing countries	Important share of GDP	Important effect on agriculture and manufacturing value chains	Less important
Transport and storage	Potentially important (e.g., truck drivers)	Important for some countries	Important share of GDP	Less important (apart from energy)	Important for economy-wide productivity
Accommodation and restaurants	Medium important for skilled jobs	Important export revenues	High in certain developing countries	Very important, including for less skilled workers	Less important
Information and communication	Important for a few countries especially for skilled workers	Potentially a major source of exports and capital inflows	Medium (mostly less than 10 percent of GDP)	Mostly forward linkages	Important productivity effects
Finance and insurance	Important, especially for skilled workers	Potentially a major source of exports and capital inflows	High (around 10 percent of GDP)	Less important for offshore centers but has the potential for forward linkages	Less important for offshore centers but important for finance directed at the real economy
Real estate	Very few jobs	Not important	Important share of GDP	Important effect on construction	Less important
Professional and support services	Important, especially for skilled jobs	Potentially a major source of exports and capital inflows	Low in developing countries	Forward linkages	Important for firm-level productivity
Public administration	Important for low- to medium-skilled workers	Insignificant	Medium to high in developing countries	Medium important	Not very important, except e.g. public infrastructure works
Education	Important for medium-skilled employment (e.g. teachers)	Less important, apart from a few countries	Relatively high share	Mostly temporary	Important for human capital in the long run
Health	Important for medium-skilled employment (e.g., nurses)	Less important, apart from a few countries	Relatively low share	Mostly temporary	Important for human capital in the long run

Source: Lifted in full from Khanna et al. [2016:10] and Balchin et al. [2016:7]

Rather than simply absorbing low-skilled workers with limited opportunities, it would be more strategic to promote exports and job creation in sectors with high potential (services as a growth escalator sector) while also supporting other

services that have significant linkages and knock-on productivity effects (services at the service of the whole economy) (te Velde [2017]; Khanna et al. [2016]).

2.2. Leverage the 4Ts: trade, technology, training, and targeting

Nayyar et al. [2021] explain that the success of services-led development depends on whether the scale, innovation, and spillovers along with job creation for unskilled labor that propelled industrialization can be replicated in the services sector. Furthermore, a one-size-fits-all approach will not be effective given the range of services which differ in terms of skill intensity, offshorability, capital intensity, R&D intensity, and intersectoral linkages.

To increase the contribution of services to development, four policy areas are suggested that will help address the potential to attain larger scale economies, enhance labor productivity through innovation, and capitalize on spillover effects through linkages:

- Trade – Achieving greater scale depends on being able to access larger markets through trade. Lower barriers at the border and reduced regulatory constraints behind the border increases market contestability, which can also help expand domestic trade.
- Technology – Digital technologies enable workers to perform tasks more efficiently and encourage investments in innovation. Support for technology adoption and use will be needed in addition to providing the necessary ICT infrastructure. Moreover, an enabling regulatory framework is essential to encourage the growth of digital tools and business models.
- Training – Improving training and skill development is crucial for increasing productivity while also assisting more workers to shift to skill-intensive subsectors or perform more complex tasks. Meeting the rising demand for digital competencies and other skills is an important aspect of the training needed by workers and firms to be competitive.
- Targeting – Given the potential for stronger linkages between services and other sectors, targeting the growth of services with higher multiplier and knock-on effects can expand the impact on job creation and productivity.

The importance of these core strategies varies across the different subsectors. For example, for information and communication as well as finance and insurance, the use of all four levers will be needed, while skill-intensive social services such as education and health will benefit from improving the trade, technology, and training dimensions.

2.3. Focus on expanding productive employment

According to Rodrik and Sandhu [2024], jobs initiatives have traditionally focused on workforce development. Given the scale of the employment needed however, productivity-enhancing labor market strategies on the demand side are crucial as well. They identify four broad strategies based on a review of various programs that aim to increase productivity and/or employment possibilities in the services sector. These initiatives target (a) job creation, (b) productivity improvement or (c) both, and address both the demand and supply side of the labor markets. See Table 2.

TABLE 2. Broad strategies for expanding productive employment in services

Target	Objective	Examples of mechanisms
Large and relatively productive firms	To expand employment, either directly or through their supply chains	Collaboration between large firms and suppliers, market linkages, sharing of unemployment data to aid in recruitment, or removal of regulatory burden
Smaller firms	To improve productivity and enhance entrepreneurial capabilities	Management training, loans or grants, business competition, internship, specific infrastructure, or technology assistance
Directly to workers or firms	To expand the skill set of less educated workers and enable them to perform tasks typically assigned to more skilled workers	Training, provision of digital tools or other new technologies to complement low-skilled labor
Less-educated workers	To enhance employability, job retention, and eventual promotion	Combination of vocational training with “wrap-around” services such as counselling, internships, and transportation stipends

Source: Rodrik and Sandhu [2024].

3. Overview of the services sector

Balaoing-Pelkmans and Mendoza [in this volume] have highlighted the increasing share of the services sector in the economy. From 52.8 percent of GDP in 2000, the sector has grown to 62.3 percent in 2023. The structure of the sector has also changed during this period. As Table 3 shows, the contribution of financial and insurance activities and professional and business services increased significantly. Except for the years from 2000 to 2005, when the share of information and communication almost doubled, its contribution has only grown slightly while the share of the other subsectors declined. Wholesale and retail trade remains the largest services subsector.

TABLE 3. Share of subsectors in total Gross Value Added (GVA) of the Services sector

Subsector	2000	2005	2010	2015	2020	2023
Wholesale and retail trade; repair of motor vehicles and motorcycles	34.2	33.6	32.1	30.3	30.8	29.8
Transportation and storage	7.2	6.4	5.5	6.2	4.8	5.9
Accommodation and food service activities	3.8	3.6	3.4	3.4	2.2	3.1
Information and communication	2.7	5.1	5.2	5.0	5.5	5.5
Financial and insurance activities	9.2	10.3	12.0	13.3	16.6	16.5
Real estate and ownership of dwellings	13.2	11.7	11.1	11.6	9.7	8.8
Professional and business services	3.9	5.6	8.2	9.9	10.0	10.1
Public administration and defense; compulsory social activities	9.0	8.1	7.5	6.4	8.6	7.8
Education	9.6	8.7	8.0	6.7	6.5	6.5
Human health and social work activities	3.2	3.5	3.0	3.1	2.9	3.0
Other services	3.8	3.5	4.0	4.1	2.4	3.1
Total	100.0	100.0	100.0	100.0	100.0	100.0
Share of the Services Sector in GDP	52.8	54.4	56.6	58.8	60.7	62.3

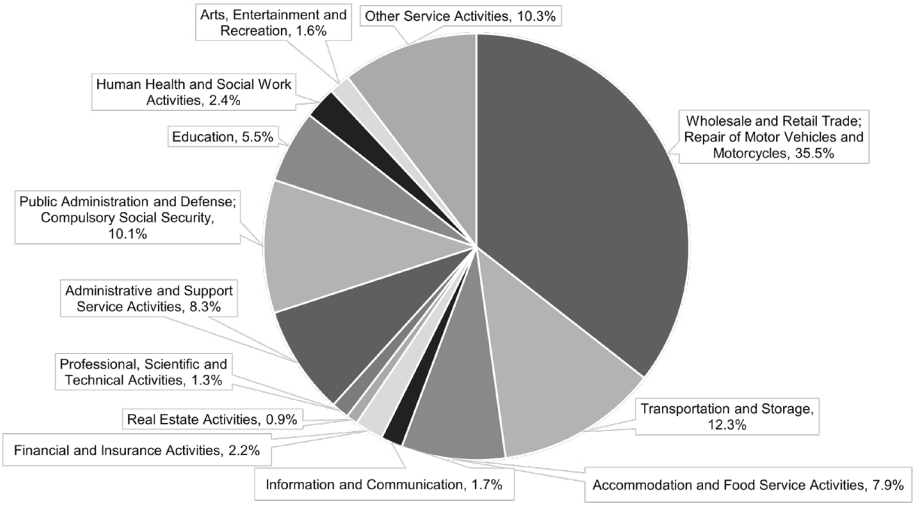
Note: Professional and business services cover professional, scientific and technical activities and administrative and support service activities. Other services cover arts, entertainment, and recreation and other service activities.
Source: PSA [2024a].

In terms of total employment, the share of the services sector was 59.3 percent in 2023. Wholesale and retail trade was the biggest subsector, and together with transportation and storage and other service activities, account for 58.2 percent of employment in the services sector (Figure 1).

Figure 2 reveals the extent to which manufacturing relies on services as intermediate inputs. In 2022, the services value-added content of manufacturing exports was 27.3 percent. The highest shares were in motor vehicles (32.9 percent), followed by fabricated metal products (31.9 percent) and coke and refined petroleum products (31.8 percent).

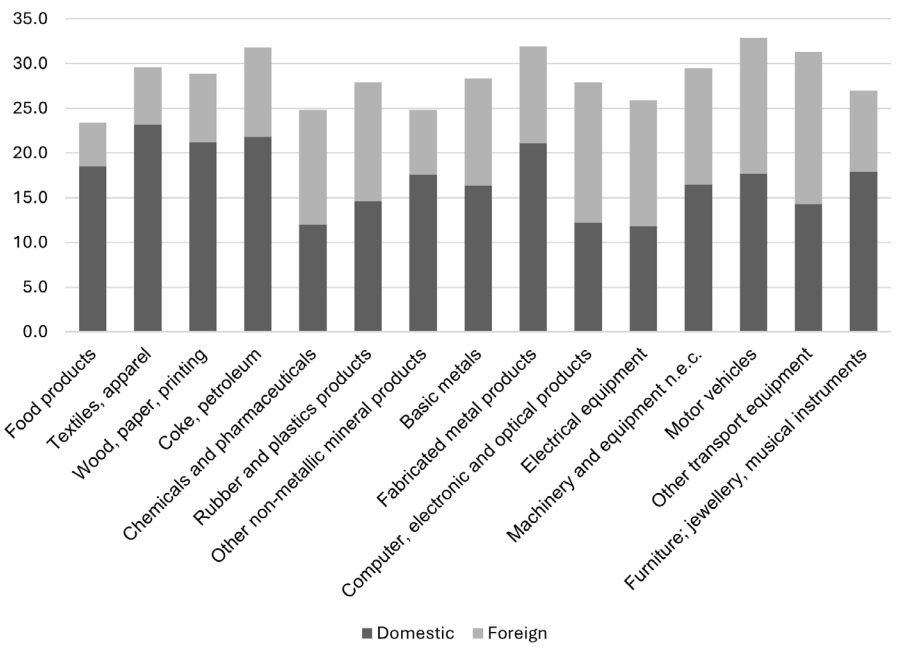
The exports of services generated about 3.7 million domestic employment in 2020. Table 4 provides a breakdown of the domestic employment in gross exports. It includes direct employment from the exporting industry as well as the employment indirectly generated in domestic industries embodied in intermediate inputs [Horvát et al. 2020]. Thus, it shows the backward linkage of services exports to other sectors (which could also involve other services) in terms of employment.

FIGURE 1. Share of subsectors in total employment of the services sector (2023)



Note: Final - January to August; Preliminary - September to December.
Source: PSA [2024b].

FIGURE 2. Services content of manufacturing exports (2020), as a percentage of gross exports



Source: OECD [2023a].

Almost 64 percent of the employment embodied in services exports are medium-skilled (Table 5). In public administration, defense, education, human health and social work activities, high-skilled occupations account for 46.6 percent, while in arts, entertainment and recreation; other service activities; and activities of households as employers, the occupations are predominantly low-skilled, accounting for 63.2 percent.

TABLE 4. Domestic employment embodied in gross exports of services (2020), in thousands

Activity	Total	Direct	Indirect
Services of the business economy	3,681	2,842	839
Wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities	2,246.2	1,828.7	417.5
Information and communication	382.4	186.3	196.1
Financial and insurance activities	62.7	28.8	33.9
Real estate; Professional and business support services	989.8	798.2	191.6
Public administration, defense, education, human health and social work activities	38.6	34.6	4
Arts, entertainment and recreation; Other service activities; Activities of households as employers	24.1	20.2	3.9

Source: OECD [2023b].

TABLE 5. Domestic employment embodied in gross exports by type of occupation (2020), in thousands

Activity	High-skilled occupation	Medium-skilled occupation	Low-skilled occupation
Services of the business economy	870.8	2,340.3	469.9
Wholesale and retail trade; repair of motor vehicles and motorcycles; transportation and storage; accommodation and food service activities	483.3	1,419.4	343.5
Information and communication	163.9	188.4	30.1
Financial and insurance activities	17.6	39.6	5.5
Real estate; Professional and business support services	206.1	692.9	90.8
Public administration, defense, education, human health and social work activities	18	15.0	5.6
Arts, entertainment and recreation; Other service activities; Activities of households as employers	1.7	7.2	15.3

Note: High-skilled occupations (managers, professionals, technicians, and associate professionals); medium-skilled occupations (clerical support workers; service and sales workers; skilled agricultural, forestry and fishery workers; craft related trades workers; and plant and machine operators, and assemblers); and low-skilled occupations (elementary occupations) [Chiapin Pechansky and Lioussis 2024].
Source: OECD [2023b].

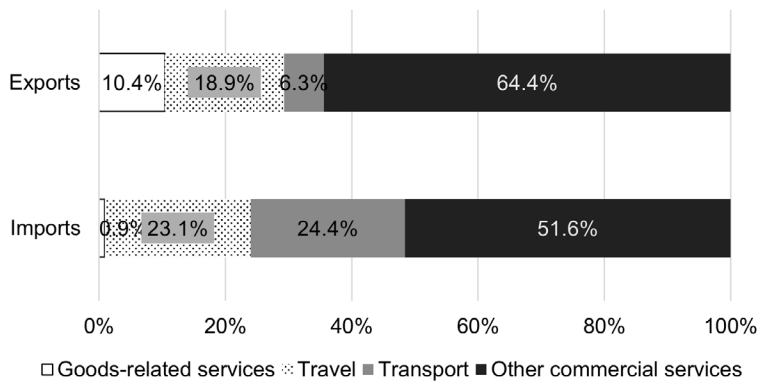
The Philippines is a net exporter of commercial services, which was dominated by 'Other commercial services' in 2023 (Table 6 and Figure 3).

TABLE 6. Trade in commercial services, Philippines

	Value (US$ million)		Share in world (percent)		Y-O-Y growth (percent)	
	Exports	Imports	Exports	Imports	Exports	Imports
2014	25,483	20,607	0.49	0.41	9	28
2015	29,047	23,355	0.58	0.48	14	13
2016	31,186	23,804	0.62	0.49	7	2
2017	34,813	25,845	0.63	0.49	12	9
2018	38,378	26,271	0.63	0.46	10	2
2019	41,245	27,686	0.66	0.46	7	5
2020	31,800	17,553	0.61	0.36	-23	-37
2021	33,548	19,124	0.54	0.33	5	9
2022	41,101	24,855	0.57	0.38	23	30
2023	48,259	28,806	0.62	0.40	17	16

Source: WTO and UNCTAD [2024]

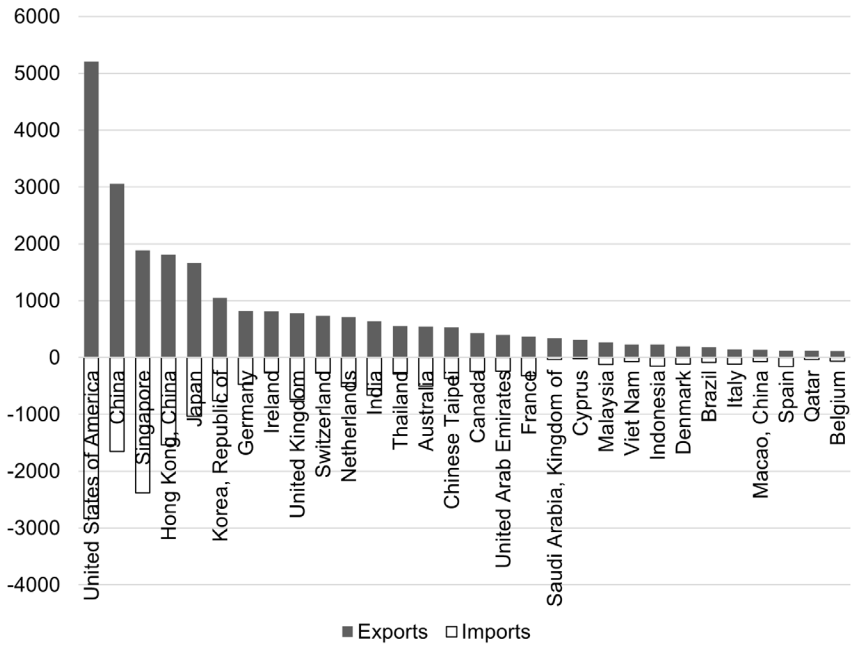
FIGURE 3. Services trade by main sectors, Philippines (2023)



Source: WTO and UNCTAD [2024]

In 2021, the country's top trade partner in services was the United States, followed by China and Singapore. The Philippines enjoyed a trade surplus with most countries except with Singapore, India, and Spain (Figure 4).

FIGURE 4. Commercial services, top 30 trade partners of the Philippines, 2021 (USD million)

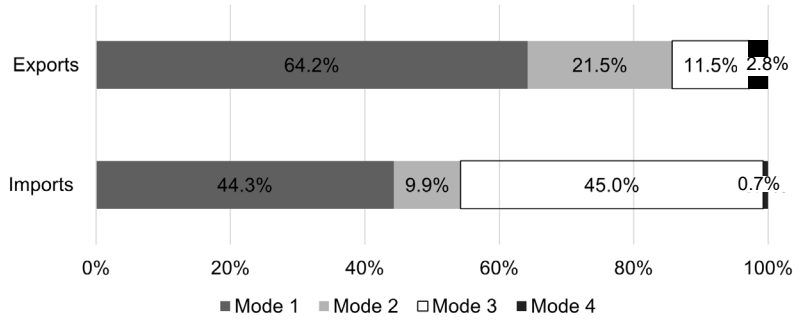


Source: OECD [2023a].

Figure 5 provides a breakdown of the Philippines' trade in services by mode of supply.[1] In 2022, the value of Philippine services exports (for all modes) was estimated at USD 48.6 billion, representing 0.28 percent of the world total. Mode 1 (Cross-border supply) was the dominant mode of supply, accounting for 64.2 percent of the total. Other business services delivered through cross-border supply was the top export of the Philippines. The value of Philippine services imports (for all modes) was estimated at USD 54 billion, representing 0.32 percent of the world total. Both Mode 3 (Commercial presence) and Mode 1 were the dominant modes of supply. Insurance and financial services through commercial presence was the top import.

[1] According to the General Agreement on Trade in Services (GATS) [WTO 1994], trade in services occurs via the following modes of supply: Mode 1 (Cross-border supply) – from the territory of one member into the territory of any other member; Mode 2 (Consumption Abroad) – in the territory of one member to the service consumer of any other member; Mode 3 (Commercial Presence) – by a service supplier of one member, through commercial presence in the territory of any other member; and Mode 4 (Presence of Natural Persons) – by a service supplier of one member, through presence of natural persons of a member in the territory of any other member.

FIGURE 5. Structure of services trade by mode of supply (2022)



Source: WTO and UNCTAD [2024]

4. Critical issues and priorities for action

4.1. Boosting productivity

The services sector has consistently exhibited a higher labor productivity than the agriculture, forestry, and fishing sector but lower than the industry sector [PSA 2019]. There is significant variation across services, however, with certain subsectors producing higher value of output per worker compared to industry, including manufacturing.

According to Debuque-Gonzales et al. [2021], when the COVID-19 pandemic hit in 2020, the services sector contracted by 9.2 percent. Significantly impacted were service activities that relied on personal contact and mobility such as wholesale and retail trade (-6.0 percent), education(-10.8 percent), transport and storage (-30.9 percent), accommodation and food services (-45.4 percent), and entertainment and recreation (-49.4 percent). In contrast, information and communication grew by five percent and financial and insurance services by 5.5 percent due to the shift to online platforms and expansionary measures adopted by the Bangko Sentral ng Pilipinas (BSP), respectively. As shown in Table 7, these two subsectors continue to thrive, while services that were badly affected have net yet recovered. For other subsectors such as real estate activities, professional and business services, and human health and social work activities, labor productivity was already on the decline even prior to the pandemic.

Considering that information and communication and financial and insurance services account for only 4.3 percent of total employment in the services sector (excluding public administration; see Figure 1), the magnitude of the challenge is quite significant. The broad strategies proposed by Rodrik and Sandhu [2024] could be useful in developing solutions for specific industries. They emphasize the value of enhancing the skills and capacities of both workers and firms, the need for intermediation services to link the demand and supply sides of labor markets,

and the importance of understanding the local context. Policy experimentation will help fill the knowledge gaps and design of effective interventions that could be expanded on a national scale.

TABLE 7. Labor productivity (GVA to employment) (at constant 2018 prices, in thousand pesos)

Sector/Subsector	2017	2018	2019	2020	2021	2022	2023
Services	451	469	478	475	444	445	459
Wholesale and retail, repair of motor vehicles and motorcycles	387	405	417	405	351	357	385
Transportation and storage	207	217	217	176	186	209	219
Accommodation and food service activities	213	233	220	158	175	182	180
Information and communication	1,219	1,279	1,286	1,674	1,437	1,426	1,517
Financial and insurance activities	2,731	2,772	2,863	3,185	2,992	3,079	3,494
Real estate activities	6,070	5,840	5,232	5,372	5,168	4,653	4,633
Professional and business services	649	624	590	572	534	490	483
Education	558	611	605	535	522	544	539
Human health and social work activities	639	596	596	566	534	542	562
Other service activities	130	133	147	100	89	106	120

Note: Professional and business services cover professional, scientific and technical activities and administrative and support service activities. Other services cover arts, entertainment, and recreation and other service activities
Source: PSA [2022;2023a;2024a]

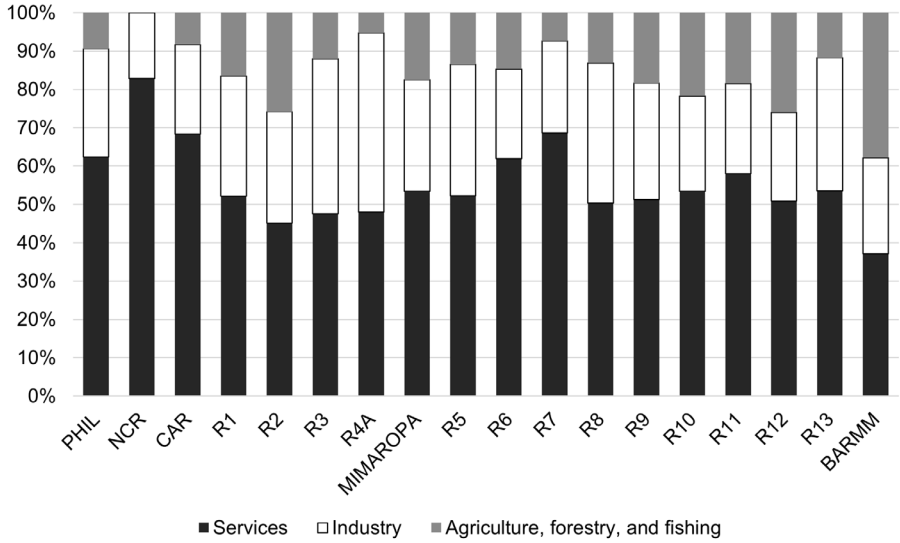
4.2. Expanding service industries outside the National Capital Region

At the regional level, the contribution of services varies. In the National Capital Region (NCR), its share is almost 83 percent, while in the Bangsamoro Autonomous Region in Muslim Mindanao (BARMM), the service sector accounts for 37 percent of gross regional domestic product (GRDP). See Figure 6.

Most of the gross value added in services is produced in NCR (Table 8). Across the different types of services, the share of NCR is highest compared to other regions, especially with respect to producer services. In terms of employment, NCR dominates in producer services as well. In the other clusters, the shares of employment in Regions III and IV-A are also significant [PSA 2024].[2]

[2] The clusters are based on Browning and Singelmann [1975]. See also Serafica et al. [2021].

FIGURE 6. GDP/GRDP by main sector, percent share at current prices (2023)



Source: PSA [2024c].

TABLE 8. GVA in Services, by region (2023)

	Total Services	Producer Services	Distributive Services	Personal Services	Social Services
Philippines (million pesos)	13991.8	5423	6155	977	1437
Share of region (percent)					
NCR	40.19	55.00	33.68	26.74	21.30
CAR	1.90	1.84	1.65	3.25	2.33
I	2.84	1.74	3.16	4.27	4.62
II	1.53	0.79	1.85	1.16	3.27
III	8.64	7.09	8.84	14.78	9.44
IVA	11.19	9.26	12.06	14.68	12.41
MIMAROPA	1.68	0.82	1.93	3.63	2.50
V	2.37	1.72	2.45	2.54	4.37
VI	5.17	3.31	6.25	6.62	6.61
VII	7.45	7.25	7.54	7.66	7.66
VIII	1.91	1.41	1.96	1.35	3.93
IX	1.80	0.84	2.39	1.07	3.34
X	4.21	2.25	5.96	4.00	4.31
XI	4.92	3.52	6.02	4.24	5.93
XII	2.06	1.60	2.12	2.26	3.37

TABLE 8. GVA in Services, by region (2023) (continued)

	Total Services	Producer Services	Distributive Services	Personal Services	Social Services
XIII	1.41	1.32	1.22	1.44	2.49
BARMM	0.74	0.24	0.92	0.31	2.14
Total	100.00	100.00	100.00	100.00	100.00

Note: Total Services exclude public administration and defense; compulsory social security; Producer Services include financial and insurance activities; real estate; and professional and business services; Distributive Services include wholesale and retail trade, transport and storage, and information and communication; Personal Services include accommodation and food service activities, arts, entertainment, and recreation, and other service activities; and Social Services include education services and human health and social work activities.
Source: PSA [2024d].

Given the differences in economic attributes, demographic profiles, social conditions, and other factors, the size of the service industries will not be the same across the country. The lack of services outside the NCR, however, stifles the development of the regions and thus provides an opportunity to strategically target specific services to promote economic transformation at the sub-national level. Both producer and distributive services are critical intermediate inputs and have significant knock-on productivity effects, as described in Khanna et al. [2016]. Nayyar et al. [2021] suggest taking a value chain approach to target the relevant services that complement specific industries. Such an approach can be applied to various types of value chains, whether in agriculture, mining, manufacturing, or even other service industries (e.g. tourism) that are important to a region and vital for economic diversification and industrial upgrading identified in Balaoing-Pelkmans and Mendoza [in this volume] and Aldaba and Aldaba [in this volume].

4.3. Implementing structural reform

The availability of services may be limited in the short run, but unlike natural resources, services are not finite and can expand with the help of technology (e.g., using mobile services, the internet, cloud computing) and an enabling policy and regulatory environment (e.g., liberalization, competition, and ease of doing business reforms). The right policies not only remove impediments to market entry and growth but can facilitate the introduction and adoption of new technologies as well.

Most service industries are regulated in response to market failures (e.g., asymmetric information, public goods, negative externalities, and monopoly power) or various objectives (e.g. social equity, cultural preservation, and national security). The purpose of structural reform is to enhance the efficiency of markets and reduce barriers to entry and expansion through improvements in institutional frameworks, regulations, and government policies [APEC 2016]. Effective structural reform requires coherence and coordination between services policies and other policy areas, such as trade, investment, competition, industrial policies, and social policies [UNCTAD 2017].

While some regulations are determined by the local government (e.g., business permits and zoning), trade and investment policies are set at the national level. In the Philippines, moreover, trade and investment restrictions in key services industries have been embedded in the fundamental law of the land [Serafica 2024]. Although market access barriers in the services sector exist around the world (See OECD [2024a]), the Philippines is quite unusual in that such limitations are locked in the Constitution. The 1987 Constitution sets foreign ownership restrictions in public utilities (up to 40 percent), educational institutions (up to 40 percent), mass media (zero), and advertising (up to 30 percent). The practice of all professions is also limited to Filipino nationals unless permitted by law.[3]

In 2022, the Public Service Act was amended (RA No. 11659), resulting in the liberalization of services that are not natural monopolies. In the case of mass media, legal opinions of the Securities and Exchange Commission (SEC) effectively extend the restriction to most types of websites and informational online platforms, including those that feature products and services provided by users and third parties (e.g., online marketplaces, learning platforms, and other publishers of third-party content) or publish advertisements [Serzo 2021]. Mass media is part of the digital network service value chain, and it is not uncommon for countries to maintain some foreign equity limits, particularly in legacy media such as terrestrial broadcasting [OECD 2024a;2024b]. Full nationalization of the entire sector constrains the growth potential of the Philippine digital economy. According to Serzo [2021], for example, limiting funding opportunities to domestic sources stifles innovation among local start-ups that require capital funds for product development and scaling up. In addition, foreign companies are discouraged from introducing novel products into the Philippine market. The prohibition leads to cross-border regulatory arbitrage, forcing firms to move their operations in full or in part to jurisdictions with lower risks.

Maximizing the benefits of greater market openness requires a robust competition policy framework to deal with anti-competitive practices and prevent dominant firms from abusing their market power. A supportive regulatory environment in which barriers to entry, exit, and expansion are removed will help eliminate inefficient service suppliers, especially in the non-tradable subsectors that lack exposure to global competition. The quality of regulatory and institutional framework is especially important in the provision of infrastructure services such as telecommunications and ICT services and transport and financial services [UNCTAD 2020]. To promote interport competition and improve the efficiency of key logistics nodes in the supply chain, Tongzon [2018] proposed separating the regulatory and management functions of the Philippine Ports Authority. In financial services, Sandoval and Milo [2018] emphasized the importance of aligning domestic regulations with the objectives of financial liberalization and

[3] The 12th Regular Foreign Investment Negative List (EO No. 175, s. 2022) contains the list of professions where foreigners are not allowed to practice and the list of investment areas that are subject to foreign equity restrictions.

the country's commitments in various regional and trade agreements. The use of the regulatory sandbox approach was also recognized to balance the need for prudential regulation with the promotion of competition and efficiency through innovation. Barcenas [2019] recommended removing unnecessary requirements in the establishment and operation of telecommunications and broadcasting service providers, particularly the need for a franchise from Congress. In addition to reforming the licensing regime to facilitate the development of ICT in the country, Serafica and Oren [2024a] stressed the importance of ensuring the regulatory independence of the National Telecommunications Commission.

4.4. Strengthening exports of digital services

Digitally delivered services accounted for 61 percent of the country's exports of commercial services in 2023.[4] The estimated value of the country's digitally delivered services exports was $29.4 billion, representing 0.69 percent of the world total. The estimated value of the country's digitally delivered services imports was $14.2 billion, representing 0.40 percent of the world total. See Table 9.

TABLE 9. Digitally delivered services exports by year

	Value (US$ million)		Share in world (percent)		Y-O-Y growth (percent)	
	Exports	Imports	Exports	Imports	Exports	Imports
2014	14,290	5,154	0.64	0.25	9	32
2015	16,858	6,824	0.78	0.35	18	32
2016	16,461	6,996	0.74	0.34	-2	3
2017	16,827	7,581	0.69	0.34	2	8
2018	17,976	7,652	0.67	0.32	7	1
2019	18,635	8,857	0.66	0.34	4	16
2020	22,938	8,809	0.72	0.30	23	-1
2021	25,017	10,370	0.66	0.32	9	18
2022	27,307	12,643	0.70	0.38	9	22
2023	29,414	14,202	0.69	0.40	8	12

Source: WTO [2023].

Other business services accounted for 75 percent (USD 22.2 billion) of total Philippine exports of digitally delivered services. In terms of imports, 58 percent (USD 8.3 billion) was also due to other business services. See Table 10.

[4] Digitally delivered services refer to services traded through computer networks . Note that "voice networks" are no longer distinct from the "computer networks" [IMF et al. 2023:90].

TABLE 10. Structure of digitally delivered services 2023

EXPORTS			
Category	Value (USD million)	Share in total digitally delivered services (percent)	Share in world (percent)
Other business services	22,136	75.3	1.26
Computer services	6,285	21.4	0.72
Telecommunications services	415	1.4	0.38
Financial services	304	1.0	0.04
Personal, cultural, and recreational services	150	0.5	0.16
Insurance and pension services	81	0.3	0.04
Charges for the use of intellectual property n.i.e.	38	0.1	0.01
Information services	6	0.02	0.01
IMPORTS			
Category	Value (USD million)	Share in total digitally delivered services (percent)	Share in world (percent)
Other business services	8,271	58.2	0.49
Insurance and pension services	1,999	14.1	0.66
Financial services	1,464	10.3	0.41
Computer services	998	7.0	0.23
Telecommunications services	769	5.4	0.83
Charges for the use of intellectual property n.i.e.	452	3.2	0.08
Information services	138	1.0	0.35
Personal, cultural, and recreational services	111	0.8	0.11

Source: WTO [2023].

The strong performance of the Philippine services trade, specifically in digital trade, can be attributed primarily to the information Technology-Business Process Management (IT-BPM) sector. The sector comprises (a) contact center and business process services, (b) information technology services, (c) game development, (d) animation, (e) healthcare or health information management, and (f) global in-house centers. In 2022, around 12 percent of the total global revenues were generated from the Philippines, and the country accounted for about 16 percent of the global full-time employees [IBPAP and Everest Group 2022]. Based on the annual IT-BPM report released by the PSA [2023e], which covers selected industries in the

information and communication (Sector J) and administrative and support service activities (Sector N) sectors, customer relationship management activities (N82211) was the biggest industry, followed by sales and marketing (including telemarketing) activities (N82212) and other computer programming activities (J62019). In 2021, these three activities accounted for 76.58 percent of employment and 77.44 percent of the revenues generated from outside the country.

The Philippine IT-BPM sector not only aims to sustain its market position but also aspires to move up the global value chain by shifting to high-value services. A key strategy is to leverage talent and technology to achieve its vision as "the world's number one experience hub for digitally-enabled and customer-centric services" [IBPAP and Everest Group 2022]. On the external front, an emerging issue in digital trade is the rise in the number of restrictions on cross-border data flows as more countries are introducing data localization measures that are becoming more restrictive. To stem the tide of rising trade barriers and fragmentation, increased collaboration on improving international rules on digital trade is needed [OECD 2024a]. The Philippines must take an active role in shaping such rules.

4.5. Accelerating digitalization throughout the country

According to the ITU [2024a], in 2022, 75.2 percent of individuals were using the internet. In 2023, while 73.7 out of 100 people had active mobile broadband subscriptions, for fixed broadband, the subscription rate was much lower at only 6.54 per 100 people. In terms of prices, mobile broadband achieved the affordability target in 2023 with a 1.78 percent share of the country's monthly GNI per capita, but fixed broadband is still expensive at 10.1 percent, far exceeding the international target of a two percent share of the monthly Gross National Income per capita [ITU 2024b]. Furthermore, uneven internet access persists across the country. Whereas over 30 percent of households in NCR have access to fixed wired broadband, in the other provinces, less than ten percent are connected. The disparity is widespread both between and within provinces [Kanehira et al. 2024]. At the firm level, digital intensity was found to be higher in services than in manufacturing, although there was significant variation in digitalization across the services subsectors. Moreover, firms that were connected using fiber broadband were more data-intensive [WB 2024a].

The lack of digital connectivity hinders productive participation in the digital economy. Prospects for online jobs and digital trade are constrained, especially for those in the countryside, and the impacts of digital services such as e-commerce, fintech, and smart city initiatives are limited. In addition to inadequate internet access, the disparity in skills, capabilities, and resources in households and firms exacerbates the digital-spatial divides, contributing further to socioeconomic divides [Bayudan-Dacuycuy and Serafica 2023]. The diffusion of digital technologies together with services policy reforms creates a virtuous cycle of enhanced opportunities and capacities, which not only increase productivity

in services and downstream sectors but also strengthen human capital through improvements in education and health [WB 2024a].

Of the various digital technologies, artificial intelligence (AI) is the most transformative for the service sector which can have wide ranging effects on industries, firms, and workers. The spectrum of AI capabilities is expanding and includes (i) **automated intelligence systems** that automate repetitive and labor-intensive tasks; (ii) **assisted intelligence systems** that examine and identify trends in data to gain insights making it easier and faster for users to complete tasks; (iii) **augmented intelligence systems** that help better understand and predict future scenarios; and (iv) **autonomous intelligence systems** that eliminate the need for human intervention in making decisions. The holy grail of AI is **artificial general intelligence (AGI)**, when AI attains proficiency in knowledge formation, comprehension, reasoning, abstraction, and communication [PWC 2018]. OpenAI's ChatGPT, which attracted global attention last year, is an example of **generative AI**, which can create content such as text and images based on the data on which it was trained [Martineau 2023]. Compared to other countries in the region, the Philippines is relatively more exposed to the displacement effect of AI because of its higher engagement in cognitive tasks in services. The emergence of new tasks and the increase in labor demand from the positive productivity effect can help offset the negative effects [WB 2024b].

4.6. Increasing innovation

The 2021 Survey of Innovation Activities of Establishments provided the first comprehensive picture of the innovation behavior of the services sector [Serafica and Oren 2024b]. It revealed that information and communication and financial and insurance activities had the highest proportion of innovation-active and innovative establishments.[5] Real estate activities and arts, entertainment, and recreation were consistently in the bottom two. A subsector that provides IT-BPM services, administrative and support services, also performed poorly, ranking third to last in terms of being innovation-active and process innovation. Moreover, it was second to last with respect to product innovation. In general, the most common type of innovation was organizational innovation, followed by marketing, process, and product innovation the least. Training was the most employed innovation activity, and there was greater reliance on internal and market sources of information rather than technical publications or regulatory bodies. Higher education institutions were not popular cooperation partners, and engaging external experts was the least common knowledge management practice.

[5] An establishment is considered **innovation-active** if it is: (a) a product innovator (b) a process innovator (c) engaged in innovation projects either not yet complete or abandoned; and/or (d) engaged in expenditure of innovation activities. It is considered **innovative** if it has implemented a product, process, organizational, or marketing innovation.

The Philippine Innovation Act [RA No. 11293] identifies numerous actions to address cost, knowledge, market, and legal or regulatory barriers to innovation. Because the services sector includes a wide range of activities, even within a subsector, strategies to increase innovation must be tailored to the specific needs of the industry and firms.

5. Conclusion

It helps to be reminded of services' basic nature. Services are "the result of a production activity that changes the conditions of the consuming units or facilitates the exchange of products or financial assets" [UN 2008:96]. Thus, there can be no agricultural modernization, industrial upgrading, or human capital development without services. Even though there is a natural tendency for the sector to grow over time, deliberate actions are needed to ensure that services contribute positively to the quality of economic transformation.

Experts have emphasized the importance of promoting exports and job creation in the sector while also recognizing the critical role of services in supporting the rest of the economy. There has also been a focus on leveraging trade, technology, training, and targeting, along with initiatives aimed at directly increasing productive employment. A variety of approaches should be pursued given the size and diversity of service industries.

In the case of the Philippines, six issues and priorities for action were identified, namely: boosting productivity, expanding services outside NCR, implementing structural reform, strengthening exports of digital services, accelerating digitalization, and increasing innovation. These recommendations are interrelated. Structural reform in the ICT sector will not only address the lack of internet connectivity but also strengthen the innovation ecosystem and improve the productivity of firms and downstream users. Accelerating digitalization will also raise the productivity of organizations and enable more Filipinos to participate in digital trade, not just as consumers but as service exporters themselves. Innovative products and business models help increase access to finance, healthcare, and education in areas that are underserved or unserved.

We are fortunate to live in a time when various digital technologies have allowed us to transcend barriers to delivering services within and across borders. Although there are still physical constraints, the lack of services, particularly outside the main urban centers, is made worse by policy and regulatory impediments. These artificially limit the availability and quality of specific services that are essential to various industries, communities, and households.

Some key reforms are straightforward but may be politically infeasible in the near term. Other proposed actions are quite general and only provide overall directions. Specific interventions to boost productivity or innovation at the firm- or household-level, for example, will benefit from experimentation to inform the

design of initiatives before these are implemented on a large scale. Regulatory sandboxes are also useful, especially in testing the impacts of new technologies, products, or business models.

For the Philippines, harnessing services to achieve broad-based and inclusive growth should be the essence of services-led development. Given the range of services and unique local requirements, various strategies are needed in addition to fixing long-standing structural issues. The pace and depth of the actions taken will depend on our level of ambition as a nation, articulated in the AmBisyon Natin 2040 vision of a "prosperous, predominantly middle-class society where no one is poor" [NEDA 2017:50].

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