

[PAPER 2]

***Enhancing the Future of Economic Relations
Between the Philippines and South Korea***

by **Fernando Aldaba, Ph.D.** and
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I. Introduction

In December last year, the 25th year of relations between the Association of Southeast Asian Nations (ASEAN) and South Korea was highlighted by a commemorative summit held in Busan, South Korea. With “Building Trust, Bringing Happiness” as the chosen theme for the occasion, ASEAN leaders met with South Korean President Park Geun-hye and issued a joint statement promoting increased political, economic, and socio-cultural cooperation.²

Come end-December this year, the ASEAN Economic Community (AEC) will be marking its official culmination. The AEC envisages the following key characteristics: 1) a single market and production base; 2) a highly competitive economic region; 3) a region of equitable economic development; and 4) a region fully integrated into the global economy. The areas of cooperation will include: 1) human

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² Here are related links: 1) <https://www.aseankorea.org/eng/page30/page33-1.asp> and 2) <http://www.mfa.go.th/asean/contents/files/news-20141229-085700-661904.pdf>.

resources development and capacity building; 2) recognition of professional qualifications; 3) closer consultation on macroeconomic and financial policies; 4) trade financing measures; 5) enhanced infrastructure and communications connectivity; 6) development of electronic transactions through e-ASEAN; 7) integration of industries across the region to promote regional sourcing; and 8) enhancement of private sector involvement for the building of the AEC. In short, the AEC will transform ASEAN into a region with free movement of goods, services, investment, skilled labor, and capital.³

Indeed, these events could augur well for the growth and prosperity of the countries involved. As Seachon (2015) correctly poses, given the growing interaction among ASEAN nations, together with the growing interaction between ASEAN and South Korea, how can the Philippines take advantage of all these relations and maximize its participation in the ASEAN-South Korea partnership?⁴

As far as economists are concerned, part of the answer to this question will entail a broad review of the economic performance, prospects, and policy challenges of the Philippines and South Korea. This paper attempts to make such a review in order to distil insights on possible areas

³ ASEAN is composed of the following countries: 1) Brunei Darussalam, 2) Cambodia, 3) Indonesia, 4) Lao People's Democratic Republic, 5) Malaysia, 6) Myanmar, 7) Philippines, 8) Singapore, 9) Thailand, and 10) Viet Nam. The interested reader can learn more about the AEC here: <http://www.asean.org/communities/asean-economic-community>.

⁴ Krista Kyla D. Seachon's article for the Foreign Service Institute can be viewed here: <http://www.fsi.gov.ph/getting-a-slice-of-the-pie-the-philippines-in-asean-south-korea-relations-by-krista-kyla-d-seachon-vol-ii/>.

where the Philippines can further enhance its economic relations with South Korea.

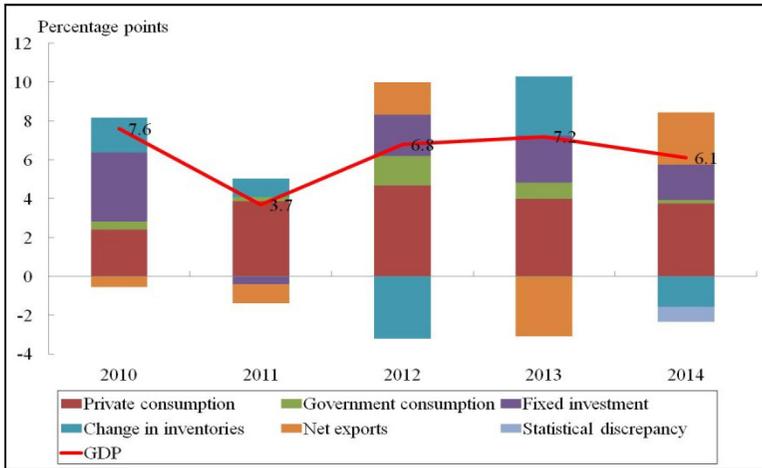
II. Economic Performance and Prospects

According to the Asian Development Outlook 2015 (ADO 2015), Philippine gross domestic product (GDP) growth was recorded at 6.1 percent in 2014, and this was fueled by sustained increases in private consumption, higher fixed investment, and recovery in exports.⁵ The pace of growth decelerated by almost one percentage point from the average of the previous two years, largely on a slowdown in government expenditure. Data show that government consumption contracted through the first three quarters of 2014, which reflects, in part, a Supreme Court ruling against certain government funds that slowed disbursements.⁶ In the fourth quarter of 2014, the government accelerated spending so that outlays for the year increased by just 1.8 percent, compared with a much bigger increase of 7.7 percent in 2013. Figure 1 shows the demand-side contributions to Philippine GDP growth.

⁵ The Asian Development Outlook 2015 can be downloaded from the Asian Development Bank website: <http://www.adb.org/publications/asian-development-outlook-2015-financing-asias-future-growth>.

⁶ Here is a link to a related news article: <http://www.philstar.com:8080/headlines/2015/02/03/1419749/supreme-court-affirms-dap-unconstitutionality>.

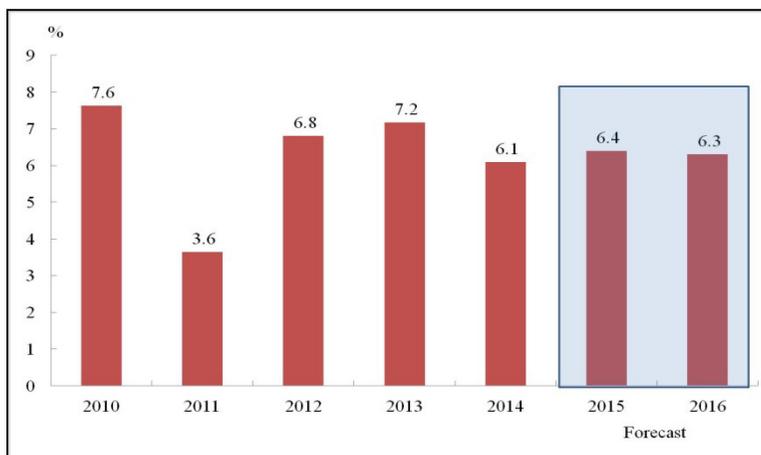
Figure 1: Demand-side Contributions to Philippine GDP Growth



Source: Asian Development Outlook 2015.

Nevertheless, strong Philippine GDP growth is projected for 2015 and 2016, based on buoyant private consumption, a solid outlook for investment and exports, and a recovery in government expenditure. GDP is projected to increase by 6.4 percent in 2015 and 6.3 percent in 2016. Figure 2 shows Philippine GDP growth rates from 2010 to 2014, together with projected growth rates for 2015 and 2016.

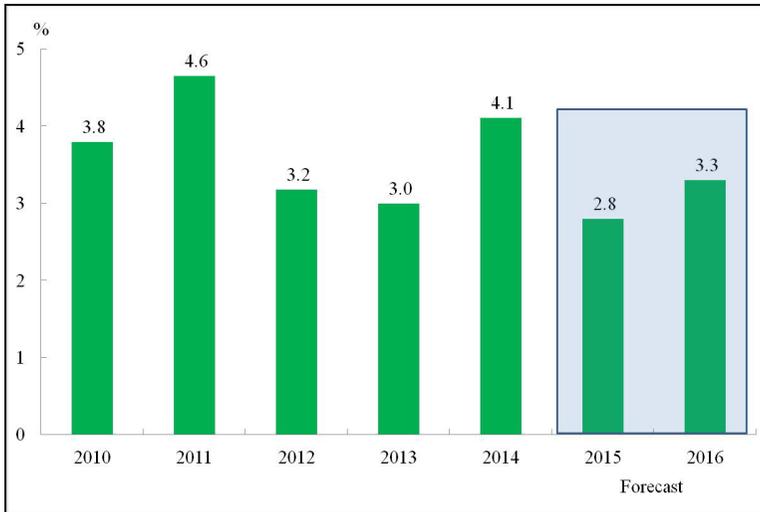
Figure 2: Philippine GDP Growth Rates



Source: Asian Development Outlook 2015.

As for Philippine inflation, data show that it eased further to 2.4 percent in the first two months of 2015, mainly owing to lower fuel prices and modest increases in food prices. For 2015 as a whole, inflation is projected to average about 2.8 percent. However, there are risks to this forecast from El Niño weather conditions that are expected to last throughout the first half, as well as from possible power shortages and pending petitions for higher electricity tariffs. In 2016, inflation is seen quickening to 3.3 percent on higher global prices for oil and other commodities. Figure 3 shows Philippine inflation rates from 2010 to 2014, together with projected inflation rates for 2015 and 2016.

Figure 3: Philippine Inflation Rates



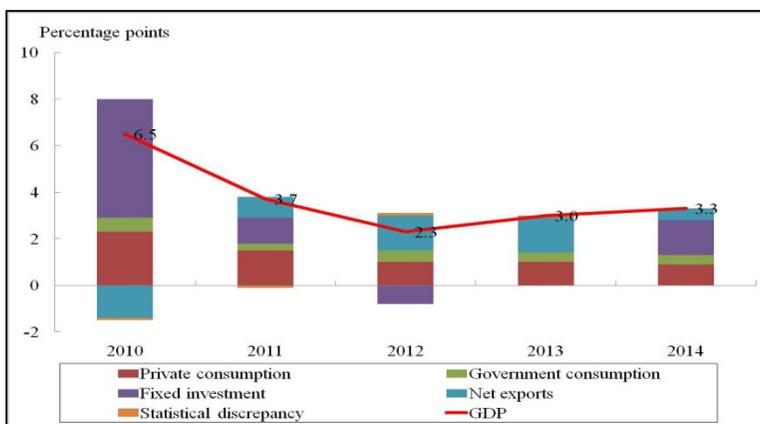
Source: Asian Development Outlook 2015.

As for Philippine exports, they are expected to rise faster than imports, pushing up the current account surplus in 2015 to 4.0 percent of GDP. Strong domestic demand will lift imports, but this will be countered by lower oil prices. The Philippines imports more than 90 percent of its oil, and crude oil comprises about 12 percent of total imports. In 2016, the current account surplus is projected to fall to 3.6 percent of GDP as oil prices rise. However, sustained growth in remittances and services exports should help bolster current account surpluses.

Next, for South Korea, the ADO 2015 notes that GDP growth accelerated slightly from 3.0 percent in 2013 to an estimated 3.3 percent in 2014. Unexpected weakness in the world economy tamped down the anticipated export-led

rebound. The contribution of net exports to GDP growth fell by two-thirds, from 1.5 percentage points in 2013 to 0.5 percentage point in 2014. Domestic demand accounted for the bulk of GDP growth in 2014. Investment, mainly in plant and equipment, contributed 1.5 percentage points, and this is a marked turnaround from 2013 when its contribution was virtually absent. Private consumption added another 0.9 percentage point, and the contribution of government consumption held steady at 0.4 percentage point. Quarter-on-quarter growth momentum failed to gain traction in 2014, as the pace of expansion slackened from 0.9 percent in the first quarter to 0.4 percent in the fourth quarter, mainly reflecting subdued domestic demand following the Sewol ferry disaster.⁷ Figure 4 shows the demand-side contributions to South Korean GDP growth.

Figure 4: Demand-side Contributions to South Korean GDP Growth

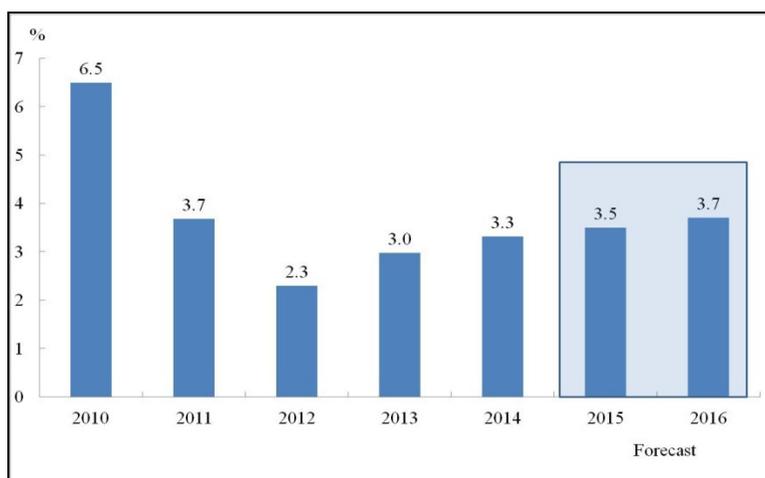


Source: Asian Development Outlook 2015.

⁷ Here is a link to a related news article: <http://edition.cnn.com/2014/04/17/world/asia/south-korea-sewol-ferry-explainer/>.

External and internal factors point to only modest recovery in 2015 that is unlikely to dispel concerns about the loss of momentum since the Global Financial Crisis. South Korean GDP growth is likely to rise a bit to 3.5 percent in 2015, as global output and trade begin to stir. Domestic demand is likely to rebound, buoyed by the improved terms of trade, much lower global oil prices (as South Korea imports virtually all of its energy), and a modest recovery in the housing market. GDP growth is expected to rise further to 3.7 percent in 2016, supported by a strengthening global economy. Figure 5 shows South Korean GDP growth rates from 2010 to 2014, together with projected growth rates for 2015 and 2016.

Figure 5: South Korean GDP Growth Rates



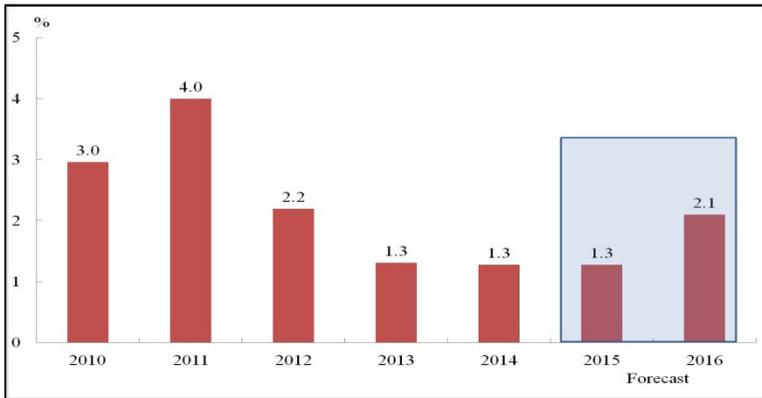
Source: Asian Development Outlook 2015.

Mirroring the continued general weakness of domestic demand and abetted by falling global oil prices, consumer price inflation in South Korea remained low at 1.3 percent in

2014, below the central bank target band of 2.5 percent \pm 1.0 percentage point. Core inflation, which strips out food and energy, was at 2.0 percent. Consumer price inflation is forecast to remain subdued at 1.3 percent in 2015, unchanged from 2014 and well below the central bank target. The steep decline in oil prices will outweigh increased domestic demand to firmly cap inflationary pressures. Core inflation will likely be slightly higher. Although inflation has been below 1.0 percent year-on-year since December 2014 (for the first time in 15 years), the risk of deflation seems remote, as domestic demand is forecast to grow, and output is expected to rise toward full capacity. Inflation is likely to accelerate to 2.1 percent in 2016, in tandem with rising commodity prices. Subdued inflation and a strong fiscal position will allow both monetary and fiscal policies to support growth. Figure 6 shows South Korean inflation rates from 2010 to 2014, together with projected inflation rates for 2015 and 2016.⁸

⁸ Data on South Korean inflation rates based on consumer prices can be downloaded here: <http://data.worldbank.org/indicator/FP.CPI.TOTL.ZG>. The Asian Development Outlook 2015 gives forecasts of Korean inflation rates for 2015 and 2016.

Figure 6: South Korean Inflation Rates



Source: World Development Indicators Database and Asian Development Outlook 2015.

As for South Korean merchandise exports, its growth in real local currency terms is expected to accelerate to over 3.0 percent in 2015, reflecting trends in global output and trade. Continuing weakness in the European and Japanese export markets poses a challenge for high-technology manufactures. The slowdown in China, together with the general sluggishness in Southeast Asia and other main emerging markets, further constrain the scope for export growth. Exports of petroleum products, chemicals, steel, mobile phones, and automobiles will be squeezed by intensified competition, especially from China and Japan, but exports of electronics parts and semiconductors could rise as the global glut eases. Despite tepid export growth, the current account surplus is projected to surge to 7.0 percent of GDP in 2015, owing to the sharp fall in global oil prices and despite a deficit in services. The current account surplus will shrink to 6.3

percent of GDP in 2016, as import volumes expand in line with anticipated stronger growth and domestic demand.

Indeed, the reviewed macroeconomic data suggest that the economic outlook for both the Philippines and South Korea is generally positive, with low and stable inflation expected to support GDP growth. Of course, output growth is good because it helps build the potential for both countries to trade with each other. Also, as the Bangko Sentral ng Pilipinas (BSP) explains, price stability is good because it would allow households and businesses (including export enterprises) to plan ahead and arrive at well-informed decisions about their consumption, investment, savings, and production needs. In the case of export firms, price stability would allow them to price their products competitively and reduce the risks related to the rising cost of raw materials.⁹

The succeeding sections expound on the main policy challenges faced by the Philippines and South Korea.

III. Main Policy Challenge for the Philippines: Making Economic Growth More Inclusive

In his 2012 bestseller Breakout Nations, analyst Ruchir Sharma described a time when the Philippines was seen as an Asian trendsetter, and fashionable young Malays would even sport the barong, the formal embroidered shirt favored by Filipinos, to look cool. That was back in the 1960s, when the Philippines supposedly had the second-highest per-capita

⁹ <http://www.bsp.gov.ph/downloads/Publications/FAQs/targeting.pdf>.

income in Asia, behind only Japan.¹⁰ Since then, however, the fortunes of the Philippines had begun to shift dramatically, as it watched its neighbors move ahead in terms of per-capita income. South Korea and Taiwan sailed away in the 1970s. Malaysia and Thailand followed in the 1980s. China blossomed in the 1990s. Indonesia had its turn in 2009.

Nevertheless, when Benigno Simeon C. Aquino III became President in 2010, at long last, the Philippines looked poised to resume a period of strong growth. Sharma boldly declared that the Philippines was no longer a joke, as President Aquino looked likely to generate just enough reform momentum to get the job done.¹¹

Indeed, President Aquino was able to triumphantly recapitulate the achievements of his administration in his last State of the Nation Address (SONA).¹² Without question, average economic growth has seen a historic high of 6.3

¹⁰ President Ferdinand Emmanuel E. Marcos, Sr. was at the helm in the 1960s, and there are those who contest the claim that the Philippines was prosperous back then. The interested reader may wish to explore these links: 1) <http://web.stanford.edu/group/sjeaa/journal3/geasia2.pdf>, 2) <http://www.hotmanila.ph/content/tyranny-and-dictatorship/5-pernicious-marcos-myths>, 3) <https://raissarobles.com/2011/04/15/meet-the-real-marcos/>, and 4) <http://www.philstar.com/opinion/2013/09/12/1200211/never-forget>.

¹¹ Ruchir Sharma is head of Emerging Markets and Global Macroeconomics at Morgan Stanley Investment Management. He has been a contributing editor with Newsweek and has penned essays for publications such as The Wall Street Journal, Financial Times, New York Times, Foreign Affairs, and Economic Times. Mr. Sharma's profile can be viewed here: <http://breakoutnations.com/>. An electronic copy of his book can be downloaded here: <https://muftbooks.files.wordpress.com/2014/12/breakout-nations-in-pursuit-of-the-next-economic-miracles-ruchir-sharma.pdf>.

¹² Here is a link to the transcribed version of President Aquino's last SONA: <http://www.gov.ph/2015/07/27/president-aquino-sixth-sona/>.

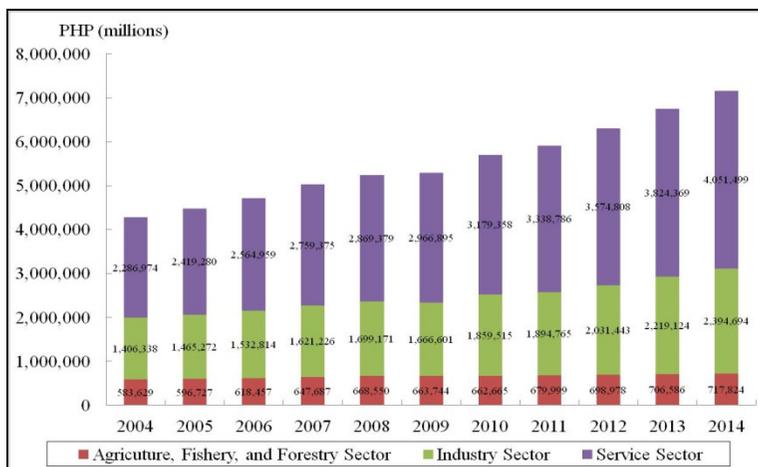
percent in the last five years, as compared to the moderate growth of 4.8 percent during President Gloria Macapagal-Arroyo's term. In the context of Sharma's work, if "breaking out" is taken to mean that the Philippines is finally breaking out from past performance patterns and graduating from its embarrassing status as an economic laggard, then perhaps there is some truth to this assertion about the country, which macroeconomic statistics could support.

However, these macroeconomic trends lie only on the surface, and a closer examination of economic data would reveal internal imbalances that tend to maintain, if not exacerbate, the more serious social problem of poverty. Figures 7 and 8 show the sectoral breakdown of GDP.¹³ Figures 9 and 10 show the sectoral breakdown of employment.¹⁴

¹³ Data can be downloaded here: <http://www.nscb.gov.ph/sna/DataCharts.asp>,
http://www.nscb.gov.ph/announce/2011/NSCB_1998_2010_NAP_summariy_tables.xls, <http://www.nscb.gov.ph/sna/2011/4th2011/2011gnpi4.asp>,
<http://www.nscb.gov.ph/sna/2011/4th2011/2011aff4.asp>,
<http://www.nscb.gov.ph/sna/2011/4th2011/2011ind4.asp>,
<http://www.nscb.gov.ph/sna/2011/4th2011/2011ser4.asp>.

¹⁴ Data can be downloaded here: <http://countrystat.bas.gov.ph/?cont=10&pageid=1&ma=P50LETEP>.

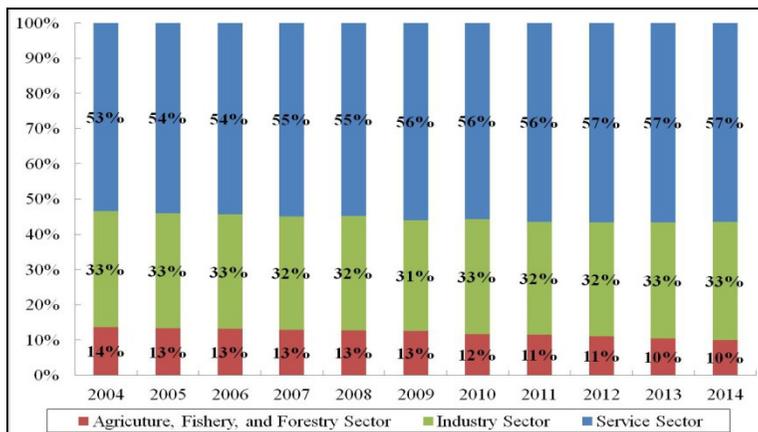
**Figure 7: Philippine Sectoral Contributions to Real GDP
(Constant 2000 Prices)**



Note: PHP = Philippine peso.

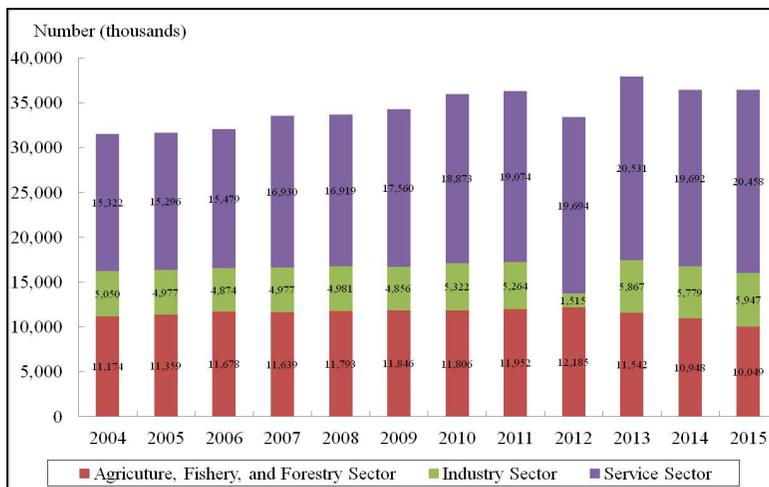
Source: Philippine Statistics Authority – National Income Accounts.

**Figure 8: Philippine Sectoral Shares in Real GDP
(Constant 2000 Prices)**



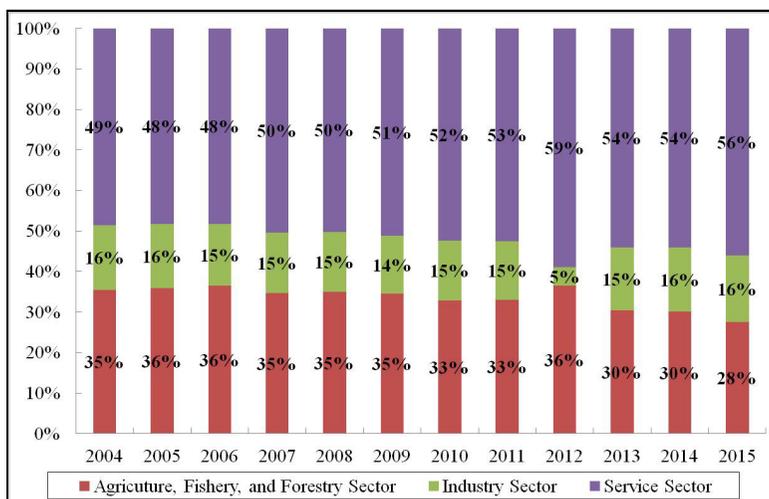
Source: Philippine Statistics Authority – National Income Accounts.

Figure 9: Philippine Sectoral Contributions to Employment



Source: Philippine Statistics Authority – Country STAT Philippines.

Figure 10: Philippine Sectoral Shares in Employment



Source: Philippine Statistics Authority – Country STAT Philippines.

The data clearly show that the agriculture, fishery, and forestry sector, which has accounted for about a third of employment on average, has had a disproportionately small share in total production (12 percent on average), which implies a low level of productivity in that sector.

Another imbalance emanates from geography. Figures 11 and 12 reveal that from 2010 to 2014, the average share in GDP of NCR (Metro Manila), Region III (Central Luzon), and Region IVA (CALABARZON) combined has been 62.5 percent.¹⁵ As Lanzona (2015) notes, the improved economic performance currently experienced in the country can be seen as fundamentally based in Luzon, particularly in Metro Manila.¹⁶

This is not really a surprising observation, as urbanization, which refers to the concentration of populations in cities and towns, is a key feature of economic growth. Given its long history as the trade center of the country, Metro Manila developed at a faster rate than the other cities in the country; however, cities need to be sustained if these are to survive. With agricultural produce coming primarily from Central Luzon and manufacturing output from CALABARZON, Metro Manila continues to be the premier urban area in the country.

Clearly, however, without the development in its surrounding regions, Metro Manila would certainly not be

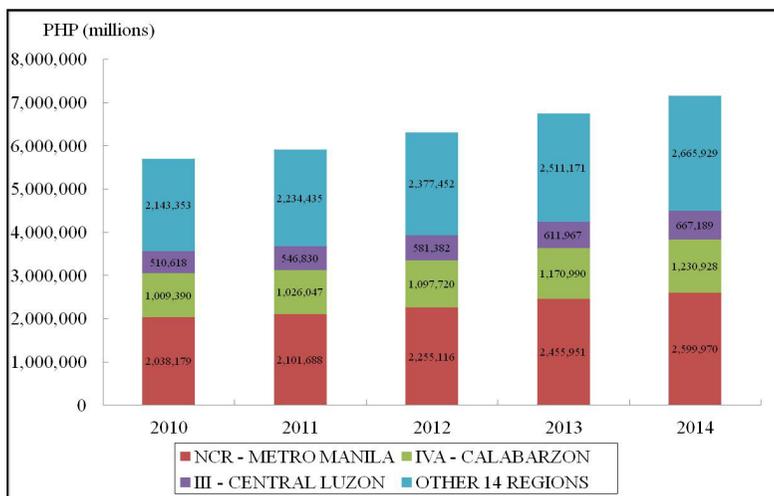
¹⁵ Data can be downloaded here: <http://www.nscb.gov.ph/grdp/datacharts.asp>.

¹⁶ Dr. Leonardo A. Lanzona, Jr. is Director of the Ateneo Center for Economic Research and Development and Senior Fellow of Eagle Watch, the macroeconomic research and forecasting unit of Ateneo de Manila University. He has written an article on urbanization and economic growth, which can be viewed here: <http://www.businessmirror.com.ph/urbanization-and-economic-growth/>.

able to maintain what others consider its “imperialistic” hold over the country. At the same time, without the necessary markets provided by Metro Manila, nearby regions would not grow at a rate faster than other regions.

The key lesson in this tale of Luzon regions is that the process of urbanization and growth can be replicated in other urban areas in the country in order to enhance current economic growth and minimize regional disparities. Evidently, this replication has yet to happen.

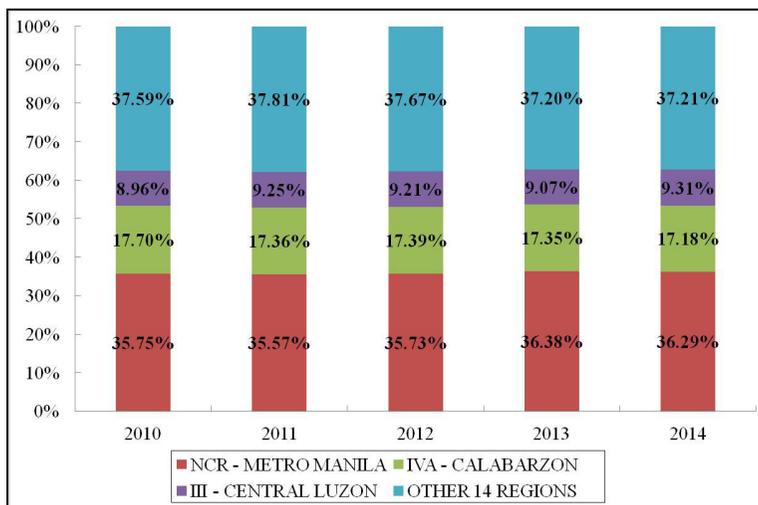
Figure 11: Philippine Regional Contributions to Real GDP (Constant 2000 Prices)



Note: PHP = Philippine peso.

Source: Philippine Statistics Authority – Gross Regional Domestic Product.

**Figure 12: Philippine Regional Shares in Real GDP
(Constant 2000 Prices)**

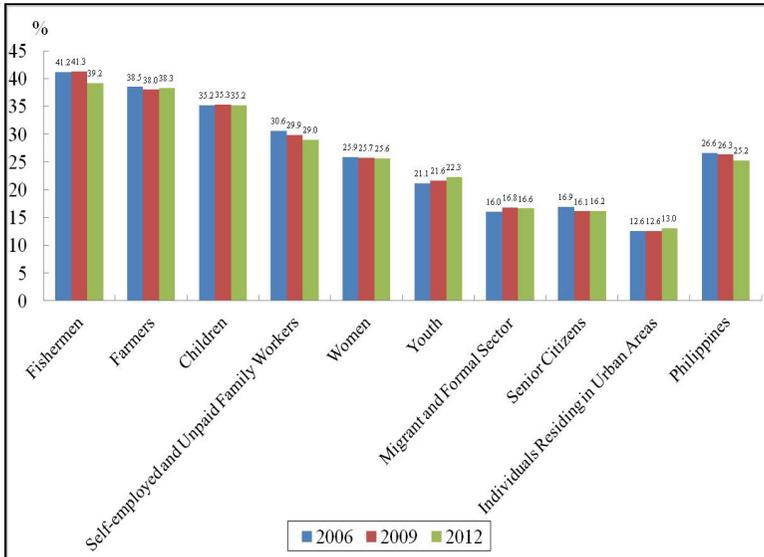


Source: Philippine Statistics Authority – Gross Regional Domestic Product.

What has happened to poverty? The Philippine Statistics Authority reports that in 2012, fishermen, farmers, and children have consistently posted the highest poverty incidences among the nine basic sectors in the Philippines, at 39.2 percent, 38.3 percent, and 35.2, respectively. Also, five of the nine basic sectors (fishermen, farmers, children, self-employed and unpaid family workers, and women) have higher poverty incidence than that of the general population, which was estimated at 25.2 percent in 2012. Poverty incidence among employed and unemployed Filipinos registered at 21.9 percent and 18.7 percent, respectively, in 2012. More recent data indicate that poverty incidence (whether by families or by population) increased from the

first semester of 2013 to the first semester of 2014. Figures 13 to 15 summarize the data.¹⁷

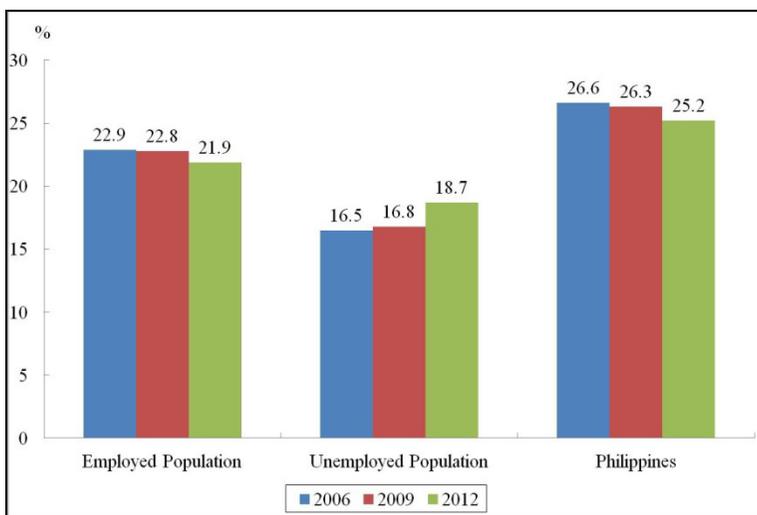
Figure 13: Poverty Incidence for Basic Sectors: 2006, 2009, and 2012 (as of July 4, 2014)



Source: Philippine Statistics Authority.

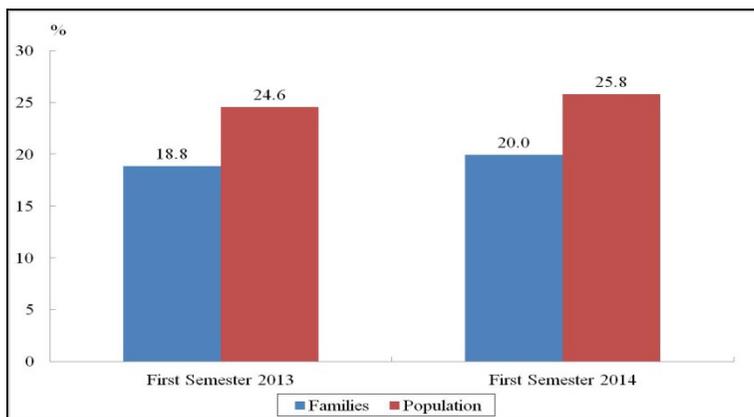
¹⁷ The official press release can be viewed here: http://www.nscb.gov.ph/pressreleases/2014/PSA-%20PR-20140704-SS2-01_poorestsector.asp. More recent data can be downloaded here: <http://www.nscb.gov.ph/poverty/dataCharts.asp>.

Figure 14: Poverty Incidence for Employed and Unemployed Population: 2006, 2009, and 2012 (as of July 4, 2014)



Source: Philippine Statistics Authority.

Figure 15: Poverty Incidence by Families and by Population



Source: Philippine Statistics Authority.

Clearly, therefore, the reviewed data show that economic growth has not yet been translated into significant poverty reduction. On the surface, it seems that the Philippine economy has managed to accelerate and sustain higher rates of GDP growth, but on a deeper level, more work needs to be done to ensure that macroeconomic prosperity involves and benefits a broader spectrum of the economy, both sectorally and geographically.

The data also suggest that the Philippines has “leapfrogged” the industrialization process, which means that the country has jumped straight from agriculture to services sector dominance.¹⁸ Indeed, thriving nowadays are services industries, such as real estate, banking, insurance, transport, telecommunications, and mass media, whose growth benefits tend to be narrowly distributed. Thus, it is quite reasonable to surmise that the persistence of poverty in the Philippines is attributable, at least in part, to this unusual structural growth pattern.

¹⁸ Economic development texts, such as Todaro and Smith (2012), typically provide a review of the evolution in scholarly thinking about how and why economic development takes place. Covered in the discussion is a well-known early theoretical model of development called the Stages of Growth Model, which was published by American economist Walt Whitman Rostow in 1960. This classic economic development story begins with a country at the early stages of development. The country is an agrarian economy where the agricultural sector dominates in both output and employment, relative to the other two major economic sectors of industry and services. As agriculture grows and productivity increases with technological change, the sector provides a growing market for the products of industry, and it releases surplus labor that further boosts industrial growth. With further scientific and technological innovation, the economy transitions to the industrialization stage, which is marked by further increases in income and employment. Wealth accumulates and the economy matures until it graduates into services sector dominance, as higher income supports growing demands for services of various kinds. Indeed, the Philippine economy appears to have deviated from this classic theoretical storyline.

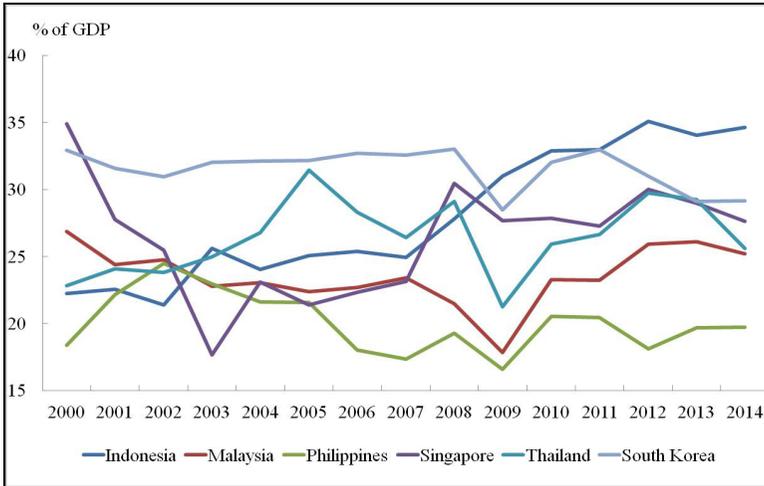
Nevertheless, is there an inherent problem with having a huge services sector? As Habito (2014) argues, a rapidly growing services sector need not be a bad thing in and of itself, especially if more inclusive services, such as tourism and personal services, could drive it. However, the economic history of the Philippines suggests that it is the wanton neglect of the investment environment in agriculture and manufacturing, whether as cause or effect of the “leapfrogging” into services, that has led the country down the path of non-inclusive growth.¹⁹

The ADO 2015 recommends that the Philippines should work on stimulating investment so that economic growth can be sustained, and more inclusive employment opportunities will be generated to reduce poverty. Gross capital formation has recently improved in the Philippines but still lags behind its neighbors, as shown by Figure 16. The same goes with net foreign direct investment (FDI) inflows, as shown by Figure 17.²⁰

¹⁹ Dr. Cielito F. Habito’s article can be viewed here: <http://opinion.inquirer.net/75676/is-our-services-sector-too-big>.

²⁰ Data can be downloaded here: <http://data.worldbank.org/indicator#topic-8>.

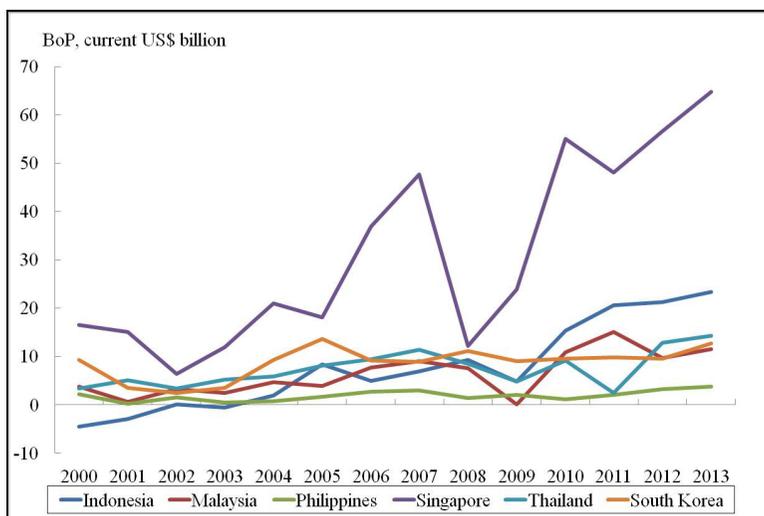
**Figure 16: Gross Capital Formation
in Selected Asian Economies**



Note: Gross capital formation (formerly gross domestic investment) consists of outlays on additions to the fixed assets of the economy plus net changes in the level of inventories. Fixed assets include land improvements (fences, ditches, drains, and so on); plant, machinery, and equipment purchases; and the construction of roads, railways, and the like, including schools, offices, hospitals, private residential dwellings, and commercial and industrial buildings. Inventories are stocks of goods held by firms to meet temporary or unexpected fluctuations in production or sales, and “work in progress.” According to the 1993 SNA, net acquisitions of valuables are also considered capital formation.

Source: World Bank Development Indicators Database.

Figure 17: Net FDI Inflows for Selected Asian Economies



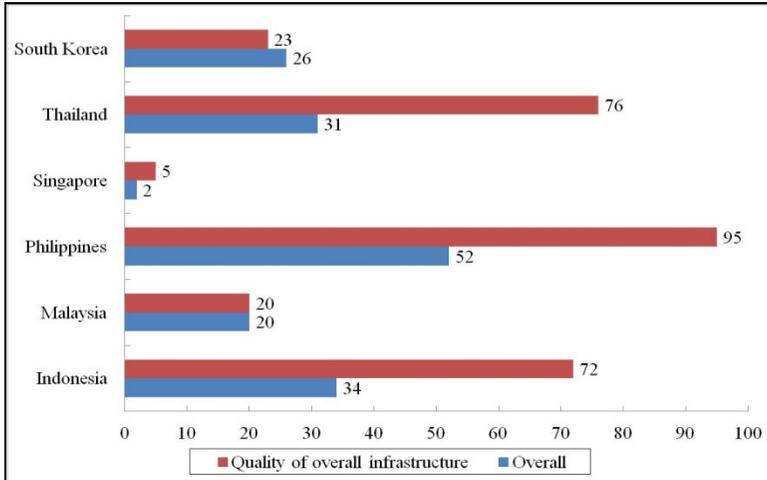
Note: Foreign direct investments are the net inflows of investment to acquire a lasting management interest (10 percent or more of voting stock) in an enterprise operating in an economy other than that of the investor. It is the sum of equity capital, reinvestment of earnings, other long-term capital, and short-term capital as shown in the balance of payments. This series shows net inflows (new investment inflows less disinvestment) in the reporting economy from foreign investors. Data are in current U.S. dollars.

Source: World Bank Development Indicators Database.

Indeed, enhanced economic relations with South Korea could potentially benefit the Philippines in several areas. One important area could be infrastructure, which South Korean investors can help build in the Philippines through public-private partnerships. As Figures 18 and 19 indicate, South Korean infrastructure is much more globally competitive than Philippine infrastructure, and among ASEAN members, the

Philippines was actually the second-largest destination of Korean FDI in 2012.²¹

Figure 18: Global Competitiveness Ranking of Selected Asian Countries, 2014-2015

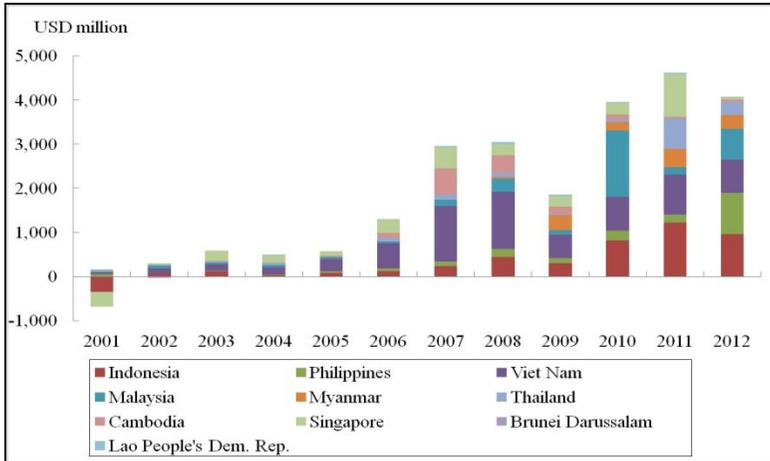


Note: Data show ranking out of 144 countries.

Source: World Economic Forum. *The Global Competitiveness Report 2014–2015*.

²¹ The Global Competitiveness Report 2014-2015, which is published by the World Economic Forum, can be downloaded here: <http://www.weforum.org/reports/global-competitiveness-report-2014-2015>. Bilateral FDI data can be downloaded here: <http://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics-Bilateral.aspx>. According to the ASEAN-Korea Centre (<https://www.aseankorea.org/eng/page30/page33-1.asp>), in 2014, ASEAN was the second-largest FDI destination of South Korea, with a value of USD 5.1 billion (16 percent share to total Korean FDI outflows). The United States was the largest destination, with a value of USD 5.1 billion (20 percent share to total Korean FDI outflows). China was the third-largest destination, with a value of USD 3 billion (12 percent share to total Korean FDI outflows).

Figure 19: South Korean FDI Flows to ASEAN Countries



Note: USD = United States dollars.

Source: United Nations Conference on Trade and Development (UNCTAD) Bilateral FDI Statistics Database.

Habito (2015b) explains that although the Philippine government can now afford to spend a lot more than it ever could before, infrastructure gaps have grown so huge that this newfound fiscal space is nowhere near enough to provide the hundreds of billions of pesos Filipinos will need to close them.²² So, apart from limited taxpayer money, funds can conceptually come from the large pool of savings held by banks and other financial institutions, all looking for ways to invest the huge sums in their hands.

In fact, South Korea is a country that has made good use of infrastructure bonds, which are debt instruments with which

²² Here is a link to Dr. Habito's article: <http://opinion.inquirer.net/87711/the-second-p-in-ppp>.

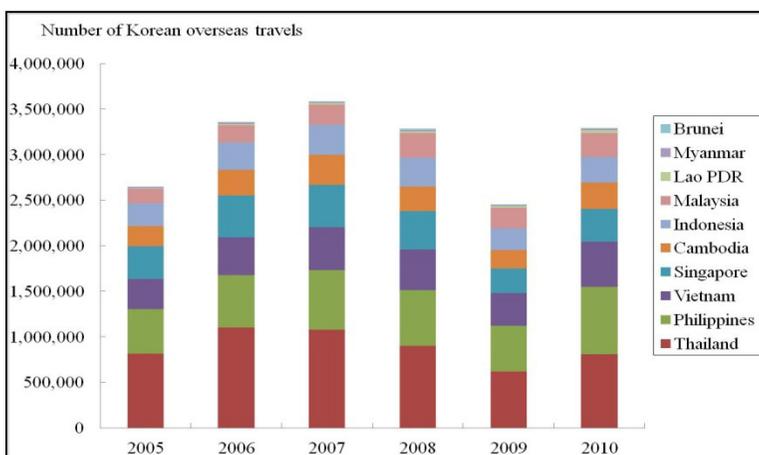
government borrows money from the public. Through the stock market, private savers can also invest directly in publicly listed infrastructure firms, which may also borrow directly from banks. The modern financial system has found various ways, from simple loans to complex derivatives, by which savings of large and small savers alike may be channeled to fund large infrastructure projects. These are usually built by private entities that must inevitably step in, given the formidable obstacle of lack of government funds, even through the longer term. As recent experience shows, an equally formidable obstacle is the inability of the Philippine government to execute, operate, and maintain such projects at the required magnitudes. Private partnership is vital to fill not only the financing gap but also the implementation gap.

Nevertheless, persisting constitutional restrictions on foreign investment in public utilities keep the field of potential private players too narrow. This is a problem because even the largest locals will be unable to muster the financial muscle needed to fill the huge needs, and the Philippines is getting to a situation where too few entities practically own (hence control) the country, private and public facilities alike. What is needed, then, is to open more opportunities for ordinary Filipinos to take part in funding infrastructure projects, including effective ways to harness overseas remittances and personal savings. Also, for practical reasons, the Philippines must open the door wider so that foreigners, especially South Koreans, can expand the pool of private sector partners who can quickly help take the Philippines out of its massive infrastructure backlog.

Another important area could be tourism, which is considered to be an inclusive growth driver for the Philippine economy. Notwithstanding problems with its infrastructure,

the Philippines was actually the second-largest ASEAN tourist destination for South Koreans in 2010, as shown by Figure 20.²³ More recent data (as of September 2015) from the Philippine Department of Tourism indicate that South Korea is still the biggest contributor of visitor earnings for the country with PHP 4.726 billion, overtaking the United States with PHP 2.815 billion. Japan has kept its position at third place with PHP 1.194 billion, followed by Australia with PHP 1.078 billion, and China with PHP 1.048 billion. Figure 21 summarizes the recent statistics.²⁴

Figure 20: Korean Overseas Travels to ASEAN Countries

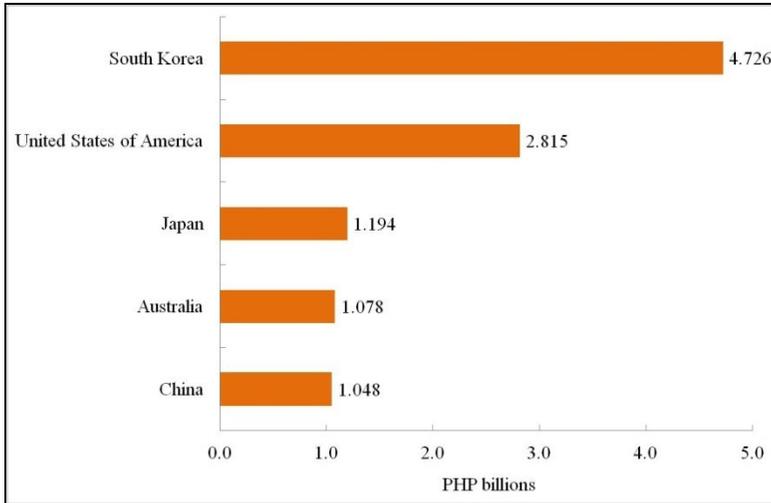


Source: ASEAN-Korea Centre.

²³ Data can be downloaded here: https://www.aseankorea.org/eng/page50/page512.asp?page=1&S_TEXT=&S_FIELD=&boa_gubun=13&pageNum=50&pageReturn=page51-2.

²⁴ The official Department of Tourism article on the industry performance of travel and tourism as of September 2015 can be accessed here: <http://www.tourism.gov.ph/pages/industryperformance.aspx>. Data can be downloaded here: <http://www.tourism.gov.ph/Pages/demand.aspx>.

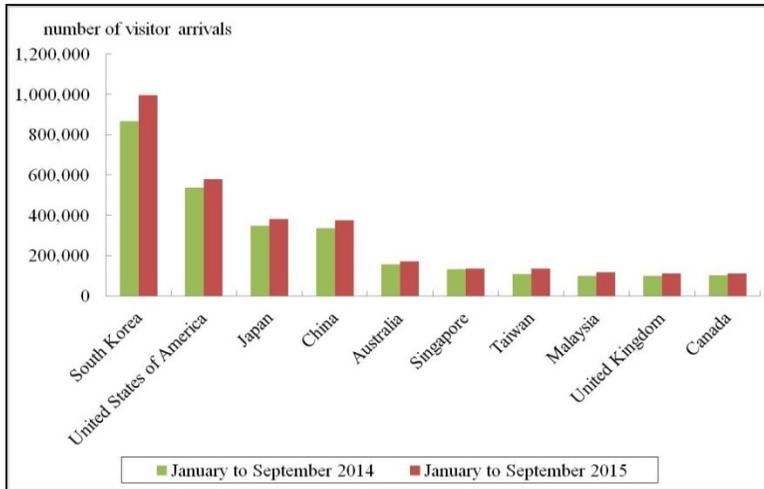
Figure 21: Top Tourism Spending Markets (September 2015)



Note: PHP = Philippine peso.
Source: Department of Tourism.

By visitor market, South Korea is still the top contributor of international arrivals to the country with 997,135 arrivals. The United States of America supplies the second-largest influx of tourist arrivals with 577,508 visitors. Japan ranks third with 380,815 visitors, followed by China with 373,795 and Australia with 170,706. Rounding up the top ten visitor markets are Singapore with 136,039 arrivals, Taiwan with 135,194, Malaysia with 117,184, United Kingdom with 112,360, and Canada with 109,852. Figure 22 provides a summary.

Figure 22: Top Ten Visitor Markets

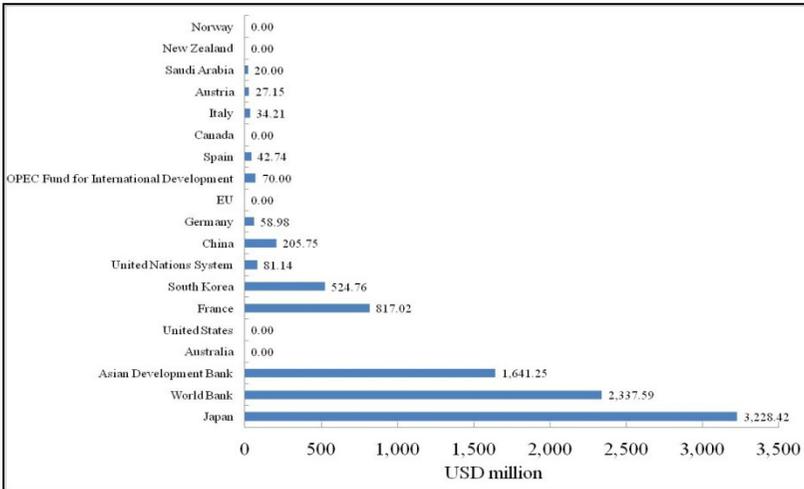


Source: Department of Tourism.

Yet another important area is official development assistance (ODA), which could be harnessed for investments that will promote inclusive economic growth in the Philippines. Based on the 2013 ODA Portfolio Review published by the National Economic and Development Authority, South Korea ranks seventh among development partners, with USD 524.76 million in loans and USD 83.96 million in grants, for a total ODA of USD 608.72 million (5.05 percent share to total ODA). It is expected that the total South Korean ODA to the entire ASEAN region will double this year, as South Korea has vowed to give assistance in order to narrow the development gap among ASEAN member-countries. Figures 23 to 26 summarize the data.²⁵

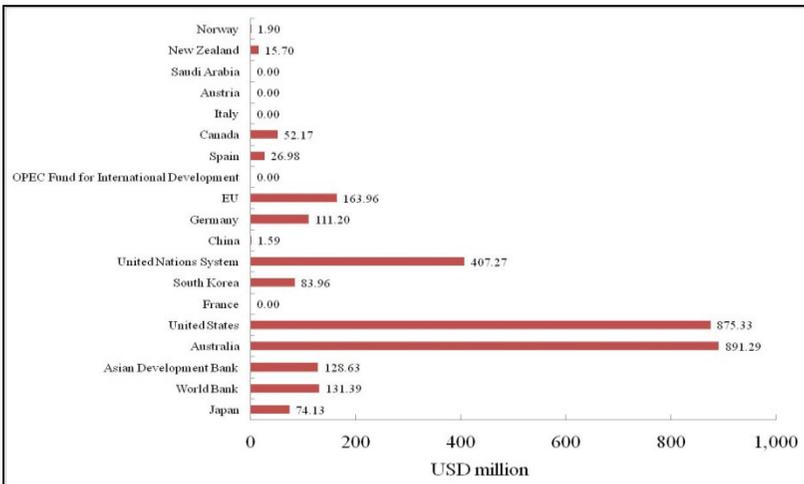
²⁵ The NEDA ODA Portfolio Review 2013 can be downloaded here: http://www.neda.gov.ph/?page_id=1188.

Figure 23: Loans by Development Partner in 2013



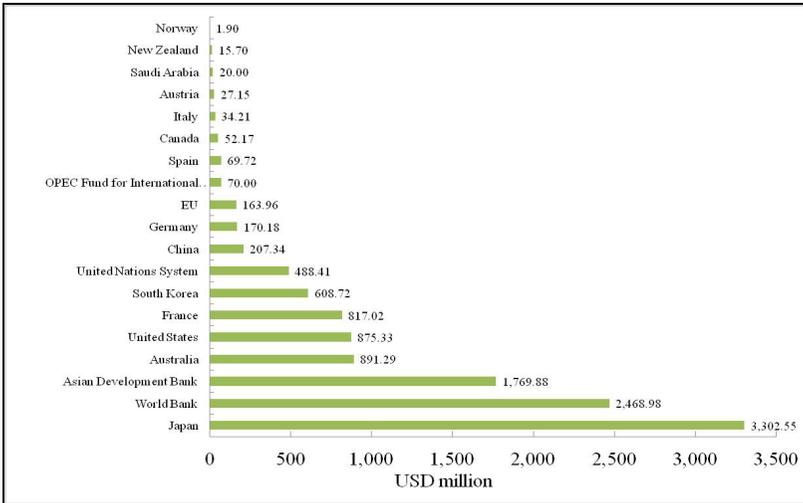
Source: NEDA ODA Portfolio Review 2013.

Figure 24: Grants by Development Partner in 2013



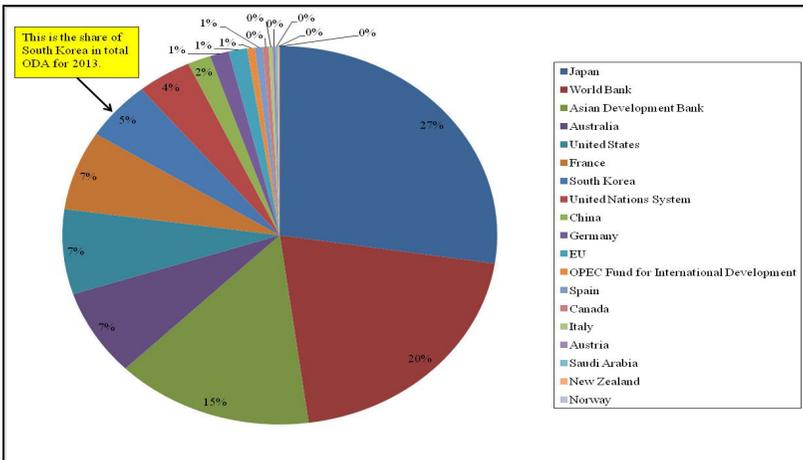
Source: NEDA ODA Portfolio Review 2013.

Figure 25: Total ODA by Development Partner in 2013



Source: NEDA ODA Portfolio Review 2013.

Figure 26: Shares of Development Partners in Total ODA in 2013



Source: NEDA ODA Portfolio Review 2013.

Last, one can consider industrial policy as another possible area where the Philippines can benefit from enhanced relations with South Korea. Industrial policy can be defined as government efforts to alter industrial structure to promote productivity-based growth. Some argue that industrial policy is the only approach that delivers real economic growth and transformation; however, others argue that it has rarely worked, because it can be captured by vested interests, or because it is not possible for civil servants to “pick winners.”

Clearly more research and clarity are needed to resolve these debates; meanwhile, there is an abundance of literature discussing industrial policy, including that of South Korea, and the Philippines can perhaps apply insights from these resources to help sustain the recent resurgence of its manufacturing sector.²⁶

As Habito (2015a) explains, manufacturing jobs tend to be superior in quality to those generated in the agriculture and services sectors. Historically, jobs in agriculture and services have not been wage-paying jobs for the most part. They fall under the category of “self-employed” (likely to be in the informal or underground economy) or “unpaid family labor” (usually insecure and/or nonremunerative work). Manufacturing jobs, on the other hand, fall mostly under the “wage and salary labor” category and come with attendant

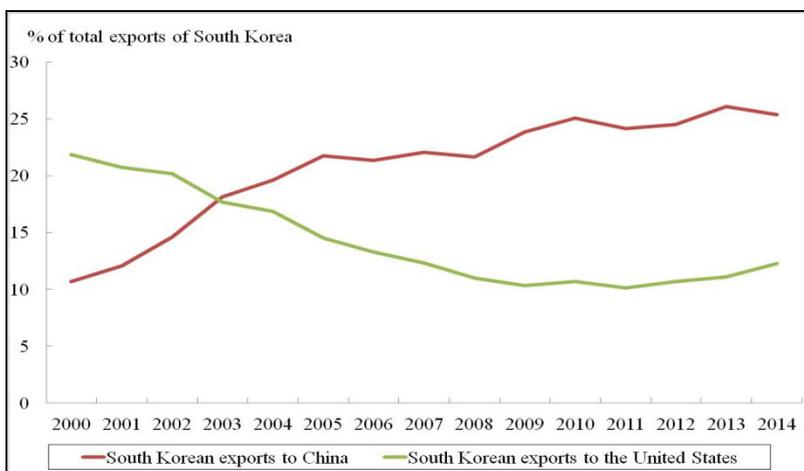
²⁶ The interested reader may wish to explore these links: 1) <http://www.enterprise-development.org/page/industrial-policy>, 2) https://books.google.com.ph/books?id=3OnoV4z4ccYC&source=gbs_navlinks_s, 3) <https://www.youtube.com/watch?v=jczfO--3ELI>, 4) <http://elibrary.worldbank.org/doi/abs/10.1596/0-8213-2414-4>, 5) http://www.ide.go.jp/English/Publish/Download/Report/2008/pdf/2008_0111_ch5.pdf, 6) https://www.wto.org/english/res_e/reser_e/wts_future2013_e/ahn.pdf, and 7) http://www.mtk.ut.ee/sites/default/files/mtk/dokumentid/karimov_industrialization_and_industrial_policy_in_south_korea.pdf.

benefits such as paid leaves, social security, health and accident insurance, and so forth. Thus, manufacturing growth could promote better-quality employment and more inclusive growth.²⁷

IV. Main Policy Challenge for South Korea: Diversifying Its Export Market

As the ADO 2015 notes, the expected slowdown in China over the next two years could have adverse implications for exports and overall economic growth in South Korea. China has been the single biggest export market of South Korea since 2003, when the giant neighbor began to overtake the United States, as shown by Figure 27.

**Figure 27: South Korean Export Shares
to the United States and China**

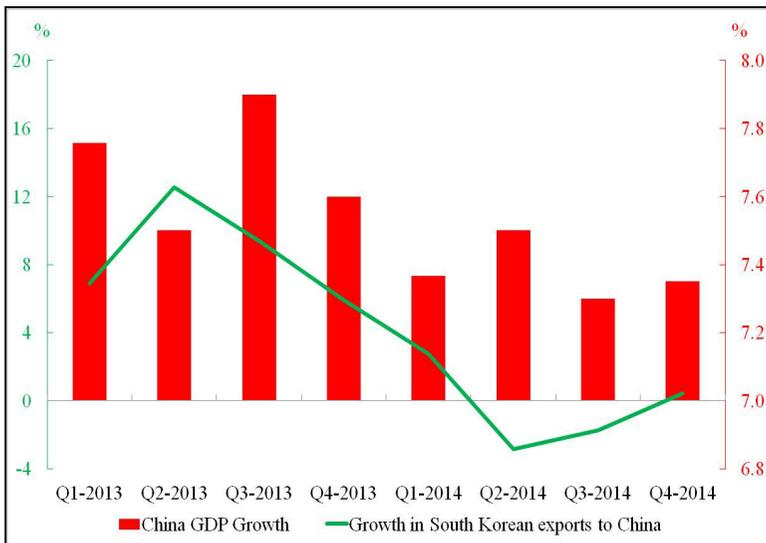


Source: Asian Development Outlook 2015.

²⁷ Here is a link to Dr. Habito's article: <http://opinion.inquirer.net/87302/closing-the-jobs-skills-gap>.

Indeed, the slowdown in China is already being felt.²⁸ Growth in exports to China has slowed in tandem with deceleration in Chinese GDP growth, especially since the second quarter of 2013, as shown by Figure 28. While exports to China mildly recovered toward the end of 2014, it is unlikely that they will return to the high growth seen before the Global Financial Crisis. Deceleration in China will weigh on export prospects for some time to come.

Figure 28: South Korean Exports to China



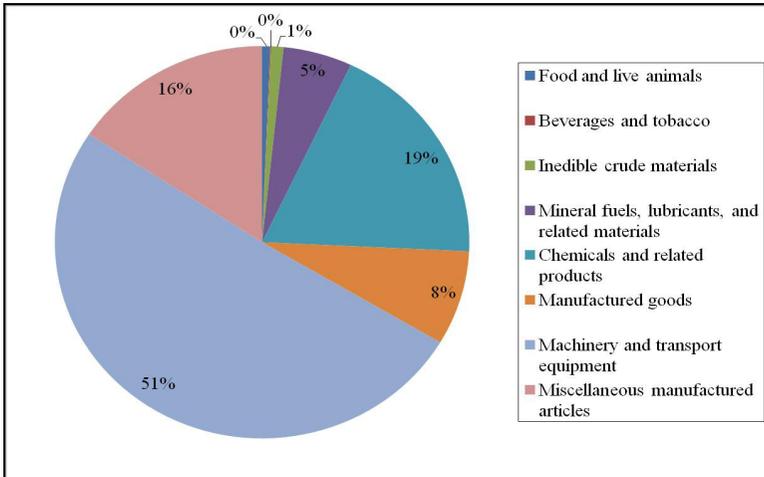
Note: Q = quarter.

Source: Asian Development Outlook 2015.

²⁸ Mr. Peña-Reyes has recently written an Eagle Watch article on the matter: <http://www.businessmirror.com.ph/is-china-becoming-a-house-of-cards/>.

Ongoing structural changes in China will also affect South Korea. As China moves toward a growth strategy that emphasizes consumption, a larger share of its imports will be consumer goods rather than investment-oriented capital goods. Currently, the bulk of South Korean exports to China are capital goods, such as machinery and transport equipment, including vehicles. Figure 29 provides details.

Figure 29: Composition of South Korean Exports to China, 2014

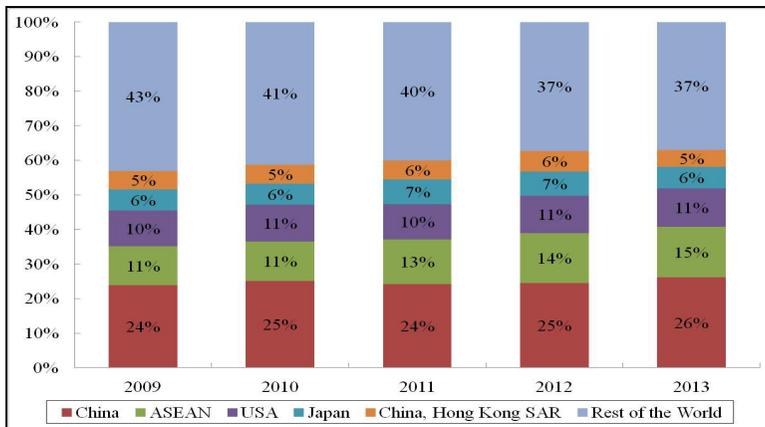


Source: Asian Development Outlook 2015.

Exports of manufactured consumer goods account for only a quarter of the total. Thus, South Korea clearly needs to further diversify its export markets, particularly toward the fast-growing emerging economies in ASEAN. As a matter of fact, the commemorative summit of ASEAN and South Korea in December last year produced calls to boost trade between

the two sides to USD 200 billion by 2020. While ASEAN was already the second-biggest export market of South Korea in 2013 (accounting about 15 percent of South Korean exports), the rapid economic growth of ASEAN, averaging 5.6 percent during 2010-2014, suggests scope for further expansion.²⁹ Figures 30 to 37 provide details of trade between ASEAN and South Korea, and for the Philippines, in particular, the data suggest that there is still much room to increase its share within ASEAN.³⁰

Figure 30: Top Export Markets of South Korea, 2009-2013

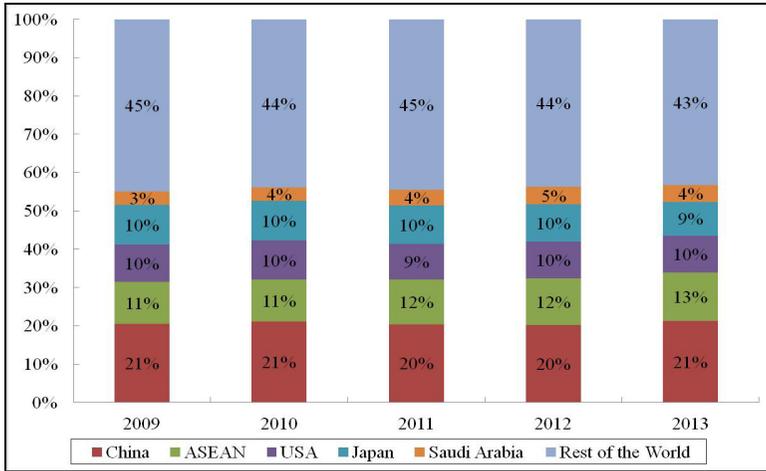


Source: United Nations COMTRADE Database.

²⁹ According to the ASEAN-Korea Centre (<https://www.aseankorea.org/eng/page30/page33-1.asp>), in 2014, ASEAN was the second-largest trading partner of South Korea, with a total trade value of USD 138 billion (13 percent share). The largest was China with USD 235.4 billion (21 percent), followed by the United States with USD 115.6 billion (11 percent), the European Union with USD 114.1 billion (10 percent), and Japan with USD 86 billion (8 percent).

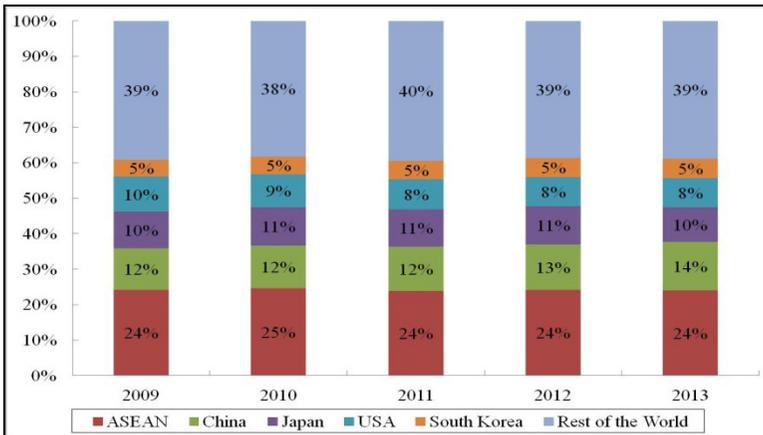
³⁰ Data can be downloaded here: <http://comtrade.un.org/data/>, <http://www.trademap.org/Index.aspx>, and <https://aric.adb.org/integrationindicators>.

Figure 31: Biggest Trading Partners of South Korea (Total Trade Covering Both Exports and Imports), 2009-2013



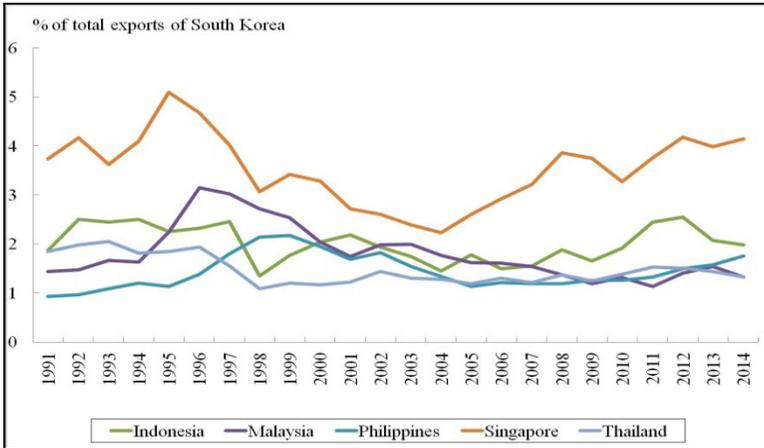
Source: United Nations COMTRADE Database.

Figure 32: Biggest Trading Partners of ASEAN (Total Trade Covering Both Exports and Imports), 2009-2013



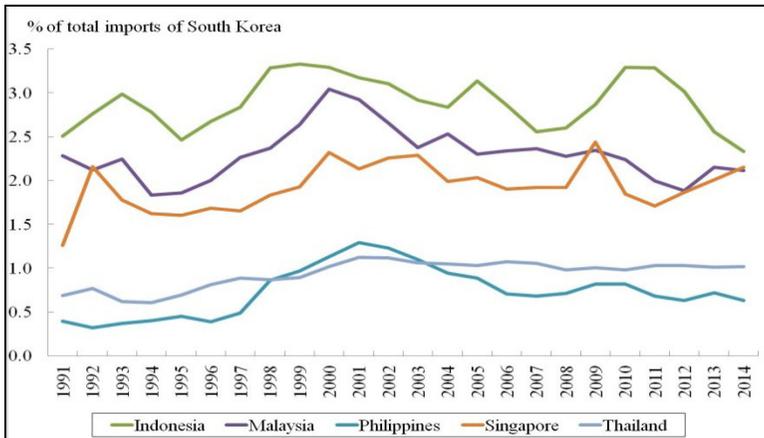
Source: United Nations COMTRADE Database.

Figure 33: Share of ASEAN-5 Countries in Total Exports of South Korea, 1991-2014



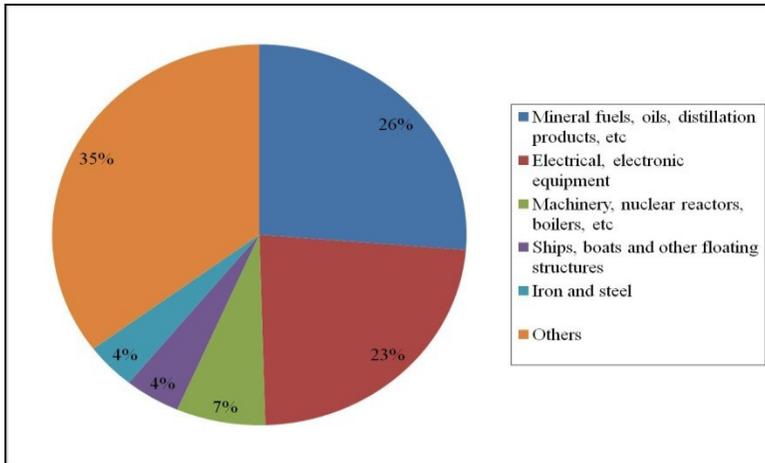
Source: Asian Development Bank – Asia Regional Integration Center Database.

Figure 34: Share of ASEAN-5 Countries in Total Imports of South Korea, 1991-2014



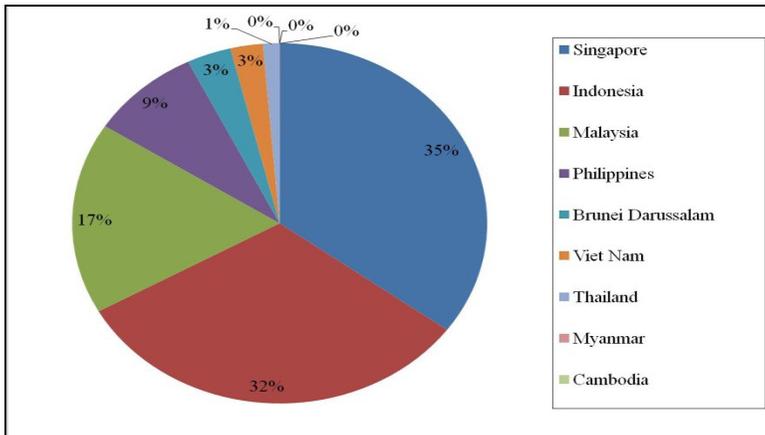
Source: Asian Development Bank – Asia Regional Integration Center Database.

Figure 35: Top Commodities Traded Between South Korea and ASEAN, 2014



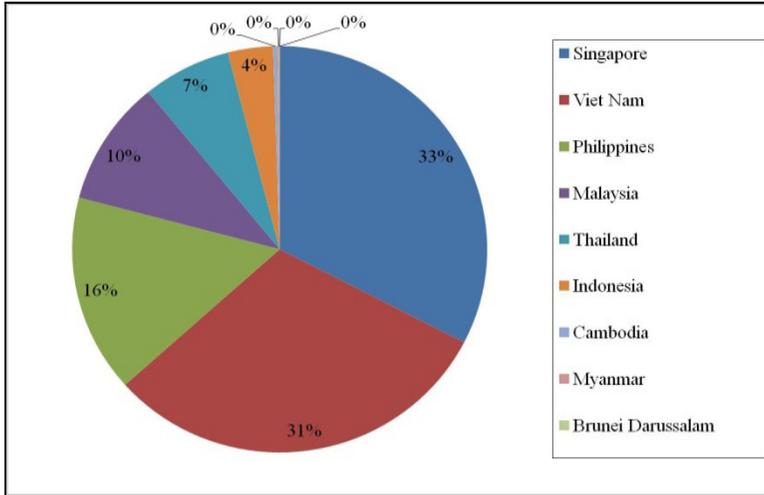
Source: Trade Map.

Figure 36: Share of ASEAN Countries in the Total Trade for Mineral Fuels, Oils, Distillation Products, Etc., 2014



Source: Trade Map.

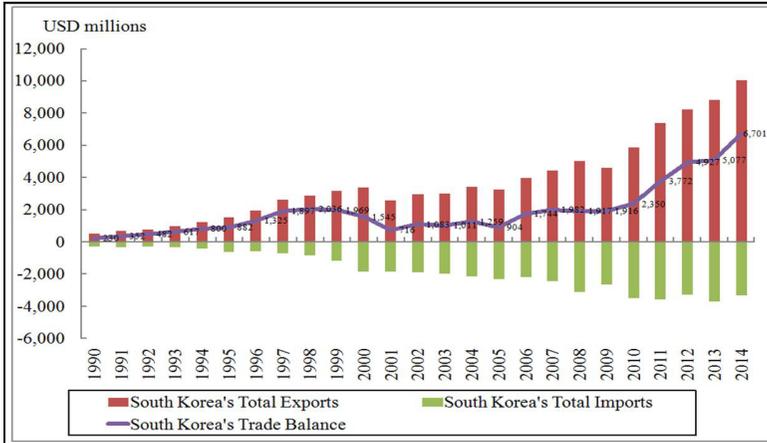
Figure 37: Share of ASEAN Countries in the Total Trade for Electrical and Electronic Equipment, 2014



Source: Trade Map.

Figure 38 shows that since 1990, South Korea has been a net exporter, while Figure 39 shows that it has also enjoyed a trade surplus with the Philippines. In contrast, Figure 40 shows that since 1990, the Philippines has been a net importer, while Figure 41 shows that it has been at a trade deficit with South Korea. As suggested by Figures 35 and 37, both countries probably trade heavily in electronics, with the Philippines exporting low-value components to South Korea and then importing high-value finished products from it. The differences in value added would probably account for a considerable portion of the trade deficits experienced by the Philippines.

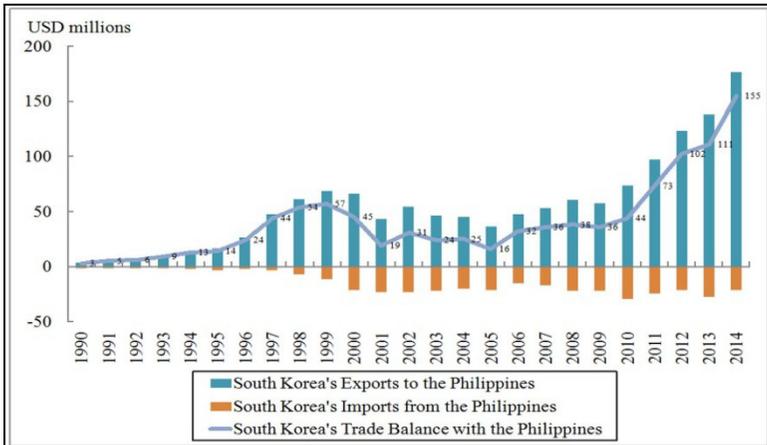
Figure 38: Total Exports, Total Imports, and Trade Balance of South Korea



Note: USD = United States dollar.

Source: Asian Development Bank – Asia Regional Integration Center Database.

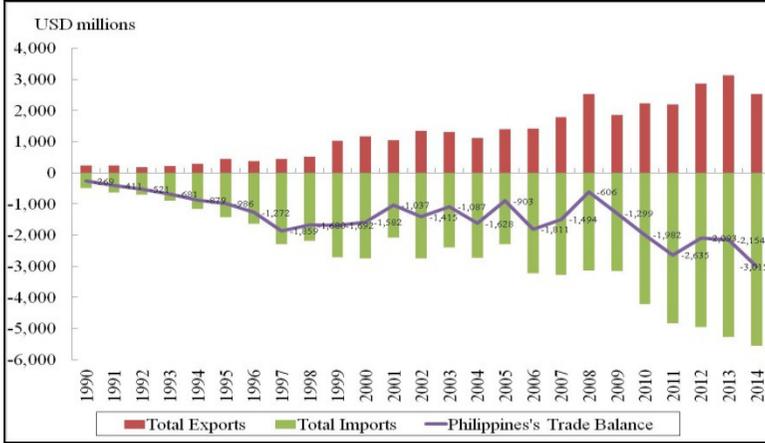
Figure 39: South Korea's Exports to, Imports from, and Trade Balance with the Philippines



Note: USD = United States dollar.

Source: Asian Development Bank – Asia Regional Integration Center Database.

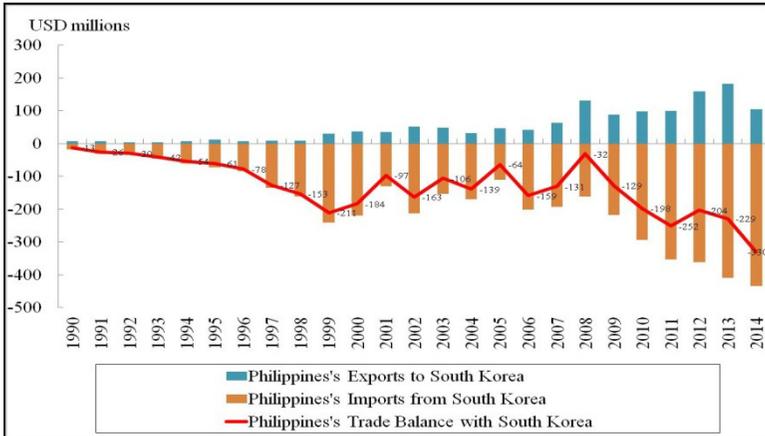
Figure 40: Total Exports, Total Imports, and Trade Balance of the Philippines



Note: USD = United States dollar.

Source: Asian Development Bank – Asia Regional Integration Center Database.

Figure 41: Philippines's Exports to, Imports from, and Trade Balance with South Korea



Note: USD = United States dollar.

Source: Asian Development Bank – Asia Regional Integration Center Database.

Thus, in relation to such observations, R. Aldaba (2015) asserts that attracting more electronic manufacturing services companies will be crucial to sustaining the position of the Philippines in regional production networks. There is actually a gradually declining trend in the number of imported parts, and this indicates the need to diversify and upgrade the global value chain participation of the Philippine electronics industry through market upgrading characterized by moving from semiconductors into electronic manufacturing services, particularly in areas with high-growth potential, such as auto electronics, power electronics, electronic data processing, and consumer electronics.

Strengthening competitiveness in semiconductor devices and electronic manufacturing services will be necessary to transform and deepen the industry position in the global value chain. The upgrading process will require the following: 1) human resources development; 2) establishment of an innovation ecosystem, efficient logistics, and infrastructure; and 3) development of a parts/supplies/materials sector to support the industry.³¹ Also, in relation to ODA, perhaps it would be good for the Philippines to channel these funds into investments that will diversify and upgrade its global value chain participation.

Lastly, the 2014 Economic Survey for South Korea published by the Organisation for Economic Co-operation and Development (OECD) mentions the need for South Korea

³¹ Dr. Rafaelita Aldaba's paper can be downloaded here: <http://www.eria.org/ERIA-DP-2015-62.pdf>. A related paper published by the Asian Development Bank can also be downloaded here: <http://www.adb.org/sites/default/files/publication/175295/smes-global-value-chains.pdf>.

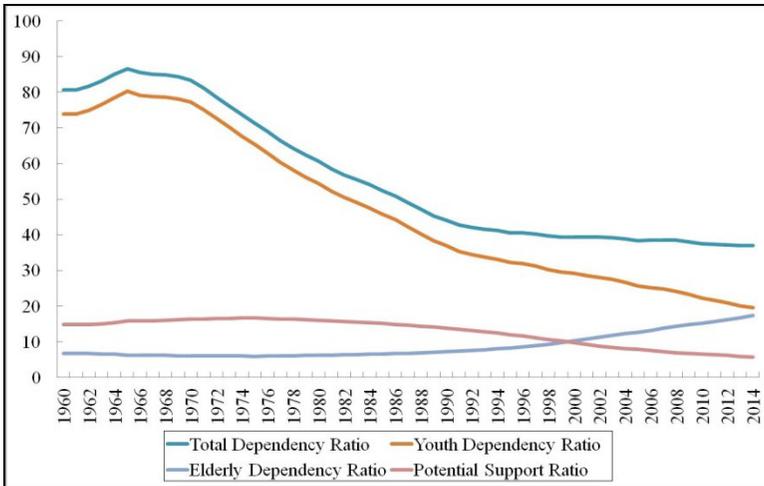
to foster a so-called creative economy.³² The report notes that while spending for research and development in South Korea was the highest among the OECD members at 4.4 percent of GDP in 2012, weaknesses in the South Korean innovation system limit the return. International collaboration in patenting and research is low, and the role of universities is small. Framework conditions to promote a creative economy are also weak, reflecting relatively stringent product market regulations and low inward FDI. The creation of new enterprises is hampered by problems in the venture capital market and the financing of small and medium enterprises (SMEs). The productivity gap between large firms and SMEs, which benefit from a wide range of public support, is widening, reflecting problems in services. Indeed, service sector productivity is only about half of that in manufacturing. Greenhouse gas emissions and energy intensity have been rising despite the 2009-2013 green growth plan.

Perhaps by promoting the free exchange of scientists, scholars, and other innovators, South Korea can work more closely with the Philippines in fostering a creative economy. Since the services sector of the Philippines is also booming, perhaps South Korea can also look to this market to address its domestic needs. Of particular interest is South Korea's ageing population, which Figures 42 to 44 serve to illustrate. Healthcare services, in particular, might be a potential area for closer cooperation with the Philippines, which enjoys a so-called "demographic sweet spot," as shown by Figures 45 to 47.³³

³² The OECD report can be downloaded here: http://www.oecd.org/eco/surveys/Overview_Korea_2014.pdf.

³³ Population data can be downloaded here: <http://data.worldbank.org/indicator>. One should look at the Health Indicators. Dependency ratios are explained here: <https://www.cia.gov/library/publications/the-world-factbook/docs/notesanddefs.html?fieldkey=2261&term=Dependency%20ratios>.

Figure 42: South Korean Dependency Ratios

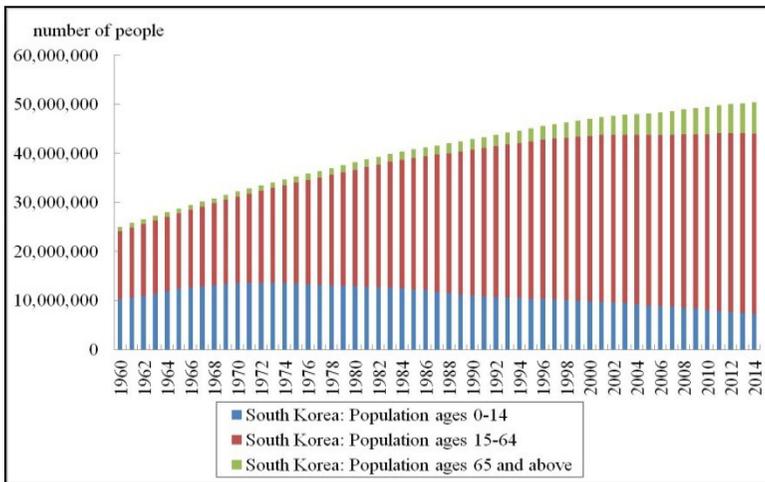


Note: Dependency ratios are a measure of the age structure of a population. They relate the number of individuals that are likely to be economically “dependent” on the support of others. Dependency ratios contrast the ratio of youths (ages 0-14) and the elderly (ages 65+) to the number of those in the working-age group (ages 15-64). Changes in the dependency ratio provide an indication of potential social support requirements resulting from changes in population age structures. As fertility levels decline, the dependency ratio initially falls because the proportion of youths decreases while the proportion of the population of working age increases. As fertility levels continue to decline, dependency ratios eventually increase because the proportion of the population of working age starts to decline and the proportion of elderly persons continues to increase. The total dependency ratio is the ratio of combined youth population (ages 0-14) and elderly population (ages 65+) per 100 people of working age (ages 15-64). A high total dependency ratio indicates that the working-age population and the overall economy face a greater burden to support and provide social services for youth and elderly persons, who are often economically dependent. The youth dependency ratio is the ratio of the youth population (ages 0-14) per 100 people of working age (ages 15-64). A high youth dependency ratio indicates that a greater investment needs to be made in schooling and other services for children.

The elderly dependency ratio is the ratio of the elderly population (ages 65+) per 100 people of working age (ages 15-64). Increases in the elderly dependency ratio put added pressure on governments to fund pensions and healthcare. The potential support ratio is the number of working-age people (ages 15-64) per one elderly person (ages 65+). As a population ages, the potential support ratio tends to fall, meaning there are fewer potential workers to support the elderly.

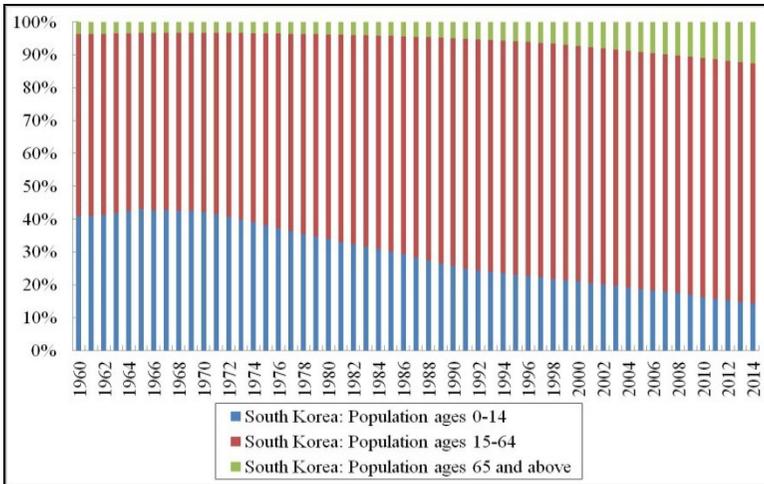
Source: Authors' calculations using data from the World Development Indicators Database and explanatory notes from the Central Intelligence Agency World Factbook.

Figure 43: Breakdown of South Korean Population in Levels



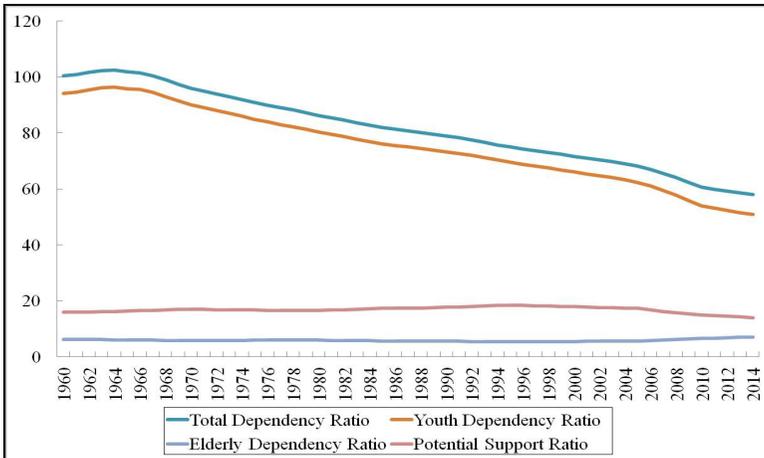
Source: World Development Indicators Database.

Figure 44: Breakdown of South Korean Population in Shares



Source: World Development Indicators Database.

Figure 45: Philippine Dependency Ratios

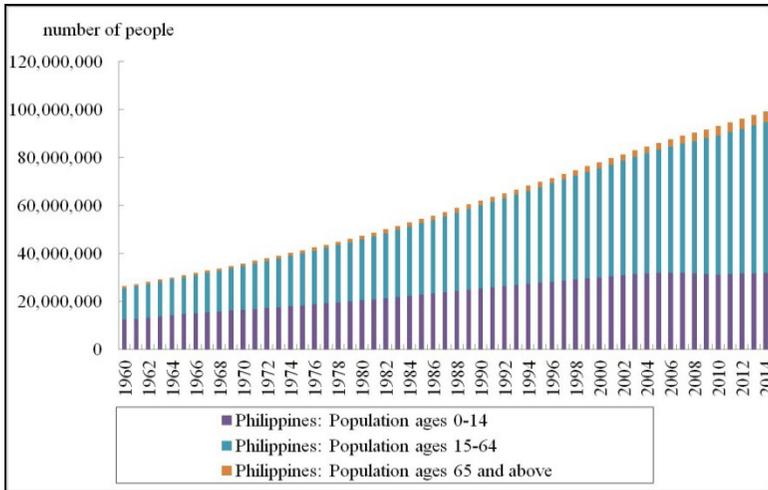


Note: Dependency ratios are a measure of the age structure of a population. They relate the number of individuals that are likely to be economically

“dependent” on the support of others. Dependency ratios contrast the ratio of youths (ages 0-14) and the elderly (ages 65+) to the number of those in the working-age group (ages 15-64). Changes in the dependency ratio provide an indication of potential social support requirements resulting from changes in population age structures. As fertility levels decline, the dependency ratio initially falls because the proportion of youths decreases while the proportion of the population of working age increases. As fertility levels continue to decline, dependency ratios eventually increase because the proportion of the population of working age starts to decline and the proportion of elderly persons continues to increase. The total dependency ratio is the ratio of combined youth population (ages 0-14) and elderly population (ages 65+) per 100 people of working age (ages 15-64). A high total dependency ratio indicates that the working-age population and the overall economy face a greater burden to support and provide social services for youth and elderly persons, who are often economically dependent. The youth dependency ratio is the ratio of the youth population (ages 0-14) per 100 people of working age (ages 15-64). A high youth dependency ratio indicates that a greater investment needs to be made in schooling and other services for children. The elderly dependency ratio is the ratio of the elderly population (ages 65+) per 100 people of working age (ages 15-64). Increases in the elderly dependency ratio put added pressure on governments to fund pensions and healthcare. The potential support ratio is the number of working-age people (ages 15-64) per one elderly person (ages 65+). As a population ages, the potential support ratio tends to fall, meaning there are fewer potential workers to support the elderly.

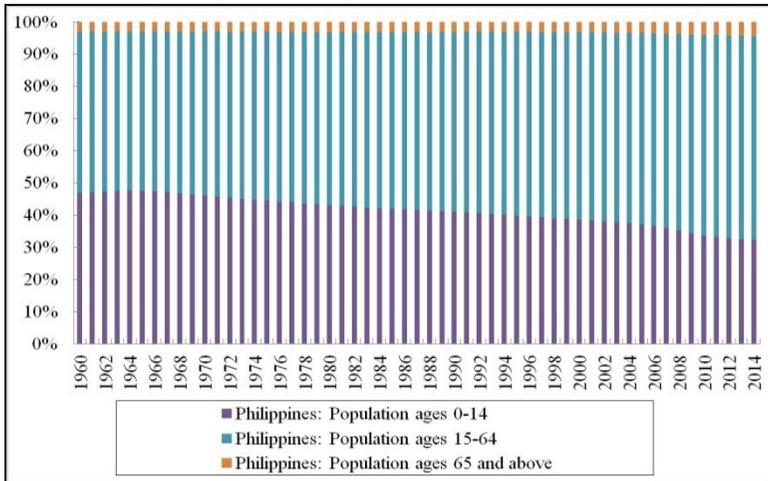
Source: Authors’ calculations using data from the World Development Indicators Database and explanatory notes from the Central Intelligence Agency World Factbook.

Figure 46: Breakdown of Philippine Population in Levels



Source: World Development Indicators Database.

Figure 47: Breakdown of Philippine Population in Shares



Source: World Development Indicators Database.

V. Conclusion

This paper notes that growth prospects are generally positive for both the Philippines and South Korea, with price stability expected to support economic growth. The main policy challenge for the Philippines is to make its growth more inclusive, both sectorally and geographically. Working closely with South Korea in the areas of infrastructure, foreign direct investment, tourism, official development assistance, and industrial policy could help the Philippines make structural changes in its economy that will help spread the benefits of growth more widely.

Meanwhile, the main policy challenge for South Korea is to diversify its international trade market. The ASEAN region appears to be a logical choice for expansion, so the Philippines should be working hard to gain a bigger share within ASEAN. The need to diversify and upgrade the global value chain participation of the Philippine electronics industry also comes to the fore.

The need of South Korea to foster a creative economy could also be a good opportunity for the Philippines to share its human resources. South Korea, which has an ageing population, could turn to the booming services sector of the Philippines (particularly healthcare services) to meet its domestic needs.

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- Figure 47: Breakdown of Philippine Population in Shares

References

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