Trade and Poverty Issues: A Country Case Study of the Philippines

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Abstract: This study begins with an overview of the poverty situation in the Philippines. It then takes a brief look at the poor in the rural areas, followed with a discussion of the poor in the informal sector. It then, brings these two sectors together, with an examination of the poor and the urban/rural and formal/informal divides. It concludes with a discussion of the relationship among trade, poverty and the structural transformation of the Philippine economy.

Note: This working paper is circulated for discussion and comment purposes.

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1. Introduction

The typical analysis of poverty or international trade generally focuses solely either on one topic or the other. In this paper, however, we have a twin focus on both trade and poverty, and the linkages and connections between the two topics.

We begin with the daunting realization that the drivers of poverty in the Philippines -- and elsewhere -- are multi-dimensional, and therefore complex. But we hope to throw some light on the impact that trade openness can have on the poor.

While we start with the premise that economic growth (an equally complex object of study) will remain the key driver of poverty reduction, and trade will continue to be a critical driver of economic growth, we keep an open mind as to the evidence we may uncover in examining the effects of increased trade openness on the livelihoods of the poor [1].

Our task requires a focus on the characteristics of the poor and an understanding of how they interact (or do not interact) with international markets. We strive to understand the constraints the poor face, based on who the poor are, where they are, and the economic activities they are involved in. An in-depth analysis of the characteristics of the poor is required to identify the main constraints faced by the poor that need to be addressed.

Before proceeding, it needs to be said that our discussion takes off from the four relevant dimensions of poverty in relation to trade openness [2]. Our selection of the rural and informal sector dimensions of poverty springs from the striking relevance of these two dimensions to the Philippine economy.

This paper is organized as follows. Section 2 begins our discussion with an overview of the poverty situation in the Philippines. In Section 3, we take a brief look at the poor in the rural areas. This is followed in Section 4 with a discussion of the poor in the informal sector. Then, Section 5 brings these two sectors together, with an examination of the poor and the urban/rural and formal/informal divides. Lastly, Section 6 concludes with a discussion of the relationship among trade, poverty and the structural transformation of the Philippine economy.

2. Poverty in the Philippines – An Overview

We present two ways of looking at the poverty situation in the country in Table 1. The first one is the estimate of poverty incidence among the population using the national definition of the poverty line.

Looking at the national poverty line, we note that the baseline estimate in 1991 (estimated to serve as a benchmark for the UN Millennium Development Goals) was 34.4 percent. This showed a large decline by the time the next estimate was done 12 years later, to around 25 percent.

However, the poverty rate stayed more or less around that level for more than a decade, despite the rapid economic growth. The latest estimate for 2015, however, showed a decline of around 3 percentage points to 21.6 percent.

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TABLE 1: POVERTY INCIDENCE IN THE PHILIPPINES

Year	Proportion of Population Below Poverty Line (%): National	International $3.10/day PPP	International $1.90/day PPP
1991	Baseline 34.4		
2000		36.5	13.9
2003	24.9	34.8	13.2
2006	26.6	36.8	14.5
2009	26.3	32.7	10.9
2012	25.2	32.0	10.6
2015	21.6		

Sources:
1. National–Philippine Statistics Authority (2012 and 2016); and National Economic and Development Authority–United Nations Development Program (2014).
2. International–World Bank (2015a and 2015b). World Bank staff estimates, using new 2011 purchasing power parity (PPP) exchange rates.

An alternative way of looking at poverty incidence is with the use of the international poverty lines of $1.90/day and $3.10/day. With the poverty line of $1.90/day, the poverty rate was at around 14 percent for more than half a decade. Then, the poverty rate declined in 2009 to around 11 percent, at which level it has stayed close to till 2012, the last year of estimate available.

The indication therefore of the poverty incidence rates is that for the past decade or so, poverty levels have remained persistently high, while only showing a decline in recent years.

3. The Poor in the Rural Areas

Despite growing urbanization, more than half (51%) of the Philippines' 100 million people live in rural areas. Despite its larger share of the total population, the rural economy (agriculture, hunting, forestry and fishing) contributed in 2016 only 7.0 percent of the country's national income [3], while the sector accounted for 28 percent of total employment [4].

Agriculture is the primary and often only source of income for poor rural people, most of whom depend on subsistence farming and fishing for their livelihoods. It has been reported that fishermen and farmers have the highest poverty incidence rates among a number of disadvantaged sectors (see Table 2). It is therefore not surprising that, of the segment of the population below the national poverty line, three out of four live in rural areas [5].

Although the causes of poverty in rural areas in the country vary widely by region, common drivers include a decline in agricultural productivity, unprofitable smallholder farming operations and unsustainable practices, which have led to deforestation and depleted fishing waters [6].

With respect to the impact of international trade on the rural poor, an important point to note is the presence of a formidable constraint facing poor rural producers wanting to take advantage of trade opportunities, namely, the evident lack of connectivity in the form of poorly developed infrastructure for transport, especially roads, port facilities and inter-island shipping.

TABLE 2
POVERTY INCIDENCE AMONG BASIC SECTORS

	2009	2012
Philippines	26.3	25.2
Fishermen	41.3	39.2
Fishermen	38.0	38.3
Self-employed and Unpaid family workers	29.9	29.0
Youth	21.6	22.3
Individuals residing in urban areas	12.6	13.0

Sources: Philippine Statistics Authority (2012 and 2014). Basic sectors are not mutually exclusive, i.e., there are overlaps among sectors (e.g., some youth who are also farmers).

About half of rural villages in the country lack all-weather access to the main transport system. Out of the overall road network, gravel roads make up about 52 percent, while 31 percent are earth roads. Only some 17 percent of the local (barangay) road network is paved, leaving a huge backlog of farm-to-market roads to be developed [7]. This highlights the remoteness of poor rural producers from internal, let alone foreign, markets.

A related point is that, in rural areas, the prices of inputs that need to be purchased from abroad or domestic centers of production (such as fertilizers, seeds, pesticides or packaging material) are higher than those in the better-connected urban areas.

4. The Poor in the Informal Sector

The poverty incidence in the informal sector is among the highest (29 percent) among selected population groups in the country (see Table 2). This section provides an overview of the micro-, small-, and medium-sized enterprises that comprise the sector [8].

Of the 946,988 business enterprises operating in the country (2014), 99.6 percent are micro-, small-, and medium-sized enterprises [9]. In Table 3, the definition of MSME as defined by the Philippine government is described.

TABLE 3
DEFINITION OF MICRO-, SMALL- AND MEDIUM-SIZED ENTERPRISES

Number of Employees	Amount of Assets (PhP million)
Micro 1 -- 9	Less than or Equal to 3 mil.
Small 10 -- 99	More than 3 to Less than 15 mil.
Medium 100 - 199	1.5 to Less than 100 mil.

Source: Employment -- *Magna Carta for MSMEs of 2008;* and Assets -- *MSME Development Plan 2011-2016.*

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Looking at each category of the MSME sector, micro firms account for 89.9 percent of all enterprises, small firms for 9.2 percent, while medium firms for 0.4 percent [10]. Given that only 0.4 percent of all enterprises are large firms, it is not surprising that the average employment per establishment in the country is 25 [11].

In terms of total employment of all enterprises, the MSME sector contributed 62.8 percent of the total jobs, which can be broken down into 30.5 percent from micro firms, 25.5 percent from small firms, and 6.8 percent from medium firms. In terms of value-added, the MSME sector contributed 35.7 percent of the total, which can be further broken down to 4.9 percent from micro firms, 20.5 percent from small firms, and 10.3 percent from medium firms.

As mentioned, SMEs contribute nearly 63 percent of the total employment of all enterprises in the country due to the less sophisticated and labor-intensive production systems. SMEs tend to have lower entry requirements in terms of skills, education, and qualifications. They are also likely to employ marginalised groups who may otherwise have difficulties finding jobs in large enterprises. As such, some SMEs are “survival enterprises”, operating out of necessity, rather than with the intention to grow, providing incomes, and livelihoods to the majority of the poor who are faced with the absence of any real alternative due to a lack of sufficient wage employment [12].

At the same time, though, it is important to note that SMEs and large enterprises do not exist in isolation, but form part of an interacting system, where large enterprises provide SMEs with markets. SMEs require access to credit, new inputs, technology, and services that lead to improved products that large enterprises are looking to purchase.

This suggests the need to focus on creating openings for small enterprises to integrate into domestic value chains or in the different stages of production and trade of goods and services. This is the means for SMEs to develop linkages with large enterprises in the economy, expanding the business scope of the SME sector and enhancing competitiveness.

With our focus on the impact of more trade openness on SMEs (and by implication, on poverty), it is legitimate to look next into whether there are differences in the survival of SMEs and large enterprises the higher their exposure to imports and lower tariffs.

There is some initial evidence that, when one takes into account a firm's size, age and productivity, the probability of exit is higher in small firms that face tariff reduction [13]. Firm exit is greater for small enterprises characterized by low productivity, non-exporter status and without foreign equity. In general, firms - large or small - that have high level of productivity, engaged in export activities and have foreign equity are better able to survive.

It is well-known that SMEs face a number of constraints such as scale disadvantage, lack of high-level employees, and financial access. To grow and adapt to the market environment and increase their survival probability, they need to increase their size. Larger firms are more likely to have levels of output close to the minimum efficient scale of production; hence smaller firms have an inherent size disadvantage.

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The implication for industry policy towards SME is that focus should be directed towards measures that would enhance firm productivity, and attracting more foreign direct investment, especially those that would improve SME linkages with multinational companies that have international production networks.

This highlights the point that the adjustment of the economy through trade openness toward more competitive parts of the economy brings long-term gains, but entails short-term adjustment costs for the poor that need to be carefully managed.

There may be unemployment or lower wages for poor people in uncompetitive sectors that contract as a consequence of trade openness. In this way, trade reform for the poor may involve long-term benefits but with high short-term adjustment costs in some cases. One strategy that can be employed is phased implementation, along with building capabilities to exploit opportunities generated through trade.

5. The Poor and the Urban/Rural and Formal/Informal Divides

With our focus on poverty, we begin here by noting the apparent paradox that the unemployed group has a poverty incidence rate that is lower than that for the employed group, 18.7 vs 21.9 percent in 2012 [14].

On the face of it, labor resources are almost fully utilized in the country. Employment rate, as defined by the ratio of employment to working age population, provides a summary measure of the utilization of labor resources. The 60 percent employment rate is average by international standards. Most people work and few are unemployed. The unemployment rate is relatively low, around 6 to 7 percent. [15}

Economic growth during the last decade created enough jobs to absorb the growing labor force. In the last 10 years employment grew at the same rate as the population of working age, meaning that the labor market fully absorbed the increase in the supply of labor. New entrants to the labor market were finding employment, and there was no increase in unemployment. Contrary to what was claimed in some earlier studies, economic growth was not jobless.

From the perspective of poverty, however, underemployment is a bigger problem than unemployment. Among the employed, one person in five is underemployed. The underemployed would like to work more to increase their earnings. Close to 60 percent work less than full-time, largely because they do not have access to regular full-time jobs. The underemployed represent about one-third of the working poor. And underemployment is more pronounced in rural than in urban areas.

In addition to underemployment and unemployment, outmigration of Filipino workers and substantial overseas employment indicate that labor resources are not domestically utilized to their full potential.

The next point to highlight is the segmentation in labor markets, with the urban/rural and formal/informal divides, which are especially pronounced.

Rural and informal workers earn little, and are at a high risk of poverty.

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In the informal sector 56 percent of workers are low-paid. Low-paid employment is almost tantamount to informal employment. The high incidence of low-paid employment is thus an upshot of widespread informality.

With low paid jobs concentrated in the informal sector, in-work poverty is closely related to informality. Over 90 percent of all low-paid jobs are informal, and as a result, informal workers are disproportionately represented among the poor. The high incidence of in-work poverty is thus just a mirror image of pervasive informality.

In-work poverty is mostly, although not exclusively, a rural and agricultural phenomenon. Rural workers account for the bulk of the working poor, and 84 percent of all working-poor live in the rural areas.

The low-paying lower tier of the labor market is informal and casual, and mostly rural. The well-paying upper tier is formal, secure, and mostly urban. Workers in the lower tier are poorly educated and hold low-skilled jobs.

To sum up, in-work poverty is pervasive in the country. On the one hand, it is caused by low labor productivity, which reflects low education and skills of the workforce. On the other, it is caused by lack of productive job opportunities.

This may give rise to a vicious circle: workers have little incentives to invest in skills because there are few jobs requiring advanced skills. At the same time, skill-intensive jobs are not being created because workers lack the required skills.

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6. Concluding Remarks: Trade, Poverty and Structural Transformation of the Philippine Economy

In the preceding sections, we have seen, that the poor - or, equivalently, the working poor -- are poorly educated and have informal jobs that offer no workers protection. Most of them live in rural areas, where productive job opportunities are few.

This points to two interrelated root causes of the situation of the working poor: low education among vulnerable workers and scarcity of "good" jobs. Addressing these two constraints requires reforms on both the supply side (education and skills) and demand side (jobs) of the labor market.

An immediate policy implication is the need for improvement in workforce education and training, especially among young cohorts entering the labor market, so that workers have the skills required in the modern sector of the economy.

The medium- to long-term policy priority is the structural transformation of the economy, which brings back our discussion full-circle from poverty to trade. Opening up to trade increases the country's output because it allows the use of its resources more efficiently by specializing in the production of the goods and services that it can produce more cheaply, while importing the others.

Structural transformation entails the development of more productive formal wage and salaried employment sector, including an increase in agricultural productivity. There would be a reallocation of labor and other resources from less to more productive activities, which involves labor and other resources moving from agriculture to services and industry. In helping allocate resources to the most productive activities, trade helps transform the economy, with the potential to reduce poverty.

ENDNOTES:

1. Antonio and Onodera (2007).
2. World Bank–World Trade Organization (2015).
3. Philippine Statistics Authority (2016c).
4. Philippine Statistics Authority (2016b).
5. Based on author's computations from data in Philippine Statistics Authority (2012).
6. International Fund for Agricultural Development (2016).
7. World Bank (2014).
8. This segment draws from the author's earlier work on this issue in Sta. Romana (2017).
9. Department of Trade and Industry (2016).
10. Based on author's computations from data in Department of Trade and Industry (2016).
11. Philippine Statistics Authority (2015).
12. International Labour Organization (2015).
13. Aldaba (2016).

14. Philippine Statistics Authority (2012 and 2014).
15. World Bank (2016).

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