

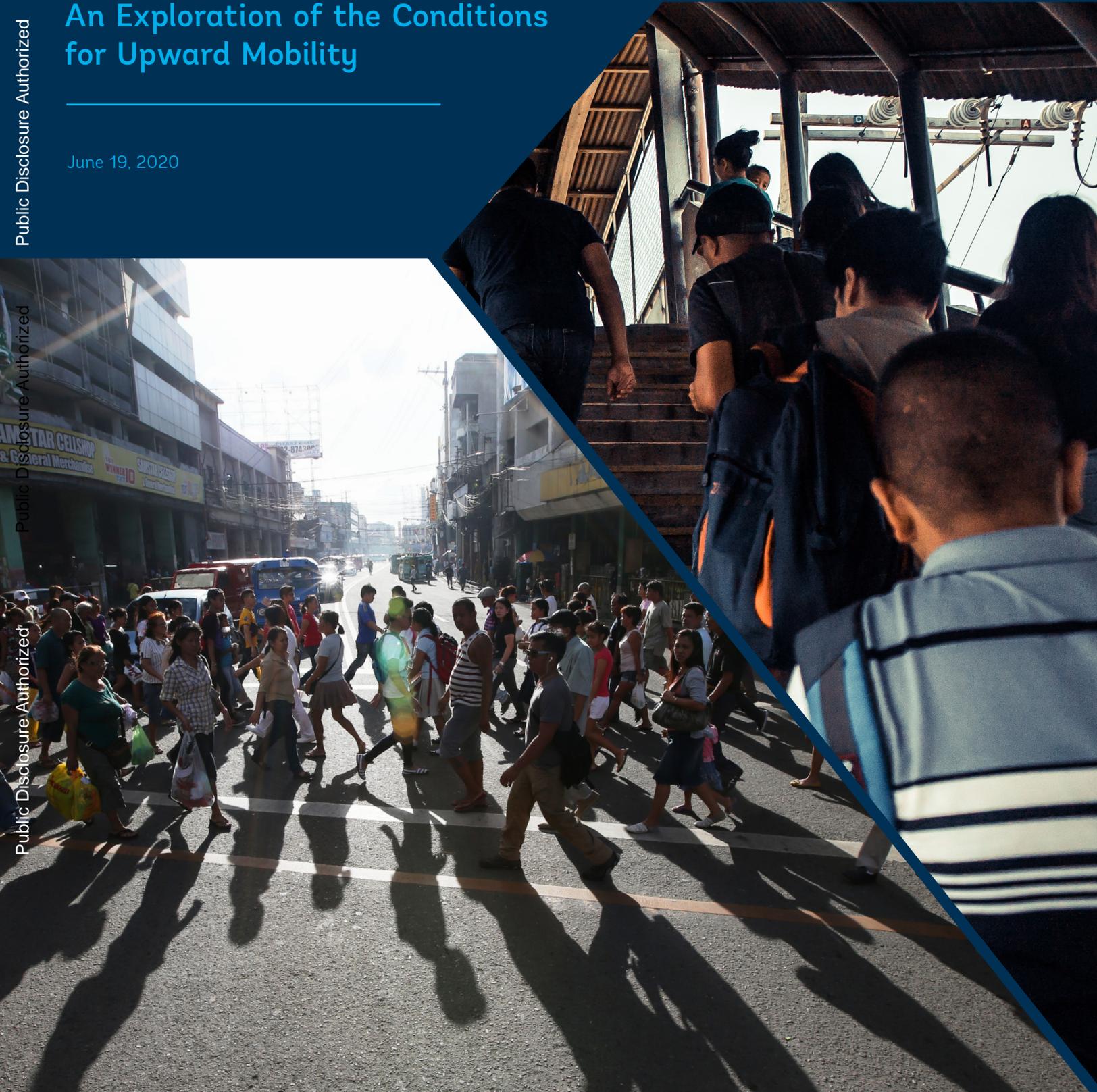


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The Middle Class in the Philippines:

An Exploration of the Conditions for Upward Mobility

June 19, 2020



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Abbreviations

ARMM	Autonomous Region in Muslim Mindanao
ARTA	Anti-Red Tape Authority
ASEAN	Association of Southeast Asian Nations
BPO	Business process outsourcing
CGAP	Consultative Group to Assist the Poor
DOLE	Department of Labor and Employment
EAP	East Asia and Pacific
FIES	Family Income and Expenditure Survey
GDP	Gross domestic product
GVA	Gross value added
HCI	Human Capital Index
HMO	Health maintenance organization
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IJBED	International Journal of Business and Economic Development
ISSP	International Social Survey Programme
LFS	Labor Force Survey
MSB	Money service businesses
MSME	Micro, small, and medium enterprises
NCR	National capital region
NCS	National Convention on Statistics
NEDA	National Economic and Development Authority
NEET	Not in employment, education, or training
OFW	Overseas Filipino Worker
OWS	Occupational Wage Survey
PDIC	Philippine Deposit Insurance Corporation
PESO	Public employment service offices
PISA	Programme for International Student Assessment
PPP	Purchasing power parity
PSA	Philippines Statistics Authority
SME	Small and medium enterprises
TLP	Total loan portfolio
TSGI	Tholons Services Globalization Index
TVET	Technical and vocational education and training

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Summary

Economic Growth, Upward Mobility, and Middle-Class Expansion

A decade of rapid economic growth has supported upward mobility and the expansion of the middle class in the Philippines. From 2006 to 2015 GDP grew 5.4 percent a year, surpassing the 4.1 percent average from 1996 to 2015. The middle class increased from 6.7 million people in 2006 to 9.3 million in 2015, and the economically secure increased from 24.2 million to 35.3 million. As the pace of growth continued in recent years, averaging 6.5 percent per year from 2015 to 2018, more Filipinos were expected to move up the income ladder and realize their dream moving toward a middle-class society.

While the Philippines' record of economic growth has been sound, many East Asian countries have performed better, resulting in higher levels of economic mobility and more rapid middle-class expansion. Compared with other countries in East Asia, in the past decade, the average rates of GDP growth and GDP growth per capita for the Philippines both rank tenth in the group, 4–5 percentage points lower than the stellar performers, such as China, whose GDP growth averaged 9.6 percent (9.05 percent per capita), Myanmar 9.2 percent (8.4 percent per capita), and Mongolia 8.4 percent (6.7 percent per capita). The 5.4 percent annual GDP growth rate in the Philippines translates into 3.6 percent growth in GDP per capita and a mere 1.6 percent of household income per capita growth. In 2015, the economically secure (\$5.50 to \$15 a day, 2011 purchasing power parity) and middle class (above \$15 a day) comprised two-thirds of the region's population, up from just over a fifth of the population in 2002. Meanwhile, in the Philippines, the increase in the middle class and economically secure was marginal, growing from 37 percent to only 44 percent, while 6.6 percent of the population was extremely poor (below \$1.90 a day), 18.7 percent was moderately poor (\$1.90 to \$3.20 a day), and 30.8 percent was economically vulnerable (\$3.20 to \$5.50 a day). The Philippines not only has a small middle class compared to regional peers and most countries at similar levels of economic development but also has experienced slower expansion (see table). The population share of the middle class in the Philippines (9.2 percent) was about half of the developing East Asia and Pacific region's 17.7 percent in 2015; and the pace of expansion (3.6 percent per year) was only a fifth of the region's 16.6 percent. To a lesser extent, it also compares unfavorably with developing countries in general.

Metrics Comparison Between the Philippines and Other Country Groupings, 2015

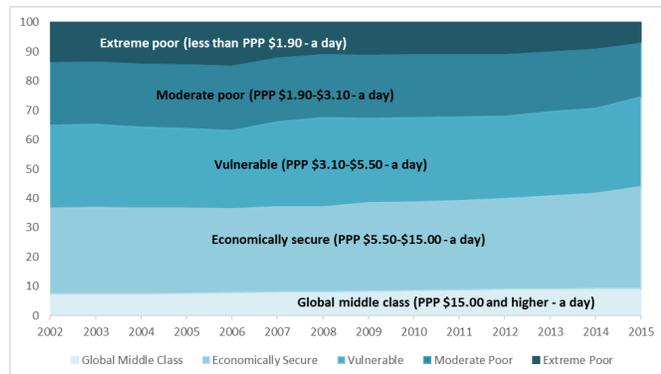
	Philippines	Developing East Asia and Pacific	Developing countries
Share of the middle class in total population (percentage)	9.2	17.7	12.8
Mean daily income of the middle class (U.S. dollars)	26.6	25.7	28.4
Growth of middle class (annualized rate, 2005–15) (2006–15)	3.7	16.6	9.4

Notes: Developing East Asia and Pacific includes Cambodia, China, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Mongolia, Myanmar, Papua New Guinea, Philippines, Solomon Islands, Thailand, Timor-Leste, and Vietnam. Developing countries include all non-OECD countries. The \$15 per day PPP threshold is used to account for the population of the middle class throughout the period 2006–15. The growth of the middle class is the compounded annual growth rate of the middle-class population. For country groupings, we add the population of the middle class and total population across countries to get the middle-class population and total population for the groups.

Source: Staff calculation and World Bank PovCalNet

Shared Prosperity Over Time in the Philippines Compared with the East Asia and Pacific Region

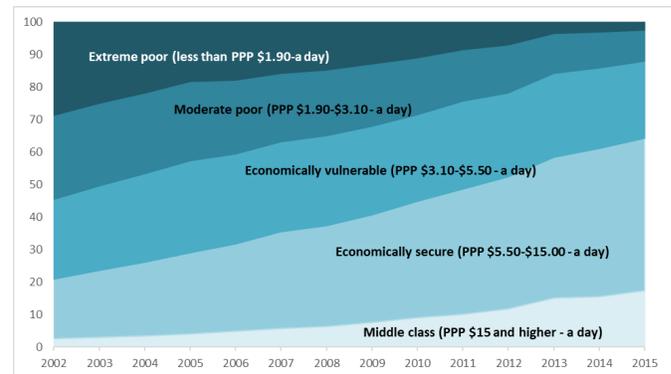
A. Population distribution by economic class in the Philippines, 2002–15



Percent of total population

Source: East Asia and Pacific Team for Statistical Development.

B. Population distribution by economic class in East Asia and Pacific, 2002–15



The government of the Philippines articulated its vision for “a prosperous, predominantly middle-class society where no one is poor” in AmBisyon Natin 2040, but more effort is needed to hasten the achievement of this goal. Assuming a distribution-neutral annual GDP growth rate of 6.5 percent, the most recent average, the projected time it will take for the extremely poor to transition into the middle class, starting from 2018, is 35 years; the moderately poor, 27 years; the economically vulnerable, 19 years; and the economically, secure 8 years. However, the COVID-19 pandemic is resulting in a gloomy economic growth outlook and increased regional and global challenges that will affect the ability to create a predominantly middle-class society in the Philippines. In this more difficult economic environment, upward mobility will require redoubled effort to accelerate growth and promote more inclusive distribution.

This study aims to inform these efforts through an in-depth examination of varying factors that affect upward mobility and middle-class expansion in the Philippines. The analysis draws from a variety of sources: objective information from micro surveys, including the Family Income and Expenditure Survey, Labor Force Survey, and Occupational Wage Survey; subjective information from Gallup World Poll, International Social Survey Programme, and Pew Research Center; as well as focus group discussions and interviews. The report portrays the lives of the middle class and other income groups in the Philippines and identifies the main impediments to upward mobility and more rapid expansion of the middle class in the past decade. It focuses on specific constraints that affect the creation of more and better jobs. It considers, on the demand side, the importance of a structural upgrade to increase the dynamism of the private sector and thereby create more well-paying job opportunities. It also considers, on the supply side, improvements in skills and education necessary to have a labor force ready to seize these opportunities. Finally, the report recommends policy interventions that the government can implement over the next three to five years to support faster upward mobility and provide all Filipinos the opportunity to realize the dream: a prosperous middle-class society free of poverty by 2040.

Profile of the Middle Class

Households in the global middle class and those who are economically secure have a demographic and socioeconomic profile distinct from households who are economically vulnerable, moderately poor, or extremely poor. They exhibit differences in family size, education, and income sources, as well as differences in where they live, and how they earn and spend.

Who are the middle class? Compared with lower classes, global middle-class households are of smaller size, with lower dependency ratios, headed by individuals with higher education. For those who are employed, the middle-class households stand out with better quality jobs in the labor market. They are more likely to work for the government or own a business, work in the services or manufacturing sectors, and have a higher wage. However, a large share of middle-class household heads is not in the labor force, relying mainly on remittances income.

Where do they live? Regional disparities remain wide and the share of middle class in total population varied across regions. Middle class families are mainly an urban phenomenon and largely concentrated in the national capital region (NCR). In 2015, 70 percent of the middle class and 61 percent of the economically secure lived in urban areas. While only an eighth of the total population lived in the NCR in 2015, nearly a quarter of the middle class lived there. The share of middle class is highest in the NCR and lowest in disaster risk areas and conflict areas—Eastern Visayas and Mindanao.

What are their income and consumption patterns? The middle class and economically secure not only have higher income and consumption levels than the rest of the population, as expected, but they also rely on different income sources and tend to spend their resources differently. The middle class are more likely to earn salaries or wages from non-agricultural activity, which account for the largest share of total household income, followed by income from entrepreneurial activities, and transfers from abroad. The middle class spend less on food and more on education, health care, and durable equipment compared to the other welfare classes. They have the highest savings rate. They have the highest rate of durable asset ownership, but ownership of mobility assets (such as cars) remains low and access to basic services (particularly clean water) is limited.

Job Quality Affects Economic Mobility

Economic growth is necessary to facilitate upward mobility, but the lack of good-quality jobs impedes the pass-through of aggregate growth into economic improvements for households and individuals. Wages are the most important source of income for most households in the Philippines. The lack of stable, well-paying jobs—as reflected in labor market performance data—was a major concern among focus group participants. In 2015, more than 80 percent of the population lived in families that received wage incomes, and over 45 percent of their total household income came from wages. The slow real wage growth—an increase of less than 5 percent in for the ten-year period 2006–15—limited the improvement of household livelihood and the prospects for stepping into the middle class.

The Philippines labor market faces multiple challenges, particularly job quality and underemployment. While numerous jobs were created and absorbed, due to the increasing number of workers in the labor market (with employment at 95 percent in 2018), underemployment remained high in 2018, 18 percent, only a few percentage points down from 22 percent in 2006.

Summary

The 9.9 million new jobs created over 2006–18 were concentrated in lower-paying subsectors, primarily in services, such as “activities of households as employed or other services,” “wholesale and retail trade;” and “accommodation and food service activities.” Similarly, the country’s export structure is marked by a shift toward service exports, slight growth in agriculture exports, and stagnation in manufacturing exports, which contrasts sharply with select countries in the East Asia region, such as China and Vietnam. The low value-added nature of the exports—while masked by the dominant share of electronics exports in manufacturing—is a weakness that has persisted for decades in the Philippines. Without a booming manufacturing sector to create large numbers of labor-intensive jobs for semi-skilled workers, the majority of the surplus labor moved out of agriculture to low-end services jobs. The share of jobs that offer workers a middle-class wage is small. The large movement of labor—nearly one percent of the labor force per year moved from agriculture to non-agriculture jobs in the past decade—into low-end services, resulted in limited labor income gains. Had faster structural transformation or upgrade accompanied the labor shift, it might have resulted in greater labor income gains.

Few jobs pay workers a wage that can lift a family to middle-income status. Even among individuals in the formal sector working in firms with at least 20 workers, which typically pays more than small and informal firms, only 10 out of 429 occupations across agriculture, industry, and services sectors surveyed in the Occupational Wage Survey in 2016 had average monthly wage rates greater than the single-earner middle-class threshold—a wage level that allows a household of five to live a middle-class life with one wage earner (above 15\$ a day per person, 2011 PPP); and only 67 occupations pay even half of that—a wage level that allows a household of five to live a middle-class life with two wage earners. For all the wage-employed, only 0.6 percent had a single-earner middle-class wage, and 4 percent had a double-earner middle-class wage in 2018. Without a significant increase in the number of well-paying jobs, purely relying on wage income to reach middle-class status is not likely for most households.

The low quality of school learning limited the translation of high intergenerational education mobility into economic mobility. The Philippines has among the highest rates of intergenerational education mobility in the world—one in five Filipinos in the 1980 cohort who were born into the bottom half of the population, ranked by years of schooling, reached the top quartile decades later. However, the low quality of education—measured by traditional cognitive skills and by non-cognitive “soft skills,” also known as socioemotional skills—has produced workers with more years of schooling but lacking in skills for competitiveness, thus constraining economic mobility. A tertiary education seems to be a ticket to many well-paying jobs but the marginal increase in the share of the labor force that has completed college limited the expansion of the middle class. In addition, dependency patterns and close tie between family members may be beneficial for supporting the education of younger siblings, especially in poorer households. While this may improve long-run economic mobility for younger siblings, that dependency also imposes a financial burden on the oldest children, which may make it more challenging for the “first generation” college graduates to swiftly move up to middle-class status in the short run.

As in many other countries, youth in the Philippines face even greater challenges in the labor market, particularly when good-quality jobs are scarce. Compared with prime age workers, youth have a higher unemployment rate, including those with tertiary education, and one out of five are not in employment, education, or training. On average, it takes Filipino high school graduate up to three years to find a first job and four years to secure a permanent wage job, and a

college graduate takes one to two years to do so. The extended periods of unemployment and underemployment after completing school reduces the value of their skills in the job market and the unmet aspirations at the start of their careers may also lead to lowered job satisfaction in the future.

Why Good Jobs Are in Short Supply and Workers Lack the Skills Required

The constraints to the creation of more gainful job opportunities come from both demand side and supply side. On the demand side, constraints on competition and binding regulations limit the dynamism of the private sector; premature deindustrialization prevents upgrade of the production structure; and lack of access to financial services inhibits business starts and expansions. All this limits the creation of well-paying jobs. On the supply side, the improved but still uneven access to education prevents the poor and vulnerable from fulfilling their potential (more daunting challenges for the ethnic minorities and indigenous populations); poor-quality schooling and mismatch between skills learned in school and those required in the job market undermined the benefits of increasing the number of years of schooling; and slow school-to-job transition lower expected lifetime earnings for youth. All this limits the economic opportunities for people, particularly those from poor households.

In addition to general constraints in the business environment, including the existing oligopolistic structure that discourages entrepreneurship and growth of micro, small, and medium enterprises (MSMEs), two obstacles limited the economic transformation and creation of more and better jobs.

Obstacle #1 Limited economic structural upgrade

Despite continuous movement of labor out of agriculture to non-agricultural jobs, the upgrade of the production structure has been limited, based on the share of high-productivity manufacturing and services over GDP and by well-paying jobs over total employment. Without continuous upgrade of the production structure, the number of well-paying jobs grew little. Premature deindustrialization, a large expansion in services jobs with much smaller growth in manufacturing, meant limited labor gains as low-end services absorbed a large share of the surplus semi-skilled agricultural labor. This was markedly different than Cambodia, China, and Vietnam, all of which have booming labor-intensive manufacturing sectors that provide large amounts of relatively well-paying jobs for semi-skilled workers, leading to large increases in productivity and wages.

Obstacle #2 Weak access to finance for micro, small, and medium enterprises

Despite progress, financial services access and use remained limited: only a third of adults have a transaction account in any financial institution and only 4 percent of small firms and 17 percent of medium firms have access to bank credit. Lack of access to finance constrains day-to-day life and hinders the ability of individuals and families to plan, save, and invest. It also affects the performance and competitiveness of firms as they cannot obtain the funding from banks and the financial markets needed to start, innovate, grow, and develop their enterprises. As a result, saving becomes difficult and costly for individuals and firms, and financial resources cannot circulate efficiently and flow to where they are needed. Challenges in access to finance are particularly severe for MSMEs, which account for 99 percent of enterprises in the Philippines and

Summary

generate nearly two-thirds of the country's total employment, resulting in a missed opportunity for business ideas to materialize and profitable firms to expand hampering the engine of growth and job creation.

Besides general constraints to human capital development, two obstacles limited the supply of skills that could meet the demand for jobs that pay well.

Obstacle #1 Inadequate quality and relevance of foundational skills acquired in basic education

Despite the increase in years of schooling, the low quality and relevance of basic education mean that employers have difficulty finding workers with the foundational skills needed to keep pace with technological changes and modern labor market needs. The Philippines' dismal PISA score—lowest among the 79 countries tested in reading literacy and second lowest in science and mathematics literacy—shows its slow progress toward improving learning outcomes, both at the primary and secondary levels. Its high rate of “educated unemployment”—unemployed people who have completed at least lower secondary education (80 percent)—suggests an urgent need to boost both the quality and relevance of basic education. In addition, an unrealistically high reservation wage for the skills that youth have or their desire to wait for secure and well-paying jobs might widen the gap between supply and demand for jobs.

Obstacle #2 Lack of socioemotional skills and technical knowledge required by the market

Despite a high association between socioemotional skills and income increases in the Philippines (especially for female workers, youth, less-educated workers, and those employed in the services sector), a growing share of firms report difficulty finding workers with the necessary socioemotional skills. In 2015, two-thirds of employers reported challenges in recruiting workers with an adequate work ethic or appropriate communication and people skills. While the global economy transitions to more technology-intensive manufacturing and service-oriented industries, demand for advanced skills will be high. In the Philippines, post-secondary education has not grown much and has been ineffective in imparting advanced technical knowledge and relevant and responsive skills. The trends in wage premiums show that higher education in the country undersupplies graduates in such fields as medicine, engineering and architecture, social science, business and law, and fast-growing service sectors. By contrast, it oversupplies areas like agriculture, the humanities, and theology.

The resulting challenges are evident in the large scale of emigration and slow school-to-job transition for the youth. Related to the lack of gainful job opportunity in the domestic market, a large share of skilled labor moves overseas where they can get higher return for the skills they have. This may be a boon for the middle class, as nearly 45 percent of middle-class households receive some foreign remittances and such remittances are the most important source of income for 18 percent of middle-class households. However, the impact of migration on the economy is complex. On one hand, remittances raise the welfare of the migrant-sending households and finance investment in human capital. On the other hand, in addition to adding stress for the migrants and the left-behind children and causing a version of “Dutch Disease,” migration may alter the incentive to pursue education and result in the uncertainty of “brain drain” or “skill flow.” Policies need to strengthen the positive impact of migration on the economy while controlling for its negative side. The loss of manufacturing sector workers and investments in education in preparation for service sector occupations—both of which are a response to foreign labor demand—help quicken

premature deindustrialization and dampen domestic economic prospects. Philippine youth face daunting challenges in getting their first jobs. Due to the lack of professional experience, the low quality of education, and mismatched skills obtained in school, and sometimes unrealistic aspirations (resulting in unrealistically high reservation wage), it takes young individuals a long time—two to three years on average—to transition from school to work. This may erode their skills and lead to frustration, which limits the expected earnings over their lifetime or make the youth more prone to migration.

Addressing the challenges in upward mobility and supporting the expansion of the middle-class requires solutions on the demand side to upgrade the production structure to create more gainful job opportunities, and on the supply side to enhance labor force skills to meet the increasingly sophisticated requirements of the job market and to improve matching.

Policy Suggestions

Productivity is essential for creating rapid and inclusive growth and is a key concern for upward mobility and middle-class expansion. As Paul Krugman argued in *The Age of Diminished Expectations*, “Productivity isn’t everything, but in the long-run it is almost everything.” Only if productive factors, including capital and labor, are effectively used, can long-term prosperity be assured; only if competitiveness is high can a country continue to grow sustainably, create more gainful opportunities for people, and support the transition of the society to middle-class status. Achieving a better economic transition requires a business environment conducive to attracting domestic and foreign investment, upgrading the value chain, and supporting the structural transformation of the economy. It also requires healthcare and education systems to support the development of human capital needed to meet the demand for the higher-level technical and socioemotional skills demanded by an advanced economic structure. In addition, it needs an efficient and equitable distribution system that can put resources to their best use. Finally, it requires a strong social protection system to help households manage risks from natural disasters and negative shocks that can trap people in low-level equilibrium. It is essential to strengthen insurance markets for middle class households and firms, while building strong systems to support the poorest and most vulnerable with public funds. The recent health and economic crisis created by the COVID-19 pandemic is yet another reminder that even the middle class is not isolated from negative shocks. Only when social protection systems are in place that protect the majority of the population will the Philippines become a true middle-class society.

Premature deindustrialization is a major reason the Philippines has not created the kind of job growth needed for rapid expansion of the middle class. Whether the boundary between manufacturing and service has been thinning and whether manufacturing can deliver the same productivity gains and well-paid employment opportunities for unskilled workers in the future as it has in the past are subjects of ongoing debate. In the era of the fourth industrial revolution, the path to better jobs in a country like the Philippines might also hinge on the “servitization” of manufacturing, draw on the comparative advantages of the country, use the young and increasingly educated labor force with an abundance of intermediate education, and adapt to global and regional challenges.

Summary

Creating more gainful job opportunities through structural upgrade, while also equipping all Filipinos with the needed skills is essential for supporting stronger upward mobility and faster middle-class expansion. The analysis in this report suggests four policy directions.

First, improve private sector dynamism and support a structural upgrade.

Firms need a level playing field on which to compete and a good flow of knowledge across firms through linkages to external markets. Strengthening firms' capabilities in innovation, management, and entrepreneurship could give rise to high-growth firms that can support economic transformation. Attracting investments in labor-intensive manufacturing to target export markets could facilitate an upgrade of the economic structure and increase demand for labor with an intermediate level of education, where the country has comparative advantages. Such support can therefore help all businesses generate good-quality jobs to support upward mobility and expansion of the middle class.

Concrete measures to increase dynamism in the private sector and support structural upgrade in the medium term include three actions. Implement the Ease of Doing Business and Efficient Government Service Delivery Act (RA11032) to reduce the cost of doing business and promote job creation. Implement the Philippine Competition Act (RA10667) and capacity building of the Philippine Competition Commission to enable fair competition. Finally, implement the Customs Modernization and Tariff Act to reduce trade costs. These measures will likely receive broad political support. In addition, existing public support programs for MSMEs could be strengthened through increasing support for firm-led innovation.

Second, improve financial services access and use.

Well-functioning, readily accessible financial services are essential to facilitate more efficient resource allocation that can support the establishment and expansion of productive firms. It requires improving financial inclusion for individuals and for firms, particularly MSMEs, and deepening the diversification of the financial system to support inclusive growth.

Specific measures include implementation of the Personal Property Security Act (RA11057) to expand access to finance to more MSMEs and rolling out the National Digital Identification System. Expanding the use of digital technology, such as moving routine cash payments into accounts, could help overcome financial inclusion challenges and support firms, especially MSMEs, to get greater access to finance. It is important to safeguard financial stability, so shocks to the financial system will not affect the savings and the financial access of the most vulnerable. It is also important to guarantee liquidity in the system, particularly while the impacts of COVID-19 are ongoing, to ensure financial intermediation and access to financial services for the population, in particular to be able to reach out to the most needed (for example, with financial support for MSMEs and households in the most affected sectors, such as services, tourism, and travel industry).

Third, improve the quality of education and enhance skills match.

Individuals need the right skills to qualify for the opportunities available in a growing market with well-paying jobs. The required reforms include raising teachers' effectiveness and competencies to improve the quality and relevance of basic education and reduce high dropout rates among the poor. Also needed are curriculum reforms both to provide demand-driven post-secondary training and

skills and to foster a well-educated and skilled workforce that can support productivity growth. Finally, more training in socioemotional, technical, and cognitive skills needs to be provided to reduce skill gaps and mismatches between the workforce and employers.

Concrete measures include improvement in the “employability” skills of senior high school students by integrating job readiness skills and labor education in school curriculums and enhancing the quality of work immersion program with longer training periods and clear training plans. Fully implement the UNIFAST program for higher education (free tertiary education tuition and subsidies). For technical and vocational education and training, invest in higher qualifications (diploma level) and university courses leading to professional licenses as these will produce graduates with higher STEM skills and would most likely end up in higher wage and higher quality jobs. To fill the knowledge gaps, the education system will need to continually analyze labor market trends and forecast the need for specific skills in key industries, as new occupations emerge in the labor market and as others become obsolete. Support for education in the Philippines is consistently high. This suggests that programs in aid of school-to-work transitions and improving the quality of education more generally are likely to receive broad support.

Fourth, improve support for school-to-work transition.

The lifetime earnings and upward mobility of youth depend on gaining early employment in a well-paying job. Improvement in this area requires helping students and jobseekers make informed training and career decisions, providing them with information on employment trends not just current job vacancies to prepare them for the jobs that will be available when they complete training or graduate from school. It is also important to provide incentives, such as tax cuts, or pass a legislative measure to encourage firms to hire more youth and new graduates, particularly senior high school graduates.

Concrete measures include improving the branding and increasing the institutional capacity of public employment service offices to cater to the unique needs of young jobseekers, increasing the effectiveness of the matching mechanism, and encouraging these young workers to use various government employment programs. Implement the First-Time Jobseekers Assistance Act (RA11261) to waive the fees for government certificates and clearances for first-time jobseekers, estimated to benefit more than 1 million new labor market entrants annually. Youth employment programs should not be a standalone or single service. The Department of Labor and Employment JobStart program has been successful not only because it puts a premium on soft skills and development of training plans with partner employers but also because it recognizes that employment facilitation should offer a “menu of complementary services” ranging from job search/matching assistance, career counselling/coaching, provision of LMI, internship, job fairs, and online support service. Offering one service without (at least linking with) the other important ingredients for getting “job ready” would be inadequate and ineffective.

1. Becoming a “Prosperous, Predominantly Middle-Class Society”

Cora, James, and their two children epitomize the modern middle class in the Philippines. Cora is 35 and James is 37. She is a working mother and he is a project manager. Both have a tertiary education. They are salaried workers and have been working consistently since they finished college.

Their total household income is PhP 100,000 per month excluding allowances and benefits. Since both are employed as full-time regular staff in their private sector companies, they have the full range of legally mandated benefits plus health maintenance organization (HMO) coverage for the entire family. The couple owns their house and pays for life insurance coverage, setting aside some savings each month which they use for travel. They recently were able to buy a car, but Cora still commutes 2.5 hours every day.

James and Cora’s children both go to private elementary schools near their house (for a tuition fee of PhP 40,000 a year), and neither she nor her husband are from wealthy families. Their life now as a family is an improvement in terms of income and amenities compared to their own families when they were growing up.

Their leisure activity is to travel as a family, and they save up for it very carefully every year. They have been to Singapore, Korea, and Japan. Every year they try to go somewhere. On weekends they have simple pleasures, resting at home and going to public parks for picnics so that they can save money. Neither one of them has credit card debt and they try to pay for things fully if they can afford it.

The family is well prepared and secured for many things, achieved through savings, financial investments, and insurance. The remaining vulnerability for the family is the costs of a catastrophic illness, which their current medical insurance coverage does not sufficiently cover. Cora’s remaining concern is finding more time to spend with her children, because when she gets home at the end of her long commute, the children have already gone to bed.

Study Rationale

1.1 The government of the Philippines launched AmBisyon Natin 2040 in 2016, a long-term vision and aspiration for the Filipino people. The vision states “the Philippines will be a prosperous, predominantly middle-class society where no one is poor; our peoples will live long and healthy lives, be smart and innovative, and will live in a high-trust society” (NEDA 2016).

1.2 Compared to many East Asian countries, however, the Philippines has exhibited little progress of the distribution of economic classes over the past decade despite strong economic growth. According to *Riding the Waves* (World Bank 2017a), in East Asia the economically secure and middle class increased to nearly two-thirds of the population in 2015 from just over one-fifth in 2002; meanwhile the ratio in the Philippines increased from 37 percent to just 44 percent. More

effort on improving the dynamism of the economy and improving upward mobility without dividing the country is needed to achieve the ambitious goals of AmBisyon Natin 2040.

1.3 **This study aims to inform these efforts through an in-depth examination of factors that affect upward mobility and middle-class expansion in the Philippines.** The analysis draws from a variety of sources: objective information from micro surveys, including the Family Income and Expenditure Survey (FIES), Labor Force Survey (LFS), and Occupational Wage Survey (OWS); subjective information from Gallup World Poll, International Social Survey Programme, and Pew Research Center; as well as focus group discussions and interviews. The report portrays the lives of the middle class and other income groups in the Philippines and identifies the main impediments to upward mobility and more rapid expansion of the middle class in the past decade. It focuses on specific constraints that affect the creation of more and better jobs. It considers, on the demand side, the importance of a structural upgrade to increase the dynamism of the private sector and thereby create more well-paying job opportunities. It also considers, on the supply side, improvements in skills and education necessary to have a labor force ready to seize these opportunities. Finally, the report recommends policy interventions that the government can implement over the next three to five years to support faster upward mobility and provide all Filipinos the opportunity to realize the dream: a prosperous middle-class society free of poverty by 2040.

1.4 The remainder of this chapter describes major trends in economic growth and middle-class development over the past decade, and their linkages. Chapter 2 examines the profile of the Philippine middle class, and chapter 3 discusses the constraints to upward mobility and reasons the expansion of the middle class has been limited. Chapters 4 and 5 focus on the role of more and better jobs in middle-class expansion from the job demand and labor supply perspectives. Specifically, chapter 4 elaborates on the reasons the private sector could not have created more high-paying jobs, highlighting the hindrance of the dynamism of the private sector, premature deindustrialization, and lack of access to finance. Chapter 5 examines why the supply of skills could not have been more prepared to match the demand in the job market, emphasizing the obstacles of uneven access to education, low quality of basic education, and prevalent skills mismatch, exemplified by the slow school-to-work transition for youth. Finally, chapter 6 discusses the constraints to more rapid upward mobility and provides policy suggestions to support the development of the middle-class society in the Philippines.

Defining the Middle Class

1.5 **“Middle class” can be defined in many ways, including monetary terms in either an absolute sense (above a certain monetary threshold) or in a relative sense (above a certain percentile of income), by occupation or social hierarchy, and subjective versus objective (Box 1.1).** Subjective, or perceived, social status is more complex than statistical measures. While perception is not directly linked to a household’s absolute income level, as people tend to compare themselves with people they interact most with, who often have similar status, there is a positive association between the objective income and perception of belonging to the middle class.¹ This

¹ See Appendix A for further discussion on the relations between objective incomes and perceptions, drawing from the data of International Social Survey Programme in the Philippines.

report adheres to an absolute threshold using a constant measure over time and across countries: \$15 per day measured in 2011 purchasing power parity (PPP).²

Box 1.1. Different Ways to Define “Middle Class”

The literature defines “middle class” in many different ways. One stream refers to the wealthier segment of the population, such as above a certain threshold, while another stream refers to the middle portion of a social hierarchy (not defined in economic terms). The latter sense—“middle of the class”—is not used in this report. The thresholds used include both monetary measures, such as income,^a and non-monetary measures, such as occupation,^b education, and asset possessions.^c Within monetary definitions of middle class, the thresholds can be either absolute or relative. Definitions with absolute thresholds use fixed real values over time and space. For example, Ravallion (2009) defines middle class as those who earn \$2 to \$13 per day (PPP). Such measures are convenient in tracking transitions between classes over time and space as well as monitoring the composition of each class within an economy. It is a common measure to gauge the size of the middle class in different countries or changes over time. Other measures use relative thresholds that change with average income or consumption. Birdsall and others (2000), for instance, defines the middle class as those who earn per capita income between 75 percent and 125 percent of the median per capita income. These relative measures are often used to mark changes in the profile of the middle class.

While statistical definitions of the middle class are many and varied, middle class is also a matter of perception. Studies have proposed that, in fact, individuals tend to build social networks with those who are most like them based on a range of characteristics (McPherson, Smith-Lovin, and Cook 2001). When assessing their social position, if they consider the individuals they interact with most closely as a comparison group, this would lead them to rank themselves approximately in the middle of the distribution of incomes for that group rather than the country as a whole (Clark, Frijters, and Shields 2008). Alternatively, this may result in a biased perception of the wealth of the country, leading individuals to think they belong nearer to the middle of the distribution than they do (Dawtry, Sutton, and Sibley 2015). Other factors may also influence perceptions of income or social, education, and health status for example (Ravallion and Lokshin 2002). In this sense, many households with income above the threshold of \$15 per day might not consider themselves part of the “global middle class,” while those who are poor might not perceive themselves as “poor” either. However, objective income still matters: there is a positive relationship between the perception of belonging to middle class and objective income, and between the perceived financial situation and objective income.

In the Philippines, a definition of middle class started to form after the late 1950s, when the social hierarchy was typified by peasant-lord relationships.^d More recently, Urbanski (2009) defines middle class in the Philippines as those who work as professionals, technicians, and administrative managers in government or private companies. Virola and others (2007, 2010, 2013) uses cluster analysis of income to define five population clusters, using the ranges of income in the second and third clusters as the thresholds for middle class. Albert and others (2018) uses multiples of official poverty line to define the thresholds for lower middle class (2~4 times), middle middle class (4~7 times), and higher middle class (7~12 times).

a. Ravallion 2009; ADB 2010; Milanovic and Yitzhaki 2002; Virola and others 2007, 2010, 2013; Albert and others 2018; Kharas 2017) and consumption (Banerjee and Duflo 2008).

b. Urbanski 2009, Murphy 2011, Nijman 2006.

c. Birdsall 2010, Bersales and others 2013, Rivera 2011.

d. Cespedes and Gibbs 1972.

e. The various measurement methods yield differing trends and profiles of the classes.

² Using an absolute threshold with a constant measure over time and across countries has pros and cons compared with using country- and time-specific measures. Recent World Bank reports on the middle class in the Latin America region (World Bank 2013) and in countries such as Indonesia provide rich discussions of middle class, including the different measures of middle class in the literature.

1.6 For easy comparison with countries in the region, this report uses the method of *Riding the Waves* to classify the population into five economic classes. These include extreme poor as per capita household income below \$1.90 a day, 2011 PPP; moderate poor as between \$1.90 and \$3.20; economic vulnerable as between \$3.20 and \$5.50; economically secure as between \$5.50 and \$15; and global middle class as above \$15. Various methods of measurement yield different snapshots of trends and profiles of the different classes. This measure serves as a credible yardstick for cross-country comparison and for the examination of trends of changes over time in the Philippines.

Box 1.2. How to Read this Report

This report focuses on the medium- and long-term structural issues that hinder faster upward mobility and more rapid expansion of the middle class in the Philippines. Its sources of information include the government’s household survey, labor force survey, subjective survey, and administrative data, as well as qualitative information obtained through interviews and focus group meetings. When the report was prepared, the 2018 Family Income and Expenditure Survey (FIES) had been completed, but the complete data were not yet available. Therefore, the FIES 2015 data, the most recent official household survey available was used for the analysis, including profiling the characteristics of the middle-class households and comparing them with other economic groups. Early results from the FIES 2018 suggest that household income growth and poverty reduction continued to accelerate during 2015–18. Moreover, the patterns of growth and income distribution remained largely unchanged prior to the COVID-19 pandemic. As the pandemic is still evolving and its social and economic impacts are still unfolding, information from the FIES 2018 and subsequent other rounds of this and other data sets will be essential to understand the impact of COVID-19 on the economy and on the expansion (or contraction) of the middle class.

Rapid Economic Growth and Limited Upward Mobility

1.7 **The Philippines has experienced rapid economic growth in recent years.** Favorable domestic and external conditions supported the acceleration of gross domestic product (GDP) growth to an average annual rate of 6.3 percent in 2010–19,³ surpassing the average of both structural and regional peers.⁴ This average growth rate is significantly higher than the 4.5 percent growth in 2000–09 and 2.8 percent in 1990–99.

1.8 **The country’s economic vitality was anchored in strong domestic demand with household consumption commanding an annual average of 71.1 percent of real GDP in 2000–19.** Since the 2000s, consumption has been supported by robust remittance flows, receipts from a buoyant business process outsourcing industry, and improving labor market conditions (World Bank 2019a). As a result, per capita gross national income, a welfare measure that captures both domestic production and net income from overseas, grew higher at an average of 4.3 percent in 2010–19 from 3.4 percent in 2000–09.

1.9 **Compared with other countries in East Asia, in the past decade, the average rates of GDP growth and GDP growth per capita for the Philippines both rank tenth in the group,**

³ This report uses PSA National Accounts data using 2000 base year.

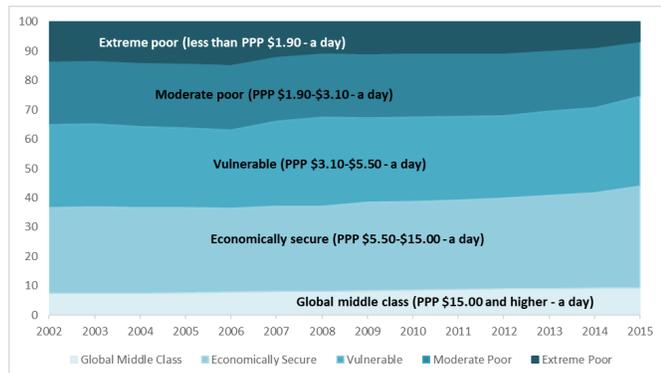
⁴ Structural peers for the Philippines are Bangladesh, Kenya, Morocco, Pakistan, Sri Lanka, and Vietnam based on the following criteria: lower middle-income countries with natural resource exports comprising less than 20 percent of exports, an above average score on the Natural Disaster Risk Index, a population of more than 20 million, an oil importer, exports not concentrated according to the Herfindahl index, and not landlocked countries, small states, or fragile states. China, Indonesia, Malaysia, Thailand, and Vietnam are considered regional peers.

some 4–5 percentage points lower than the stellar performers, such as China, whose GDP growth averaged 9.6 percent (9.05 percent in per capita terms), Myanmar 9.2 percent (8.4 percent in per capita terms), and Mongolia 8.4 percent (6.7 percent in per capita terms). The 5.4 percent annual GDP growth rate in the Philippines is translated into 3.6 percent growth in GDP per capita and a mere 1.6 percent of household income per capita growth.

1.10 Rapid economic growth did not translate into a notable increase in upward mobility (Figure 1.1). Like the perceptions of the focus groups, compared with many East Asian countries, data from official sources including the Family Income and Expenditure Survey (FIES) show little dynamism in expansion of the middle class.⁵ Strong aggregate economic growth did not translate into commensurate rapid income growth at the household level, despite a slight decline in the income Gini from 47 in 2006 to 44 in 2015. Along with a relatively fast-growing population, growth of income per capita at the household level averaged only 1.6 percent annually during 2006–15. While the numbers of people in the middle class increased from 6.7 million in 2006 to 9.3 million in 2015, and that of the economically secure increased from 24.2 million to 35.3 million, their relative shares of the total population remained low. In 2015, while only 6.6 percent of the population was extremely poor (below \$1.90 a day, 2011 PPP), 18.7 percent was moderately poor (\$1.90 to \$3.20 a day), and 30.8 percent was economically vulnerable (\$3.20 to \$5.50 a day), only 34.7 percent was economically secure (\$5.50 to \$15 a day), and only 9.2 percent was in the global middle class (above \$15 a day).

Figure 1.1. Shared Prosperity Over Time in the Philippines Compared with the East Asia and Pacific Region

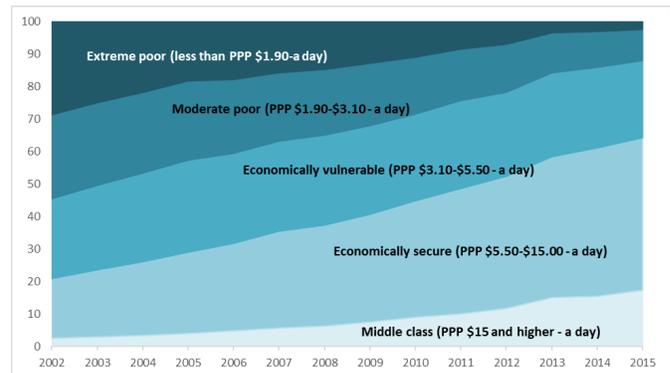
A. Population distribution by economic class in the Philippines, 2002–15



Percent of total population

Source: East Asia and Pacific Team for Statistical Development.

B. Population distribution by economic class in East Asia and Pacific, 2002–15



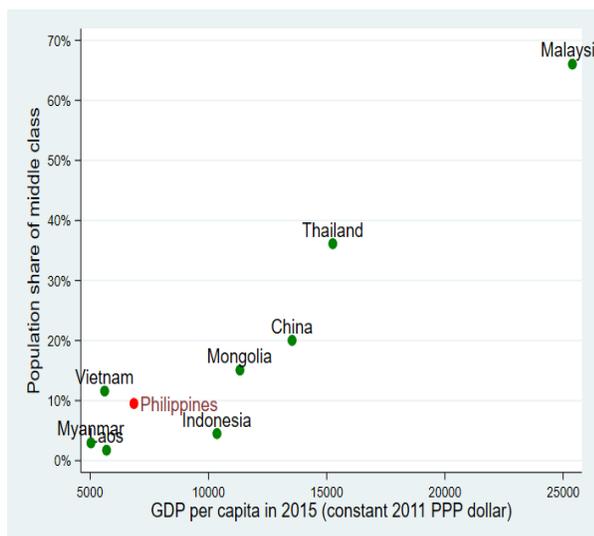
1.11 The lack of dynamism in upward mobility in the Philippines is in stark contrast with many developing countries in East Asia and the Pacific. The economically secure and middle class comprised two-thirds of the region’s population in 2015, up from just over a fifth of the

⁵ At the time this report was prepared, the FIES 2018 full data were not yet accessible. Household income information in this report therefore draws from the FIES 2015. The official results from the PSA website drawing from the FIES 2018 information suggest that household income growth and poverty reduction accelerated during 2015–18 compared with the previous period 2012–15, which was more favorable compared with the earlier years since the mid-2000s. The size of the middle class is expected to continue to expand more rapidly during 2015–18.

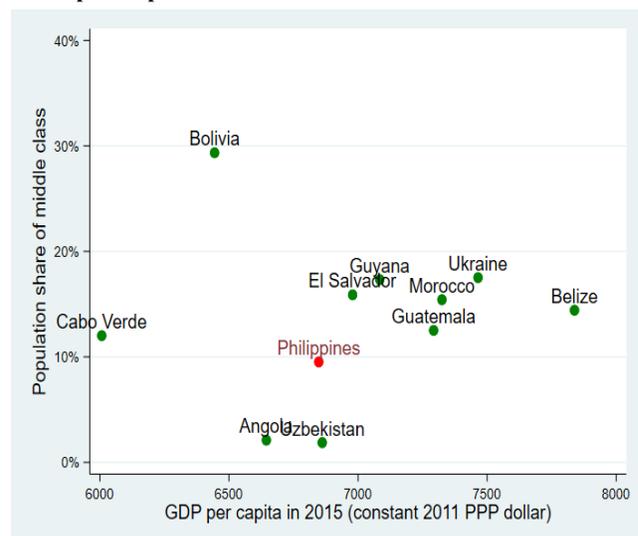
population in 2002. In the Philippines, the increase was very modest, however, with a rise from 37 percent to 44 percent.⁶ The Philippines not only has a small middle class compared to both regional peers and most countries at similar levels of economic development but also with a slower expansion. The population share of the middle class in the Philippines was about half of the developing East Asia and Pacific region’s 17.7 percent in 2015. Among its regional peers, the Philippines performed poorly compared to Malaysia, Thailand, China, Mongolia, and Vietnam, but fared better than Indonesia, Myanmar, and Lao People's Democratic Republic (Figure 1.2A). When compared with countries at a similar level of GDP per capita, the Philippines only outperforms Angola and Uzbekistan (Figure 1.2B). Almost all regional peers more than doubled the share of middle-class population during 2002–15, but the size of the middle class in the Philippines expanded less than 2 percentage points from 7.4 percent to 9.2 percent, or less than 25 percent (Figure 1.3).

Figure 1.2. The Philippine Middle Class Compared to Peers

A. Share of middle-class population among regional peers



B. Share of middle-class population among economic development peers

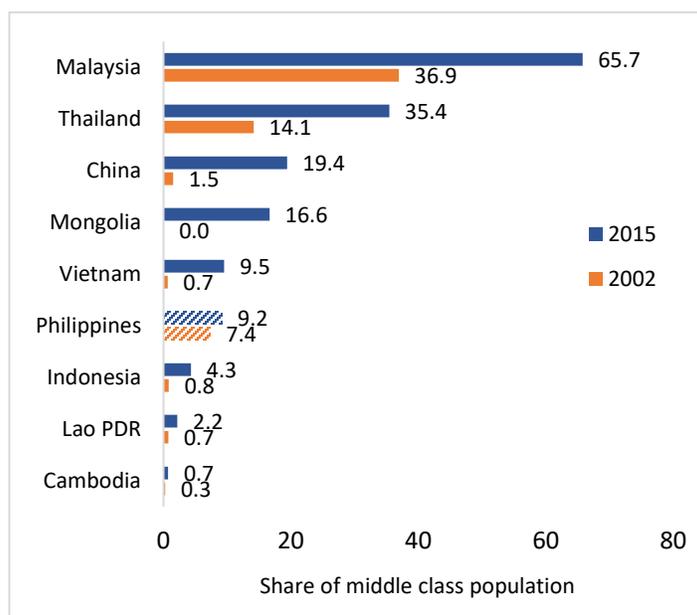


Source: Staff calculation based on World Bank PovCalNet and World Development Indicators

⁶ However, a lack of panel data for recent years prevents examination of the pattern of mobility and the profile of the individuals and households that had moved upward or downward.

1.12 The expansion of the middle class in the Philippines is not only slower than the East Asia countries but also the developing countries in general. The Philippines’ average annual expansion of the size of middle class (3.7 percent) was lower than the average among developing East Asia and Pacific countries (16.6 percent) and developing countries in general (9.4 percent) (Table 1.1). The mean daily income of the middle class in the Philippines is within the range of that in developing East Asia and developing countries in general.

Figure 1.3. Expansion of Middle Class, 2002–15



Source: PovCalNet

Table 1.1. Metrics Comparison Between the Philippines and Other Country Groupings, 2015

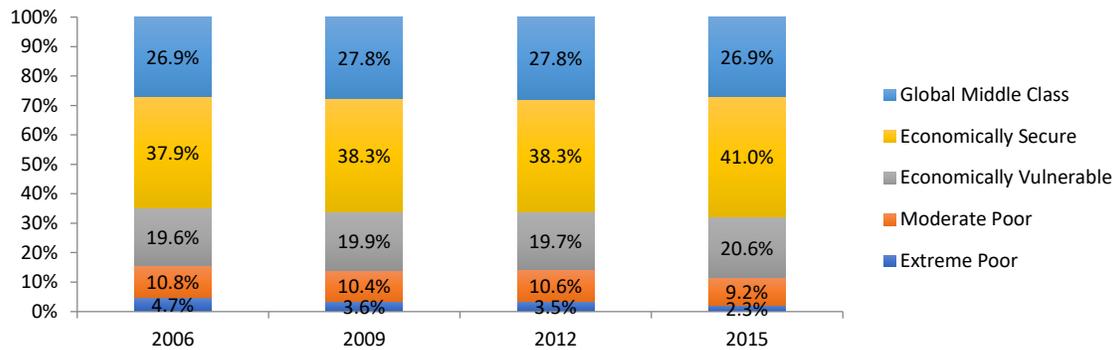
	Philippines	Developing East Asia and Pacific	Developing countries
Share of the middle class in total population (in percentage)	9.2	17.7	12.8
Mean daily income of the middle class (in U.S. dollars)	26.6	25.7	28.4
Growth of middle class (annualized rate between 2005–15)	3.7 (2006–2015)	16.6	9.4

Notes: Developing East Asia and Pacific includes Cambodia, China, Fiji, Indonesia, Lao People’s Democratic Republic, Malaysia, Mongolia, Myanmar, Papua New Guinea, Philippines, Solomon Islands, Thailand, Timor-Leste, and Vietnam. Developing countries include all non-OECD countries. The \$15 per day PPP threshold is used to account for the population of the middle class throughout the period 2006–15. The growth of the middle class is the compounded annual growth rate of the middle-class population. For country groupings, we add the population of the middle class and total population across countries to get the middle-class population and total population for the groups.

Source: Staff calculation and World Bank PovCalNet

1.13 The share of national household expenditure by various economic classes changed little over time (Figure 1.4). The share of middle-class household consumption hovered around 27–28 percent during the years 2006–15. The consumption share of the economically secure grew slightly from 38 percent in 2006 to 41 percent in 2015, while the share of extreme poor and moderate poor combined—due to the shrinking size as more people were lifted out of poverty—declined from 16 percent in 2006 to 12 in 2015.

Figure 1.4. Share of National Total Household Expenditure by Economic Class, 2006–15



Source: FIES various rounds

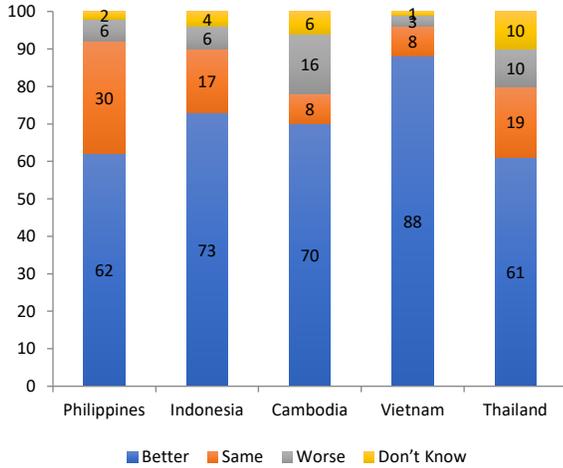
1.14 **Many studies, using various definitions of middle class, have similar findings of limited upward mobility in the Philippines.** For example, Virola and others (2007, 2010, 2013) find that the middle class, defined as PhP 65,787 to PhP 805,582 annual per capita income using the 2006 price, was stagnant at about a quarter of the population for the period 1997–2009. Albert and others (2018) find that the middle class, defined as PhP 18,200 to PhP 109,200 monthly family income at 2015 prices, makes up about 40 percent of the population and hardly changed during 2006–15. Martinez and others (2014), using longitudinal subsamples in the earlier years (from 2003, 2006, and 2009 FIES surveys), find that, while there is considerable relative mobility, the average consumption level barely increased. They find that the household income distribution of the Philippines is much more dynamic than conventionally thought—72 percent of the population moved into a different income decile and 53 percent moved into a different quintile during the period, but overall mobility is neutralized by this symmetrical upward and downward mobility.⁷

1.15 **The lack of dynamism in upward mobility may have contributed to the less favorable subjective perceptions of the public** (Figure 1.5). Compared with many other East Asian countries, people in the Philippines are less optimistic about the improvement of welfare for the next generation. According to the Gallup World Poll (2016), only 62 percent of Filipinos believed that the standard of living for their children would be better than their parents when they grow up, which compared to a similar percentage in Thailand, 70 percent and 73 percent in Cambodia and Indonesia, and significantly lagged Vietnam (88 percent). Similarly, the gaps between the poor and the rich might seem more insurmountable for people in the Philippines. According to the Pew Research Center (2014), 53 percent of Filipinos believe that the gap between the rich and the poor is a very big problem, which is higher compared to Indonesia, Malaysia, Thailand, and Vietnam.

⁷ In other words, for every person who experienced an income increase at any point in the income distribution, another individual or a commensurate number of individuals experienced an income decline.

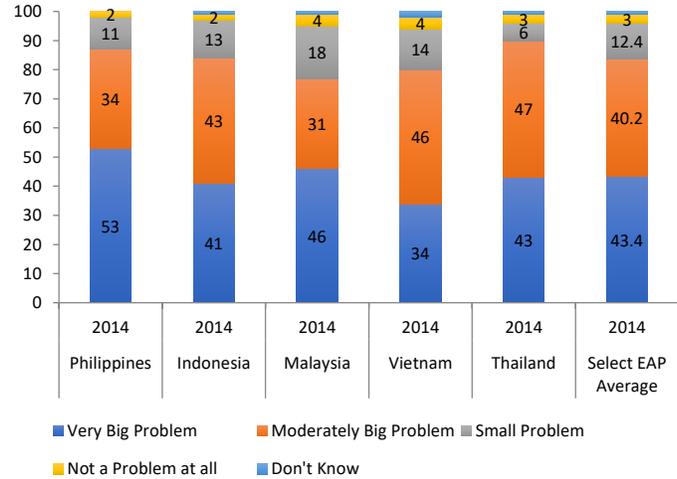
Figure 1.5. General Public Perceptions in the Philippines Compared with Selected Countries in the East Asia and Pacific Region

A. Perception of standards of living of children compared with parents



Source: Gallup World Poll, 2016

B. Perception of gaps between the poor and the rich as a problem



Source: PEW Research Center, 2014

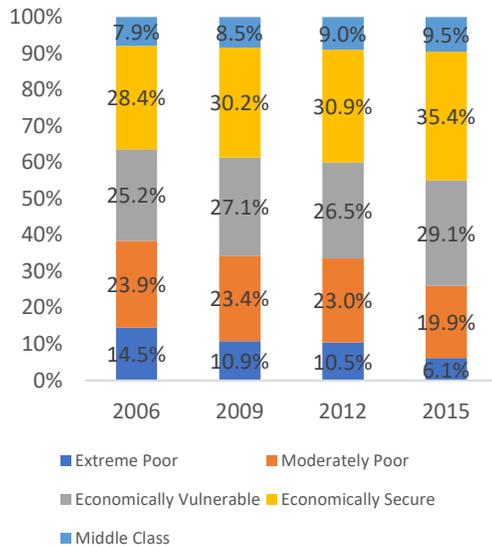
1.16 Guided by AmBisyon Natin 2040, the government aims to triple real per capita incomes and eradicate poverty by 2040. This implies that the Philippine economy needs to grow at an annual average of 6.5 percent in the next 22 years, faster than the average growth of 5.3 percent since 2000⁸ (World Bank 2018a). Following the same ambition and vision, assuming a distribution-neutral annual GDP growth rate of 6.5 percent, how long will it take for the current extremely poor to transition into the global middle class? A simple simulation exercise following Morduch (1998)⁹ shows that the average transition time for the extremely poor to move into the middle class starting from 2018 is 35 years; the moderately poor 27 years; the economically vulnerable 19 years; and the economically secure 8 years (Figure 1.6). To achieve the AmBisyon Natin 2040 goal of creating a predominantly middle-class society in the Philippines, upward mobility will need to speed up, requiring concerted effort to accelerate growth and facilitate more inclusive distribution.

⁸ This assumes a neutral growth distribution.

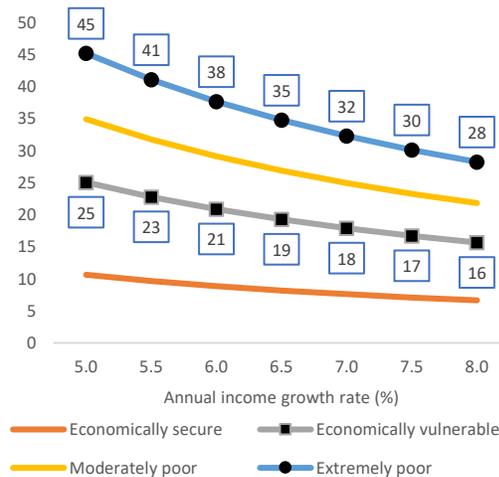
⁹ If the income of household grows at a constant positive rate g per year, the relationship of the middle class income threshold to current income can be written as $z = y_i(1 + g)^{t_i^g}$, where z is the income threshold of middle income class, y_i is current income for household i , t_i^g is the time it takes for household i to reach income level z . This relationship implies that t_i^g is approximately $\frac{\ln(z) - \ln(y_i)}{g}$.

Figure 1.6. Population Distribution by Economic Class and Average Transition Time into the Middle Class

A. Share of income group to population



B. Average transition time into the middle class (years)



Source: World Bank PovCalNet

1.17 Repeated and increasingly frequent natural disasters result in severe economic loss and undermine upward mobility in the Philippines. The country suffers a high asset loss due to disasters each year (PhP 70 billion). When disasters strike, the poor are more likely than the middle class to have to make tough tradeoffs between spending on food, housing, education, and reconstruction, which might delay actual recoveries and push poor households deeper into poverty or prevent them from escaping it. Lacking socioeconomic resilience, the poor and even the economically secure often must scale back discretionary spending with significant long-term consequence in response to disasters, which limits their upward mobility. The middle class is not immune, however. According to an estimate, each year, 1.8 percent, or 200,000 middle class individuals, are pushed out to economically secure or worse due to disasters; 4 percent, or 1.1 million economic economically vulnerable are pushed into poverty.¹⁰ Investing in disaster risk management in countries with frequent disasters, like the Philippines, can help not only save lives and avoid losses but also reduce risks and uncertainty to stimulate investment, including those with a long time horizon, which is crucial for growth (Hallegatte and others 2016).

1.18 The most recent economic disaster, produced by the COVID-19 pandemic, offers a gloomy outlook for the rest of 2020 and will have extensive impact on livelihoods and mobility. For the Philippines, the National Economic and Development Authority (NEDA) issued an early estimate in March showing a cumulative loss of PhP 131 billion to PhP 268.8 billion in gross value added (GVA) in current prices in total on the areas of transport and tourism, exports, remittances and consumption. This is equivalent to 0.64 percent to 1.39 percent of the 2020 nominal GDP. These numbers will likely change with later analysis. The dire challenges of slower growth,

¹⁰ See Appendix B for details.

disruptions in the supply chains from both the supply and demand sides, and regional and global uncertainty that will affect trade and investment, will worsen the job outlook for skilled and unskilled alike, lower returns to physical and human capital, and limit upward mobility. This is discussed further in Chapter 3.

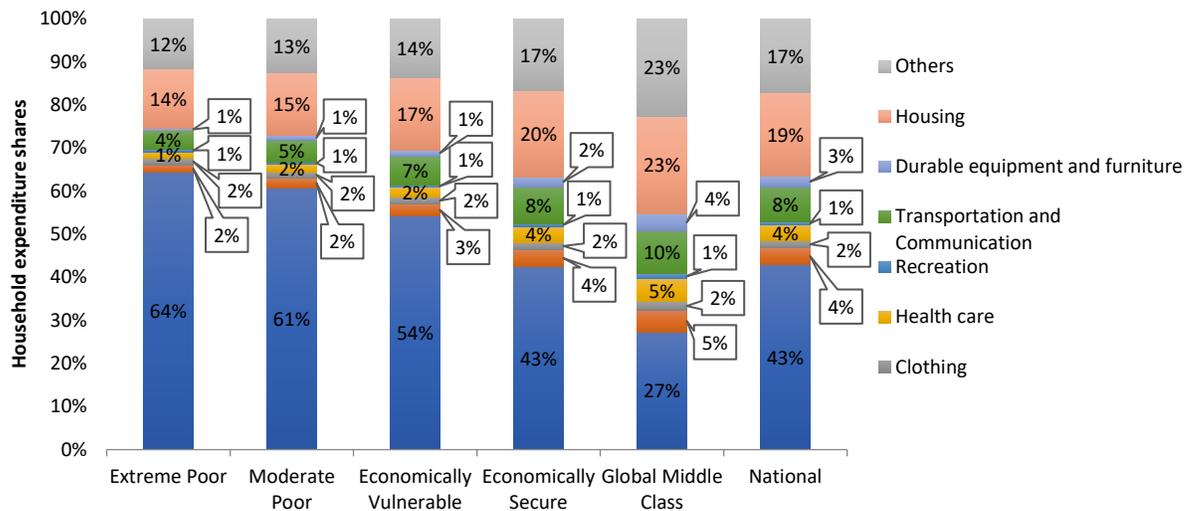
Middle-Class Expansion and Economic Growth

1.19 The expansion of the middle class and economic growth are strongly associated. The association can be viewed from two perspectives. The first is that economic growth brings more people out of economic vulnerability and into the middle class (Dollar and Kraay 2002). Growth increases an economy’s productive potential and creates opportunities to raise household incomes. The second perspective is that the middle-class expansion is itself a driving force of the economy. In most cases, countries with a larger middle class tend to grow faster (Easterly 2001). A larger middle class brings with it new economic demands, including products and services of higher quality, which support the upgrade of the economy, leading to further growth. In bridging these two perspectives, Birdsall (2010) emphasizes that the emergence of a middle class and economic growth constitute a virtuous self-reinforcing cycle, but more importantly on the policy implications, they underline that a focus on the middle class does not exclude a focus on the poor but extends it, because a pattern of growth that is good for the majority of people is more likely to be economically and politically sustainable.¹¹ A burgeoning middle class potentially can support economic growth through four channels: (i) consumption and domestic demand, (ii) human capital accumulation, (iii) domestic savings, and (iv) contribution to public goods.

1.20 The first channel captures the enhanced consumption pattern and stable domestic demand that is typical of the middle class. The middle class stands out for having a well-diversified expenditure pattern, which balances basic needs and the desire for new and more value-added goods. It is such a desire for the niche that provides profit incentives of innovation and replenishes investments in production, which in turn generate growth (Murphy, Shleifer, and Vishny 1989). In a consumption-driven economy, the Philippines’ middle class shows a more diversified expenditure pattern compared to the other economic classes. In 2015, the middle class spent less than a third of total expenditure on food, compared to over 60 percent for the extreme poor and moderate poor, over 50 percent for the economically vulnerable, and over 40 percent for the economically secure (Figure 1.7). The expenditure shares on housing, transportation, communication, health care, and education are all highest for the middle class. Such a consumption pattern makes the middle class the backbone to maintain the complexity and quality of goods and services as a vigorous and sizable consumer market is fundamental to reward costly innovations and capital-deepening (Rosenstein-Rodan 1943).

¹¹ See Besley and Kanbur (1990) and Gelback and Pritchett (2000).

Figure 1.7. Expenditure Patterns by Economic Class, 2015



Source: Staff calculation using FIES 2015

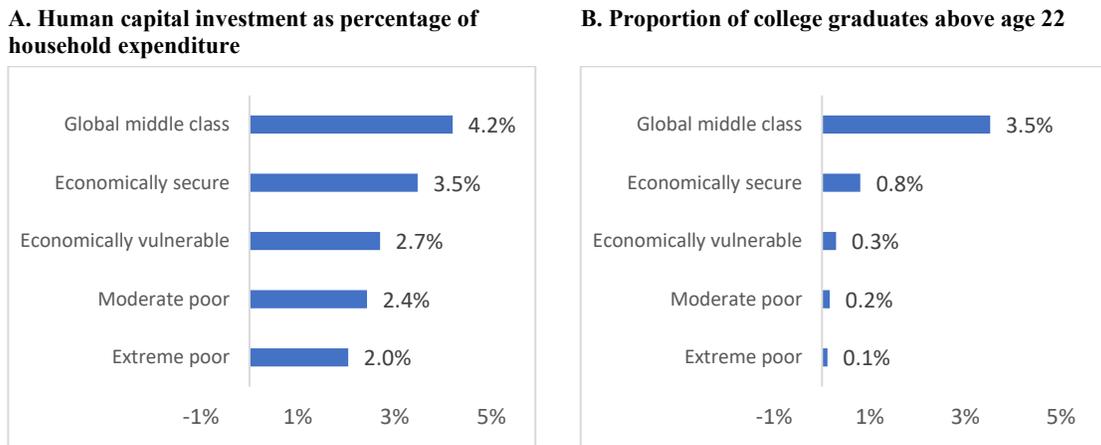
1.21 The second channel rests on increased human capital accumulation in households.

Investment in human capital, innovation, and knowledge are significant contributors to economic growth (Romer 1986). The emphasis of the middle class on the accumulation of human capital makes them central to the process of growth. Banerjee and Duflo (2008), for example, find that the middle class¹² spends much more proportionally per child on education.¹³ This investment in education is partly due to a less constrained budget compared to the poor and vulnerable, and partly rooted in the desire of the middle class for improved skills and productivity, and enhanced economic competitiveness (Doepke and Zilibotti 2005 and 2007). In the Philippines, as in many other developing countries, private human capital investment is significantly higher in the middle-class families. Defined as the per capita household expenditure on education, nutrition, and preventive medical services, human capital investment is the highest (4.2 percent) in the middle class compared to the other economic classes. The middle class also has the highest share of college graduates (3.5 percent) among people older than 22 (Figure 1.8). Meanwhile, middle-class families tend to have fewer children, which is linked to their greater resource investment per child. The continuous expansion of the middle class may have implications for demographic transition and human development as well.

¹² They define the middle class as those who have per capita household expenditure in the ranges of \$2 to \$4 (the lower middle class) and \$6 to \$10 (the higher middle class).

¹³ The study is based on data from Ivory Coast, Pakistan, Udaipur, Nicaragua, Panama, Papua New Guinea, Tanzania, and East Timor.

Figure 1.8. Household Human Capital Investment and College Graduates by Economic Class, 2015

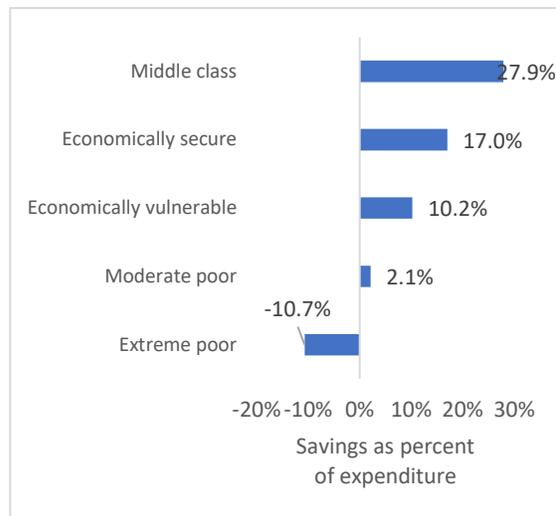


Source: Staff calculation using FIES 2015

1.22 The third channel is the higher domestic savings of the middle class, which helps finance investments and entrepreneurship. Savings is a major source of domestic financial capital that can drive productivity growth (Arthur 1954). Domestic savings matter for innovation and growth because higher savings can translate into higher levels of productive investments. In many countries, the availability of savings also enables local entrepreneurs to put equity into the cooperation with foreign investors who are normally equipped with frontier technology (Aghion and others 2016). In the Philippines, saving rates are significantly higher among middle-class families compared to the rest. In 2015, middle-class households saved 28 percent of their total household income, 65 percent higher than the economically secure class, more than twice that of the economically vulnerable, and more than four times that of the moderate poor (Figure 1.9).

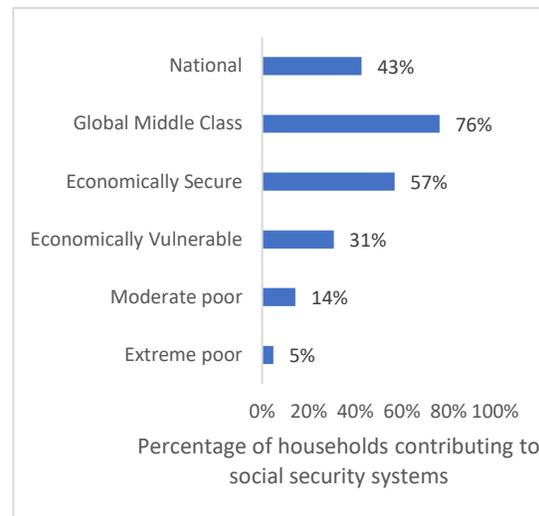
1.23 The fourth channel is through the contribution of the middle class to public goods provision, mainly through tax revenues. The middle class is observed to be more productive and better able to pay taxes and bear the cost of public investments and services than other economic segments of society (Porta and Shlefer 2014 and Daouda and others 2019). They are the main contributors to public goods provision in transportation, energy, and education, which can expand the productive capacity of the nation, and are essential complements to private investments (Fisher and Turnovsky 1998, Goodin and Grand 2018). In the Philippines, the middle class has the highest share of formal employment, and thus, the highest probability of becoming a part of the much-needed tax base. Using the contributions to social security systems (pension, housing, and health insurance funds) as the proxy of formal employment and incorporation into the government fiscal system, 76 percent of the Filipino middle-class families are contributing to social security systems, compared to 57 percent in the economically secure class, 31 percent in the economically vulnerable class, 14 percent in the moderately poor class, and only 5 percent among the extreme poor households (Figure 1.10).

Figure 1.9. Household Savings by Economic Class, 2015



Source: Staff calculation using FIES 2015

Figure 1.10. Share of Households Contributing to Social Security Systems by Economic Class, 2015



Source: Staff calculation using FIES 2015

1.24 At the current stage of development, for the Philippines, as for most developing countries, growth-driven expansion of the middle class will result in further growth, according to the simulation results by Brueckner (2019).¹⁴ The analysis draws on data from 164 countries in the period 1980–2015 and remains robust when restricted to ASEAN countries and the post-2000 period. It suggests that, for developing countries, an increase in the population share of the middle class that is driven by growth in GDP per capita has positive effects on the incomes of other segments of the population (the extreme poor, poor, economically vulnerable, and economically secure); while that driven by redistribution from the upper class to the middle class has negative effects due to the drag on savings and investment.¹⁵ In the Philippines, the effect of an expansion of the middle class driven by growth is particularly strong for the economically secure.

1.25 Meanwhile, expansion of the middle class may also result in changes of government policies due to the difference of the attitudes toward government spending between the middle class and the rest of the population. Overall, the global middle class in the Philippines has been more likely to support government spending on education and health, less likely to support redistributive policies, and less likely to support government provision for the unemployed than other income groups, according to the data from the International Social Survey Programme (ISSP) 1996, 2006, and 2016.¹⁶ As the middle class gradually expands and their voter turnout increases,

¹⁴ The analysis is based on Markus Brueckner, “The Middle Class and Economic Growth: A Case Study for the Philippines,” a World Bank–commissioned background paper, July 2019. The paper examines an empirical relation between the middle class and economic growth and differentiates between redistribution-driven and growth-driven approaches to the middle-class expansion. See Appendix C for details.

¹⁵ See also Galor and Zeira (1993) for the discussion of the links between inequality and economic growth at the different stages of development.

¹⁶ See Appendix D for details.

the impact on the direction of the government decision-making will increase. As revealed in several circumstances, including the ongoing COVID-19 pandemic, the poor and vulnerable, many of them informal and dayworkers, are more affected by negative shocks. Having policies in place to swiftly protect the bottom of the distribution in various ways is crucial not only for limiting loss in the short-term but also for sustainable growth in the medium and long term. Supporting the design and implementation of policies that catalyze faster and more inclusive growth as well as strengthening the built-in protection of the poor and vulnerable in times of uncertainty are key as the size of the middle class continues to expand.

2. Profile of the Philippine Middle Class

2.1 This chapter profiles the global middle class in the Philippines—who they are, where they are, and what income sources and consumption patterns they have drawing from information of micro surveys. It pictures the types of lives they live in contrast with other groups with lower income.

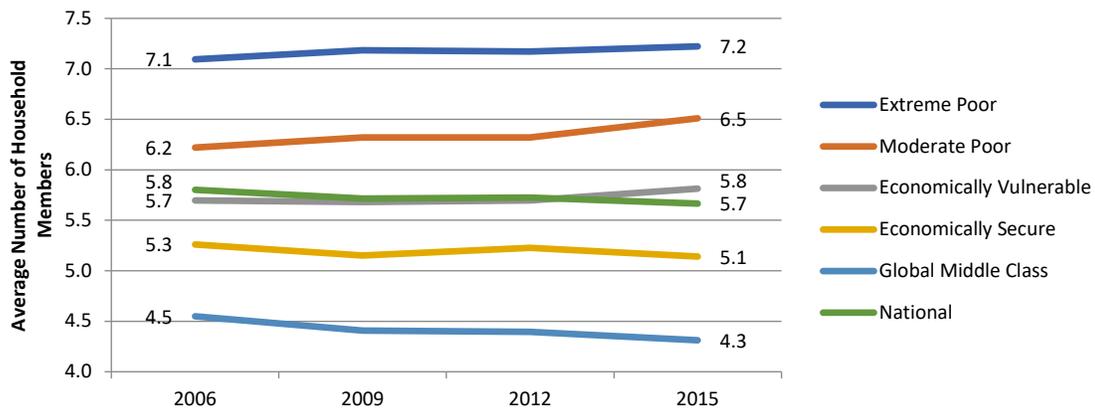
Who Are the Middle Class?

Highlights: *Households of smaller size, with lower dependency ratios, headed by individuals with higher education are more likely to be in the global middle class. For those who are employed, the middle-class households stand out with better quality jobs in the labor market. They are more likely to work for the government or own their business, work in the services or manufacturing sectors, and have a higher wage. However, a large share of middle-class household heads is not in the labor force, relying mainly on remittances income.*

GENERAL CHARACTERISTICS

2.2 **Household size:** The average global middle-class Filipino household has four members, compared to five for the economically secure and seven for the extreme poor (Figure 2.1). Over time, the household size of the global middle class and that of the economically secure decreased while the household sizes of the poorer classes increased.

Figure 2.1. Average Household Size by Class, 2006–15

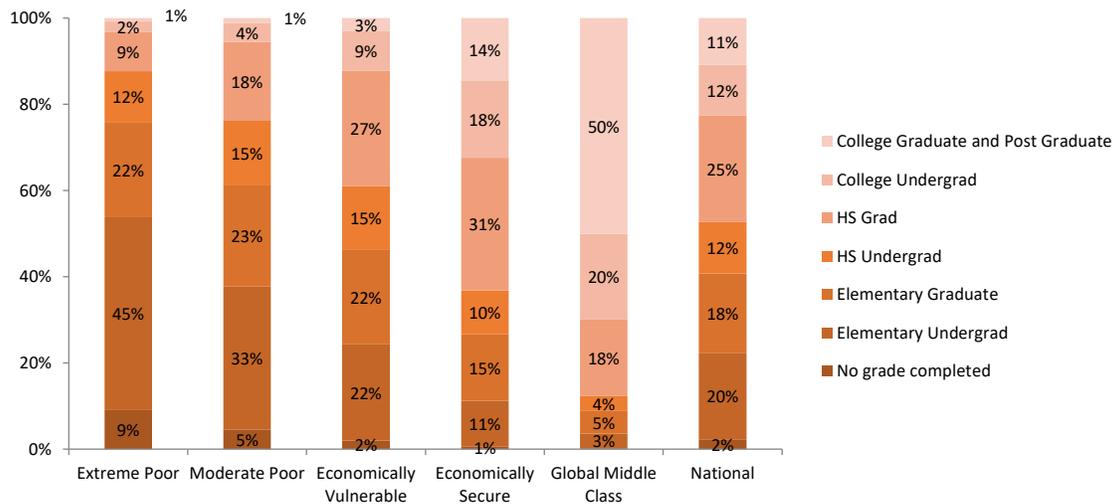


Source: FIES various rounds

2.3 **Child dependency ratio:** Middle-class households have the lowest child dependency ratio. In 2015, a typical middle-class household has only 1 child dependent less than 17 years old; this compared with 4.2 child dependents for the extreme poor, 3.3 for the moderate poor, 2.5 for the economically vulnerable, and 1.7 for the economically secure. The national average is 2.4 children per household.

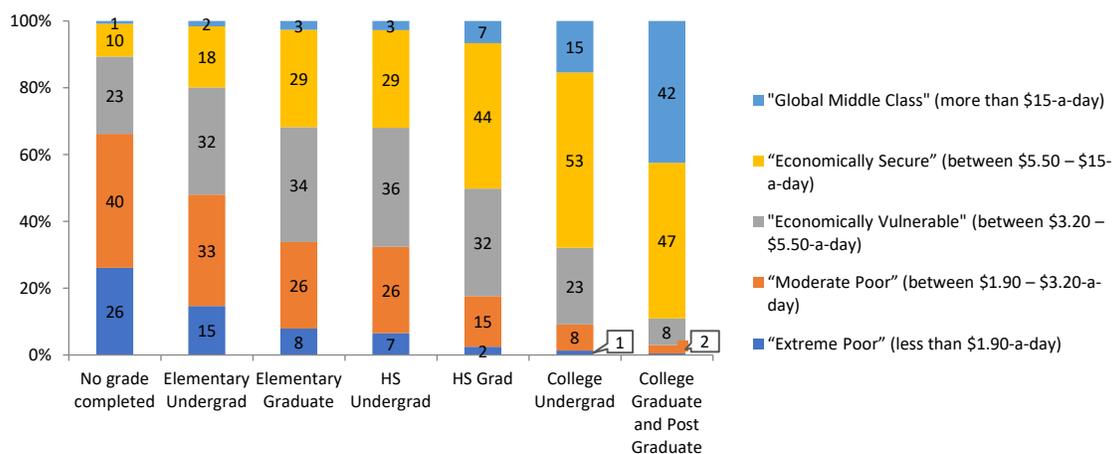
2.4 Education level of household head: Like most countries, the Philippines shows a strong positive correlation between the possibility of being in the middle class and the education level of the household head. College education stands out as the key threshold. Half of the households in the middle class are headed by individuals who have completed college, compared to 11 percent of the national average, and 45 percent of the households that are extreme poor have heads that did not complete elementary school compared to 20 percent of the national average (Figure 2.2). Among all college graduate household heads, 42 percent are in the global middle class, 47 percent are economically secure, 8 percent are economically vulnerable, and only 3 percent are poor (Figure 2.3).

Figure 2.2. Distribution of Educational Attainment of Household Head by Class, 2015



Source: FIES-LFS 2015

Figure 2.3. Distribution of Economic Class by Educational Attainment of Household Head, 2015

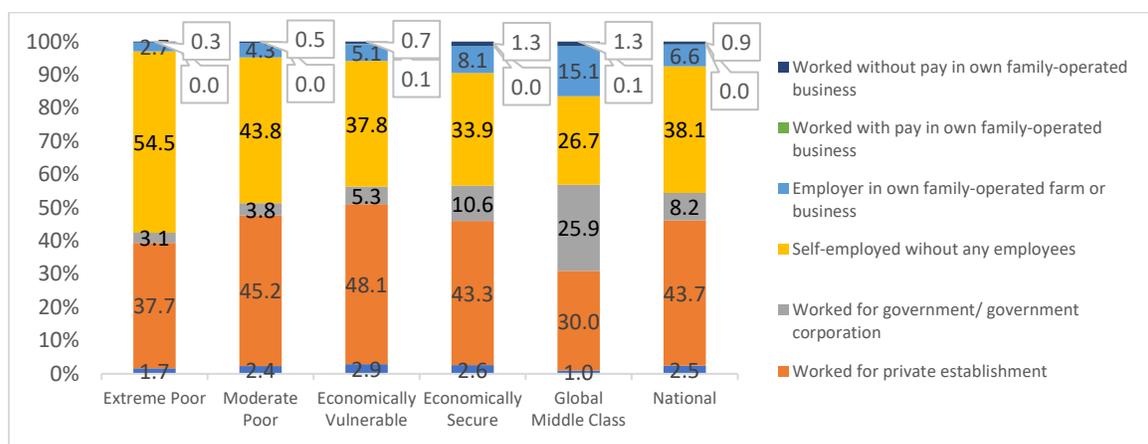


Source: FIES-LFS 2015

LABOR MARKET STATUS

2.5 Nature of work of household head: Compared with those of other economic classes, a high share of heads of middle-class households work in government and as employer in a family-operated farm or business and a low share work as self-employed without employee (Figure 2.4). Among those that are employed, 26 percent of the middle-class household heads are working for the government, and 15 percent as employer in own farm or business. This contrasts with the poor: less than 4 percent of heads of extreme poor households are working in the government, less than 5 percent are own farm or business employers. In addition, only 27 percent of the middle-class household heads are self-employed without any employee. This contrasts with the extreme poor where more than 50 percent are self-employed without any employee, while 15 percent of middle-class household heads operate their own farm or business with employees.

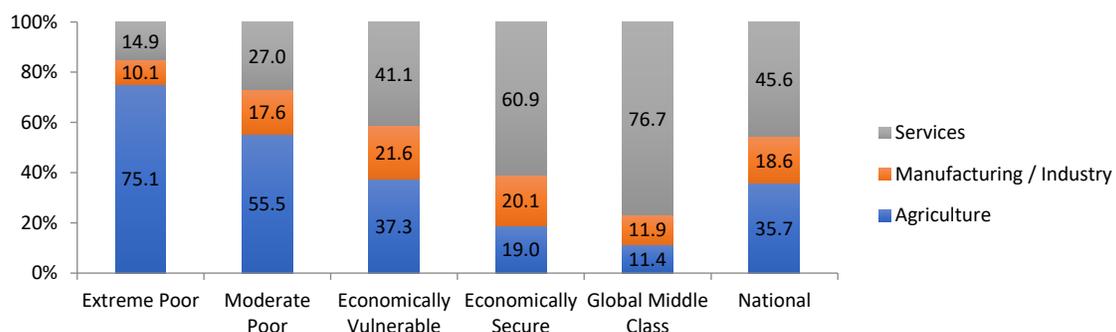
Figure 2.4. Household Head Class of Work by Economic Class, 2015



Source: FIES-LFS 2015

2.6 Employment sector of household head: Over three-quarters of the middle-class household heads work in the services sector, compared to just above 60 percent of the household heads of the economically secured, and less than 15 percent of those of the extreme poor (Figure 2.5). In contrast, three-quarters of extreme poor household heads are working in the agriculture sector, compared to less than 20 percent of those of the economically secure and just over 10 percent of those of the middle class.

Figure 2.5. Major Sector of Household Head by Economic Class, 2015

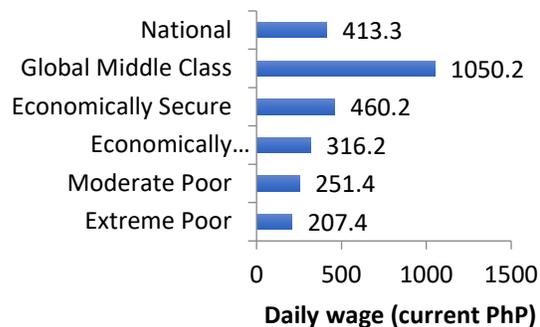


Source: FIES-LFS 2015

2.7 Daily wage of household head: The middle class who are employed have higher wages (Figure 2.6). The average daily wage of the household heads of the middle class is more than twice that of the economically secured, three times that of the economically vulnerable, four times that of the moderately poor, and five times that of the extreme poor.

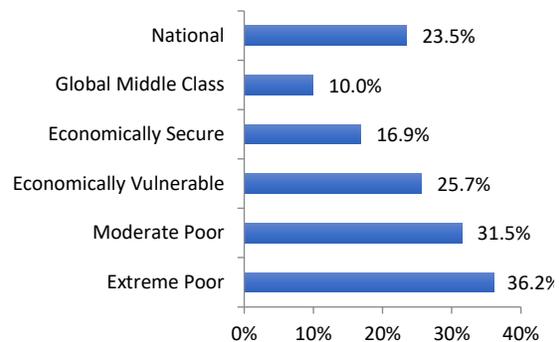
2.8 Underemployment of household heads: Few middle-class household heads are underemployed (Figure 2.7). In 2015, only 10 percent of the global middle-class household heads who are employed are underemployed, compared to 36 percent of the extreme poor or 24 percent of national average.

Figure 2.6. Daily Wage of Household Head, 2015



Source: FIES-LFS 2015

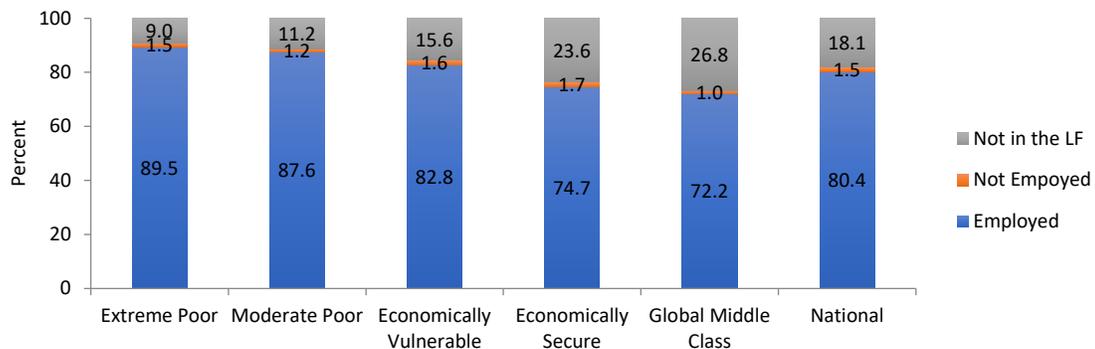
Figure 2.7. Percentage of Underemployed Household Head by Economic Class, 2015



Source: FIES-LFS 2015

2.9 Labor market participation of household head: The household heads in the higher income classes are more likely to not participate in the labor market (Figure 2.8). In 2015, 27 percent of the household heads in the global middle class were not in the labor force; this compares to 9 percent of the household heads of the extreme poor, 11 percent of the moderate poor, 16 percent of the economically vulnerable, and 24 percent of the economically secured. This might suggest a heavy reliance on other sources of income, particularly remittances, for middle-class households.

Figure 2.8. Employment Status of Household Head by Economic Class, 2015



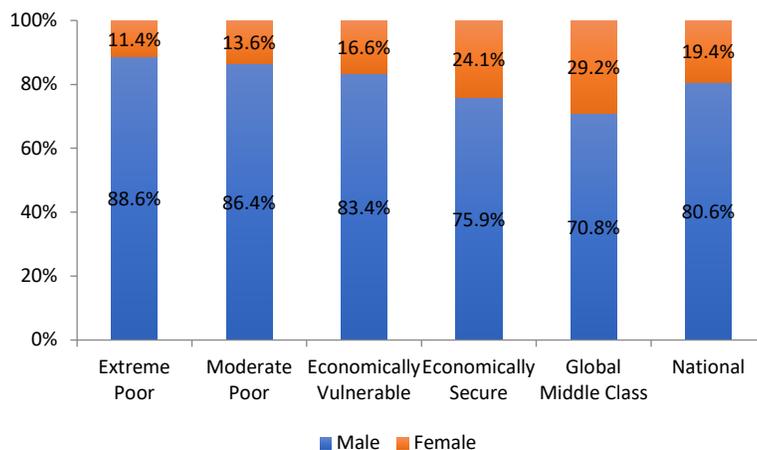
Source: FIES-LFS 2015

GENDER

2.10 Gender of household head:

Female-headed households are more likely to be in the middle class (Figure 2.9). Seventy-one percent of middle-class households are headed by males and 29 percent by females, compared to 89 percent headed by males and only 11 percent by females in

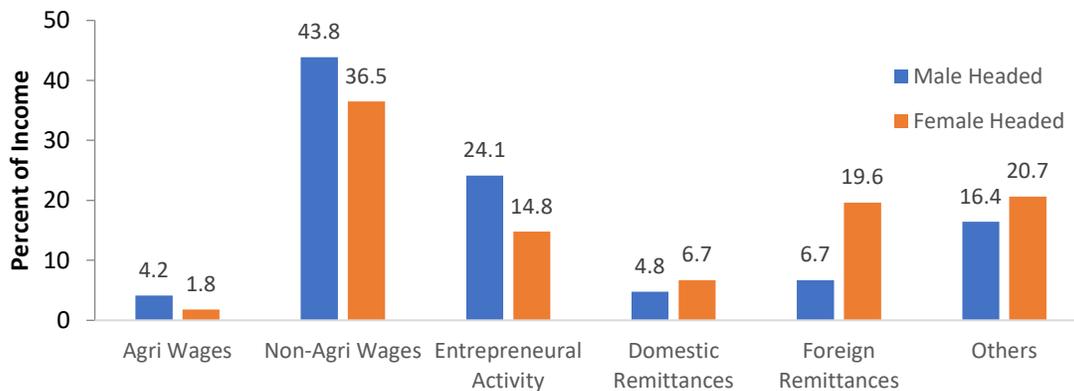
Figure 2.9. Household Head Gender by Economic Class, 2015



Source: FIES 2015

extreme poor households. The higher probability of female-headed households in the global middle class is related to the high share of foreign remittances in their household income (Figure 2.10). Female-headed households have a lower share of income from agriculture wages, non-agricultural wages, and entrepreneurial activity, but a significantly higher share from domestic and foreign remittances. On average, among female-headed households, foreign remittances represent 20 percent of total household income, and domestic remittances represent 7 percent. This compares with 7 percent and 5 percent for male-headed households. Among the female-headed global middle-class households, foreign remittances and domestic remittances represent 26 percent and 3 percent of total household income, respectively.

Figure 2.10. Income Sources by Gender of Household Head, 2015



Source: FIES 2015

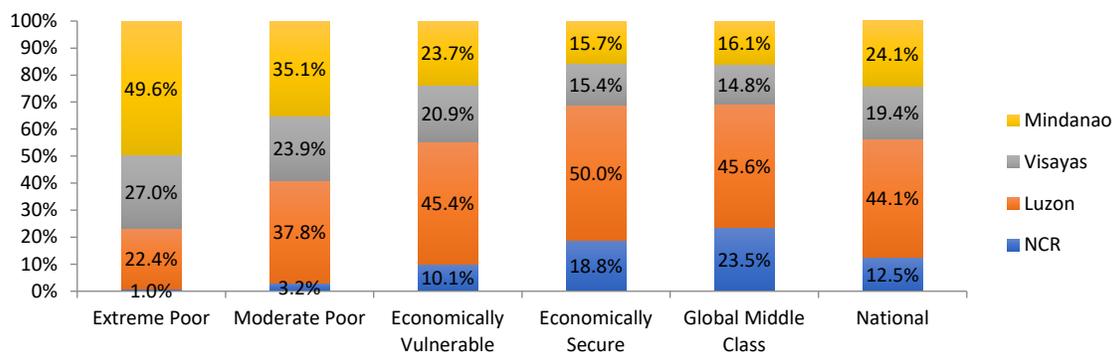
Where Are the Middle Class?

Highlight: Regional disparities remain wide and the share of middle class in total population varied across regions. Middle-class families are mainly an urban phenomenon and largely concentrated in the national capital region (NCR). While only 12.5 percent of the total population

lived in NCR in 2015, nearly a quarter of the middle class lived there. The share of middle class is the highest in NCR and lowest in disaster risk areas and conflict areas—Eastern Visayas and Mindanao.

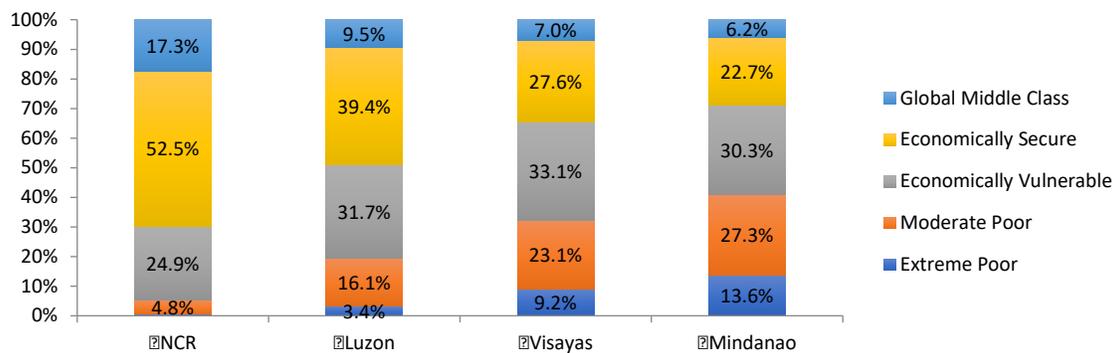
2.11 Regional dimension: The majority of the middle class live in NCR and Luzon, while the most extreme poor live in Mindanao (Figure 2.11). In 2015, 24 percent of the middle class lived in NCR and 46 percent in Luzon (12.5 percent of the total population lived in NCR and 44 percent in Luzon). In 2015, 14 percent of the population in Mindanao was extreme poor and 27 percent was moderate poor, while only 6 percent was in the middle class and 23 percent economically was secure. This compared to 0.5 percent, 5 percent, 17 percent, and 52 percent, respectively, in NCR (Figure 2.12 and Map 2.1, page 23).

Figure 2.11. Economic Class by Island Group, 2015



Source: FIES 2015

Figure 2.12. Population by Economic Class and Island Group, 2015

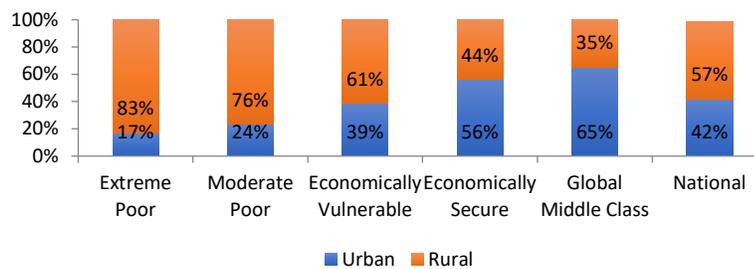


Source: FIES 2015

2.12 Urban-Rural:

Middle class is mainly an urban phenomenon (Figure 2.13). Most of the economically secure and middle class live in urban areas, while that of the extreme poor and moderate poor live in rural areas. In 2015, nearly 65 percent of the middle class and 56

Figure 2.13. Economic Class by Urban-Rural, 2015

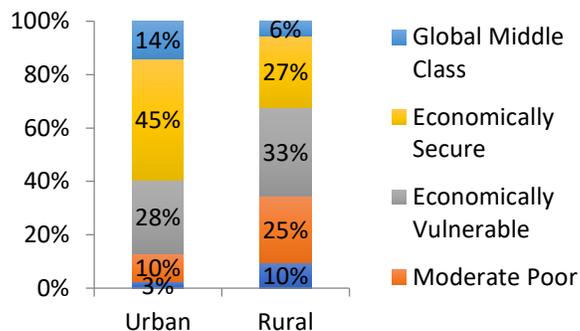


Source: FIES 2015

percent of the economically secure lived in urban areas, this compared to 42 percent of the national average, 24 percent of the moderate poor, and only 17 percent of the extreme poor. The urban-to-rural ratio in each economic class changed little over the past decade.

2.13 The distribution of economic classes shows wide gaps between urban and rural areas (Figure 2.14). In 2015, 14 percent of the urban population was in the middle class and 45 percent was economically secure, compared to only 6 percent of the rural population in the middle class and only 27 percent economically secure. In contrast, only 3 percent of the urban population was extremely poor, and 10 percent was moderately poor, compared to 10 percent and 25 percent of the rural population, respectively.

Figure 2.14. Population Distribution by Economic Class and Urban-Rural, 2015



Source: FIES 2015

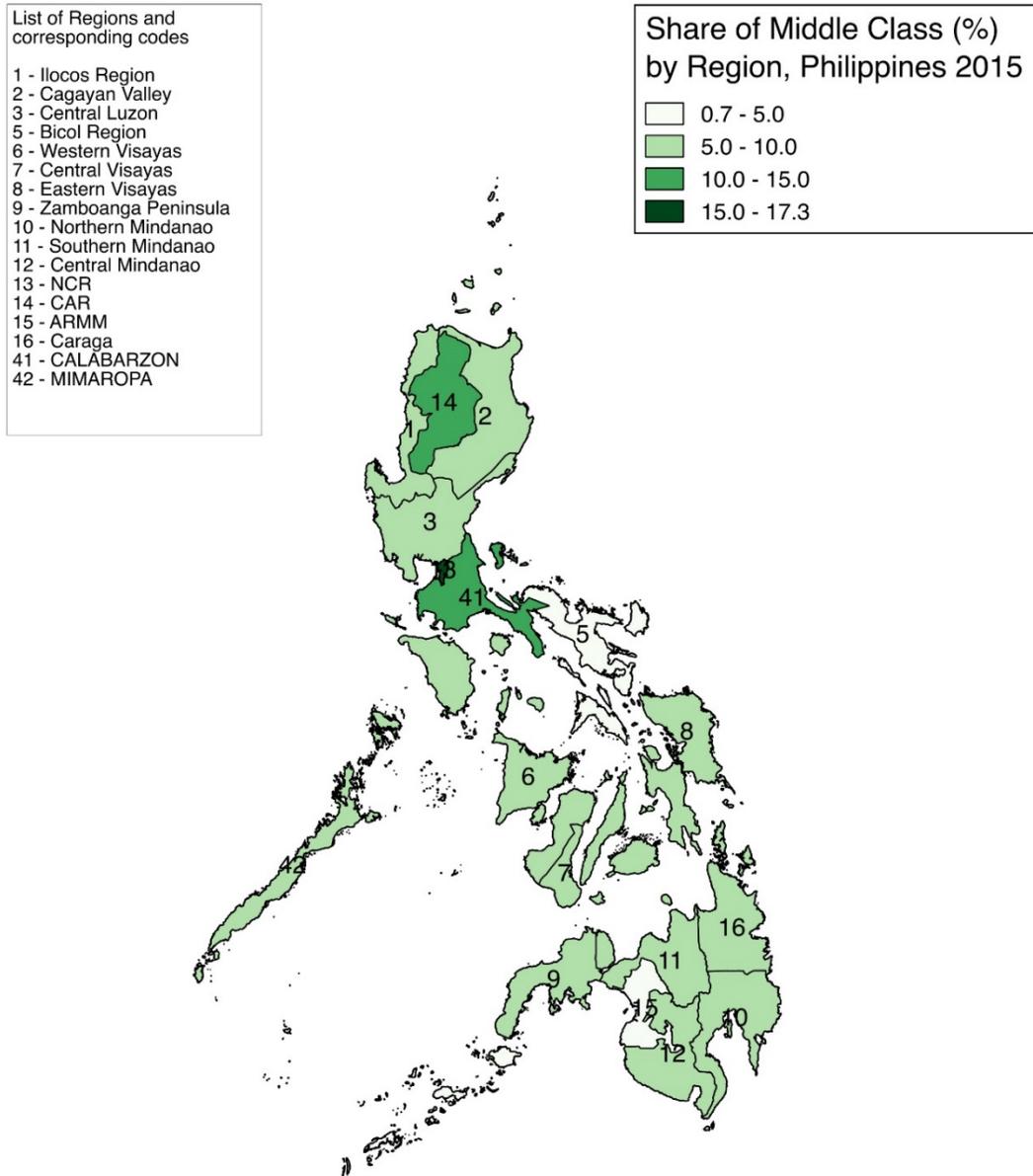
2.14 **Conflict:** The extremely low share of middle-class population in ARMM and parts of Mindanao are associated with persistent conflicts in those areas. Conflicts destroy assets as well as human capital, and ruin opportunities. Less than 5 percent of the population live in conflict-affected Mindanao are middle class, with the share of middle class in ARMM being virtually zero, this compared to nearly 10 percent in Luzon and 17 percent in NCR (Table 2.1).

Table 2.1. Share of Population in Middle Class in High-Conflict Regions, 2015

IX – Zamboanga Peninsula	2.49
X – Northern Mindanao	4.21
XI – Southern Mindanao	4.90
XII – Central Mindanao	2.72
ARMM	0.26

Source: FIES various rounds

Map 2.1. Where Are the Middle Class?



2.15 **Disasters:** Some of the other areas with extremely low percentages of middle class are frequently hit hard by natural disasters. Like other countries with high exposure to disasters, the poor and vulnerable suffer the most due to their higher exposure to disaster risks (including living in the wrong locations and more reliant on agriculture) and more limited capacity to cope (due to lower saving to buffer), while the middle class is not immune. Disasters trap people in poverty and pull the better-off down. The most disaster-prone regions of the Philippines have lower share of the population that reaches the middle-class income level (Table 2.2).

Table 2.2. Share of Population in Middle Class for Regions Most Prone to Earthquakes

Regions with Degree IX – XII in the Mercalli Scale for Earthquake Intensity	2015
Bicol Region	2.90
Eastern Visayas	2.70
Western Visayas	5.51
Caraga	1.55
Southern Mindanao	4.90

Source: FIES and staff estimates

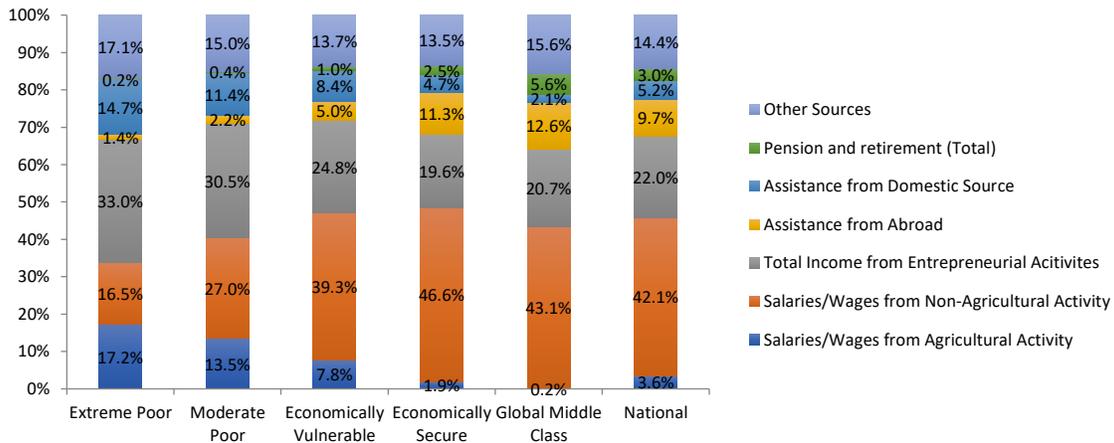
What Are the Income and Consumption Patterns of the Middle Class?

Highlights: *The middle class and economically secure not only have higher income and consumption levels than the rest of the population, they also primarily rely on different income sources and tend to spend their resources differently. The middle class are more likely to rely on salaries or wages from non-agricultural activity, which account for the largest share of total household income, followed by entrepreneurial activities, and transfers from abroad. The middle class spend less on food and more on education, health care, and durable equipment compared to the other welfare classes. They have the highest savings rate. They have the highest durable asset ownership, but ownership of mobility assets (such as cars) remained low and access to basic services (particularly clean water) remains limited.*

2.16 Income patterns: Non-agricultural wages and salaries, assistance from abroad, and entrepreneurial activities are the three most important sources of income for the largest share of the middle class (Figure 2.15). The middle class itself has a high share of non-agricultural wage income, a high share of entrepreneurial income, a high share of foreign transfers, and virtually zero income from agricultural wages. For the middle income and economically secure households, salaries or wages from non-agricultural activity represent the largest share of total household income (over 40 percent of total household income), followed by entrepreneurial activities (about 20 percent),¹⁷ and transfers from abroad (over 10 percent). In contrast, for the extreme poor, the major income sources are entrepreneurial activity income (33 percent), followed by salaries or wages from agricultural activity (17 percent) and salaries from non-agricultural activities (17 percent). The pattern of major income sources of the moderate poor is similar as that of the extreme poor, but with a higher share of income from non-agricultural salaries or wages and a lower share of income from agricultural salaries or wages.

¹⁷ For the middle class and economically secure, entrepreneurial activity income more likely come from own business income (as business owners/employers); while for the rest of the less fortunate classes, particularly the extreme poor, entrepreneurial activity income mainly comes from self-employed activities and odd jobs.

Figure 2.15. Income Shares of Households by Economic Class, 2015

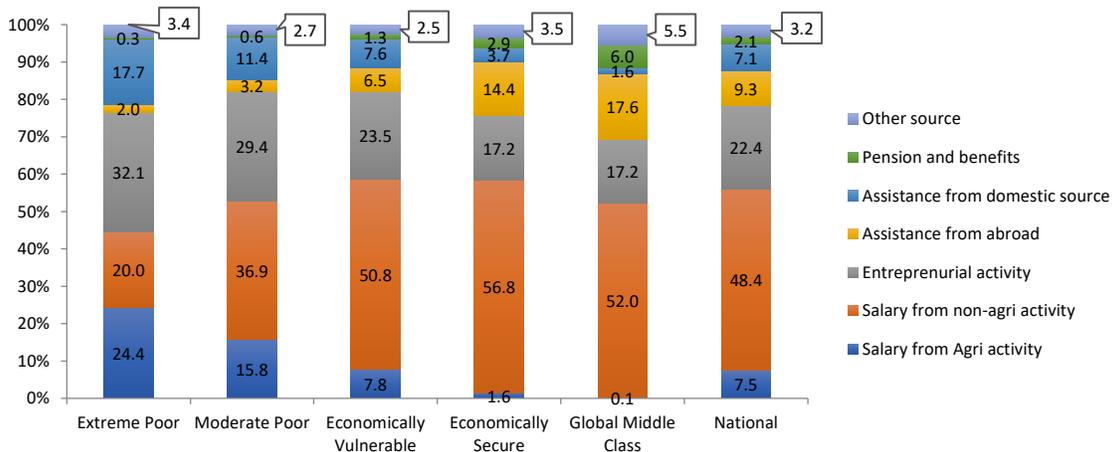


Note: Other sources of income include gifts, dividends from investments, net value of harvest share.

Source: FIES 2015

2.17 The most important source of household income also varied widely across households in different economic classes (Figure 2.16). Most notably, almost 18 percent of middle-class households, and 14 percent of economically secure households derive the largest share of their total household income from foreign assistance. Most middle-class households and economically secure households have non-agricultural wages or salaries as their major income source.¹⁸ In 2015, 52 percent of the middle class and 57 percent of the economically secure derive the largest share of their total household income from non-agriculture wages and salaries. Virtually zero (0.1 percent) middle-class households derive the majority of their total household income from salaries from agricultural activities. Meanwhile, entrepreneurial activities, agricultural wages, non-agricultural wages, and assistance from domestic sources are the most important sources of income for the extreme poor and moderate poor.

Figure 2.16. Main Income Source of Households by Economic Class, 2015

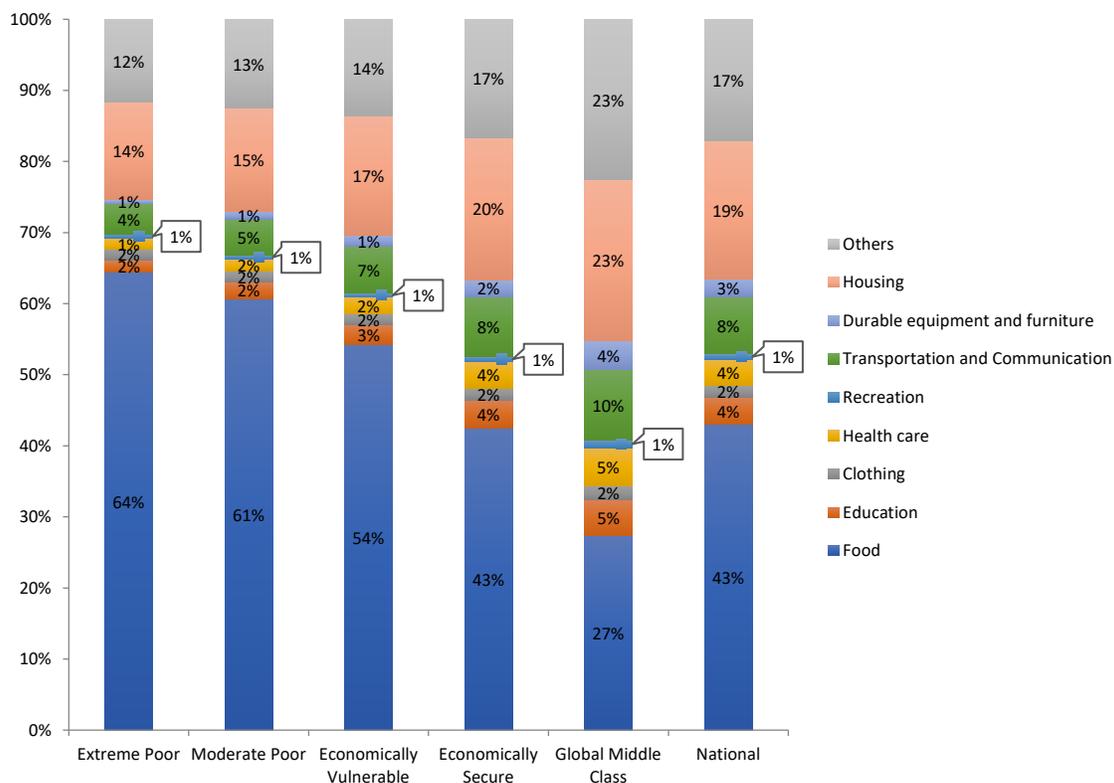


Source: FIES 2015

¹⁸ Major source of income is defined in the FIES datasets as the source of income that has the highest share of total household income.

2.18 Consumption patterns: The economically secure and middle class have a distinctly different consumption pattern than the other classes (Figure 2.17). The middle class spends only one-fourth of their total expenditure on food, compared to over 60 percent for the extreme poor and moderate poor, over 50 percent for the economically vulnerable, and over 40 percent for the economically secure. The middle-class households spend more on education, health care, and durable equipment compared to the other welfare classes. In 2015, the middle classes spend 5 percent on education, 5 percent on health care, and 23 percent on housing. The extreme poor, however, spend less than 4 percent for education and health care combined and less than 15 percent for housing.¹⁹ Nearly a quarter of the total expenditures of the middle class go to gifts, assistance, contribution to religious organizations, special occasions, and other disbursements (other expenditures). In contrast and due to limited resources, the poor spend less than 15 percent on these other expenditures.²⁰

Figure 2.17. Expenditure Shares of Households by Economic Class, 2015



Note: Other expenditures include gifts, assistance, contribution to religious organizations, special occasions, and other disbursements.

Source: FIES 2015

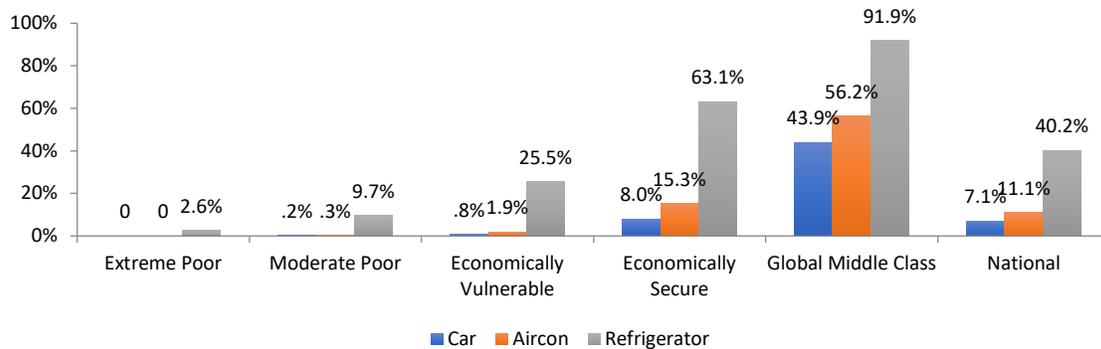
2.19 Asset ownership: A closer look at the consumption patterns of the different economic classes reveal distinctively different ownership of durable goods (Figure 2.18). For the middle class, 92 percent own refrigerators, 56 percent have air conditioners and 44 percent own cars. The extreme poor and moderate poor, by comparison, have little to no ownership of important durable

¹⁹ Housing expenditure includes expenditures on electricity, gas, maintenance, rent

²⁰ Other expenditures include gifts, assistance, contribution to religious organizations, special occasions, and other disbursements

assets such as cars, air conditioners, and refrigerators. The economically vulnerable also share this pattern only having a higher percentage (25 percent) ownership of refrigerators.

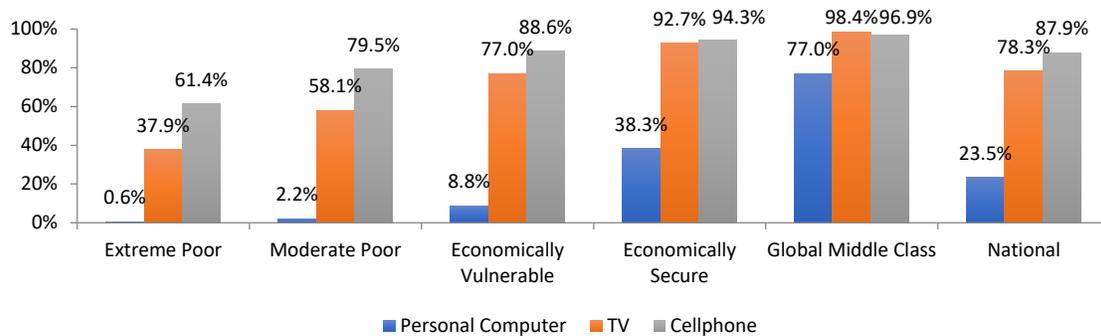
Figure 2.18. Selected Durable Asset Ownership by Class, 2015



Source: FIES 2015

2.20 The middle class has the highest percentage of access to digital technology and information assets: cellphones (97 percent), televisions (98 percent), and personal computers (77 percent) (Figure 2.19). The extreme poor have extremely low access to personal computers and only 38 percent have access to televisions and moderate access to cellphones (61 percent). As digital technology and information assets are increasingly important in the current era, reducing the gap and fostering adoption of digital technologies could help strengthen economic resilience across the income distribution and increase upward mobility.

Figure 2.19. Access to Technology and Information by Class, 2015



Source: FIES 2015

2.21 Middle-class households are still deprived of basic mobility assets. The majority of middle-class households do not travel with their own private cars or motorcycles. Only 44 percent own a car and only 38 percent have a motorcycle. Quality mass transit would be important to connect people with job opportunities for all income groups.

2.22 **Access to basic services:** Despite economic security, some of the middle class are still deprived on at least one non-monetary dimension. While all (100 percent) middle-class households enjoy the security of house tenure and have access to electricity, sanitation, and communication assets, such as mobile phones, 17 percent still lack access to clean water, 34 percent also do not have access to mobility assets, and 5 percent of the middle class do not have access to good housing materials.

3. Jobs and Economic Mobility

3.1 This chapter discusses the role of good-quality jobs in economic mobility. First, it presents the disparity between strong intergenerational education mobility and weak economic mobility, drawing from administrative data, micro surveys, and focus group discussions. Second, it examines the challenges in the labor market with a focus on the link between good-quality jobs and upward mobility and the contrasting trend of expansion of lower-paid jobs in the market. Third, it discusses specific challenges that the youth face and the resulting constraints to upward mobility.

3.2 **Middle-class households, as supported by the focus group discussions, are likely to have been born into middle-class families and had the financial and social capital to maintain or improve their quality of life.** Many of these households do not have to spend decades paying off housing loans as they inherited their homes, others were able to get into good colleges and become very competitive in the workforce because their parents were able to afford a private elementary and high school education. Family origin, property ownership, and education are among the factors that influence upward mobility in the Philippines.²¹ Upward mobility is challenging and participants revealed that breaking into the middle class from a lower-income background means breaking through

Breaking into the Middle Class

“My greatest aspiration now is to help make my family stable (parents and siblings). I just started my job, my father just stopped working. In our house I am the only one with a job. We are saving first for a house in the province for my mother, in case our house now is demolished [they are informal settlers whose house is threatened by a road construction project]...We want to build a house for our parents. For ourselves, that can wait. My youngest sibling, I am still paying for her education, that is another thing, she has to finish her education first. She is in third year college.”

—Aries, young college graduate with
Global Middle Class salary

multiple barriers: strong competition for regular employment with decent wages, high levels of dependency that includes not only children but also parents and siblings, inadequate safety nets for health or disaster costs, and the intangible absence of social capital that accompanies relative wealth. The lack of upward mobility was evident for many families in the focus group.

Intergenerational Mobility

3.3 **Although intergenerational educational mobility (educational attainment) is strong in the Philippines, economic mobility (progression in class) remains stagnant.** As reflected in survey data and the focus group discussions, the younger generation receives more years of schooling than their parents’ generation did but only a small share of the population managed to move up the economic ladder in the past decade.

3.4 **The Philippines has among the highest rates of intergenerational education mobility in the world.** One in five Filipinos in the 1980 cohort who were born into the bottom half reached the top quartile, measured by years of schooling, according to a recent World Bank report (Narayan

²¹ The results of focus group discussion are intended to provide a narrative of the views of select individuals from the respective background and income brackets. The group membership was not representative. The results need to be interpreted with caution. See Appendix E for details of the arrangement of the focus group discussions and interviews.

and others 2018) on economic mobility across generations globally.²² In the past three to four decades, a Filipino's ability to obtain education has been less dependent on how well educated his or her parents are, compared to many other countries. According to the report, in the median developing country, less than 15 percent of individuals born in the bottom half make it to the top quarter, while more than two-thirds stay in the bottom half.

Box 3.1. Focus Group Discussions and Interviews

Focus group discussions and interviews were conducted for this study to gather information about the lives of Filipino families from different income levels. Five focus group discussions had 8-10 participants each for the four income groups (poor, economically vulnerable, economically secure, and global middle class, as defined in chapter 1) plus one group with individuals who were economically vulnerable and had experienced natural hazards or health shocks. The discussion topics included family background, education, jobs, access to financial services, and health, to understand from their perspectives the main factors that have helped or limited their income mobility.

The seven individuals interviewed did not overlap with the focus group participants. They were the head of household or next responsible adult with knowledge of family finances and history. Interviewees were economically vulnerable from poor background; economically secure from poor background; global middle class from foreign worker income; global middle class from business process operation income; and SME employer with 20 and 50 employees.

The findings from the focus group discussion and interviews are drawn from 48 individuals in Manila and are not meant to be representative.

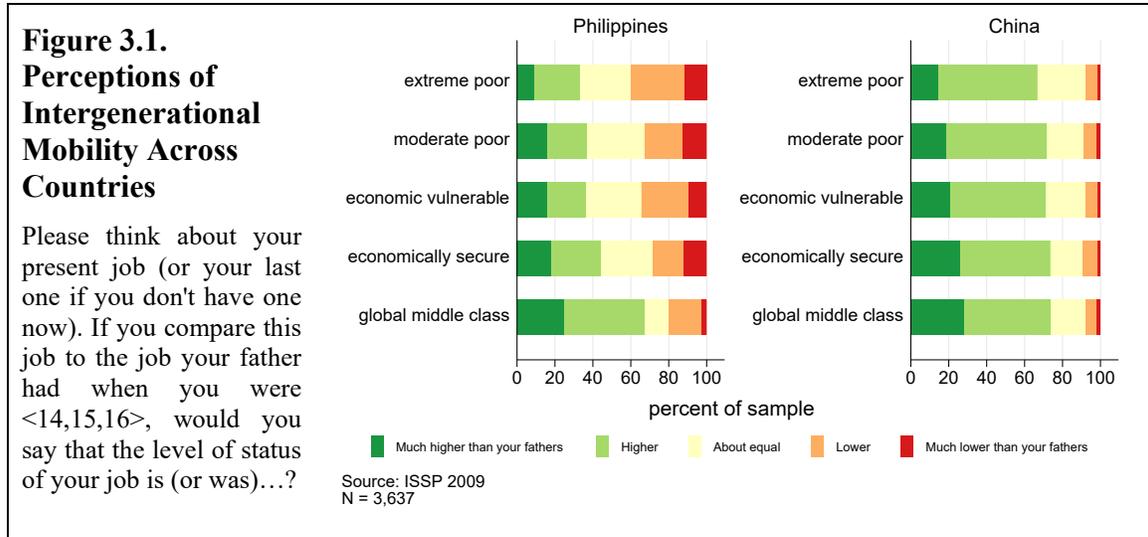
Source: Appendix E

3.5 Intergenerational mobility in job status, measured by subjective perception of whether one's job status is higher than that of one's father, is, however, lower in the Philippines for the general population than elsewhere in the region as reflected in ISSP data.²³

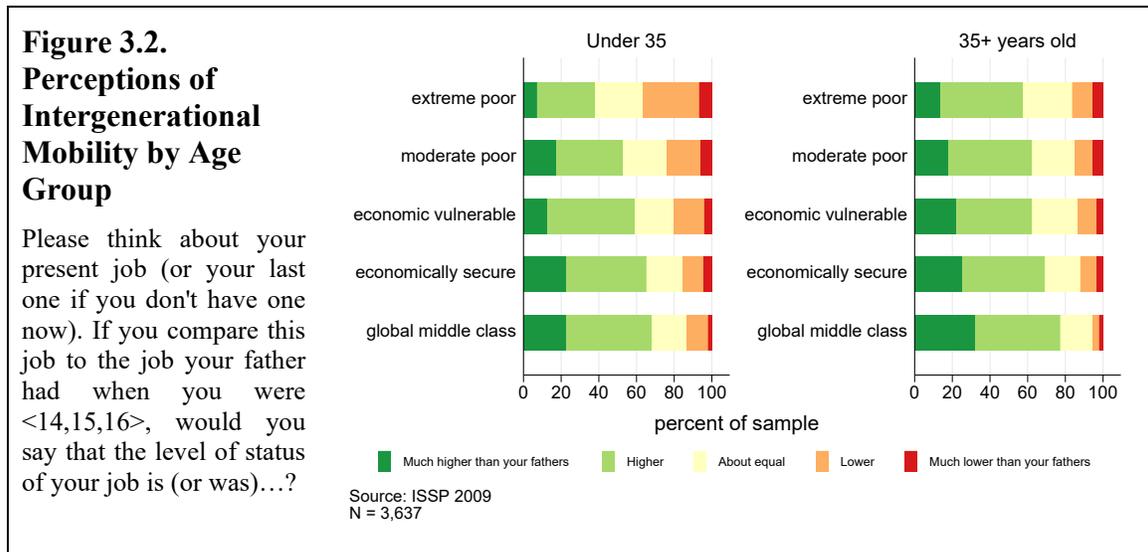
As shown in chapter 1 (see Figure 1.1 on page 5), the high rate of growth in the Philippines has not resulted in increased mobility in the class structure. This is largely due to the quality of jobs available. In 2009, perceptions of intergenerational mobility were modest: just under half of individuals not in the middle class thought their job was better than their father's (Figure 3.1). For the global middle class, the story is different: over two-thirds believe their job is better than their father's. This pattern is striking compared with China, where large majorities in all income groups say their job status is higher or much higher than their father's. Although a bit dated, the 2009 data are important because they represent the midpoint of the country's rapid transition to upper middle-income status over the past 20 years. This indicates a broad-based transformation in China, one characterized by seemingly universal social mobility compared with the more modest and limited mobility in the Philippines.

²² In the World Bank report *Fair Progress*, the results of the Philippines are drawn from a combination of two surveys, the 1999 wave of the ISSP and the 2012 waves of FIES.

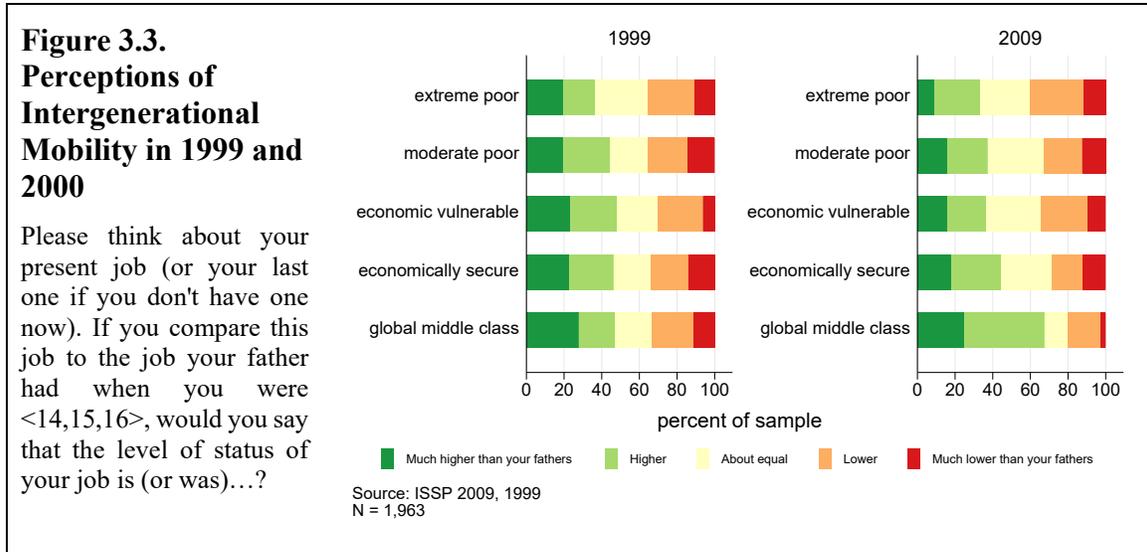
²³ Haller, Max, Roger Jowell, and Tom Smith. 2009. "Charting the Globe: International Social Survey Programme." <http://w.issp.org/about-issp/publications/>. Data from the International Social Survey Programme (ISSP).



3.6 **Perceptions of mobility also vary by age**, which may represent the effect of different generations experiencing different social mobility. Those who are under 35 are more likely to believe their job is lower status than their father's, and less likely to think it is much higher (Figure 3.2).



3.7 **Finally, these patterns have evolved over time.** While in 1999, perceptions of mobility were similar across income classes, by 2009 the global middle class were much more likely to believe their status had improved over the generations (Figure 3.3). For the other income classes, perceptions of mobility stayed similar over the period.



3.8 **The mismatch between high education mobility and economic mobility is mainly due to three reasons:** the limited availability of well-paying jobs; the generally low quality of education and wide disparity in quality of education, particularly those from poor households; and dependencies related to supporting an extended family. While chapter 5 covers these issues in more detail, the broad outlines are sketched here.

3.9 **First, the lack of well-paying jobs.** While the number of new jobs created in the past decade matched the increase of the labor force, real wages increased little. Without a booming labor-intensive manufacturing sector to absorb the large amount of labor, most Filipinos who left agriculture ended up in low-end services jobs. The manufacturing sector remained small in the Philippines and high-end services, many in technology areas, absorbed only a small share of labor. The stagnant average wage income hindered upward mobility.

3.10 **Second, the quality of education and its uneven access.** Even if a well-paying job opportunity is available, workers, particularly those born in poor households, may not have the skills employers need. Challenges of access to quality education are even more daunting for ethnic minorities and indigenous populations. As in many other countries, more effective schooling leads to access to wage employment and higher income as the probability of employment in the formal sector rises with high educational attainment. According to the World Bank Human Capital Index, a Filipino child who is expected to attend 12.8 years of schooling would learn as much as a child in a high-performing system learns in 8.4 years (discussed in chapter 5). Focus group participants noted that expensive elite colleges and universities are still only accessible to the wealthy. Even highly subsidized elite state universities require an investment in living expenses and other costs that can impede attendance. Hence, poor families whose children qualify to attend college send them to more affordable, lower-quality institutions, which may result in lower-quality jobs later. Further, the socioemotional skills²⁴ and social capital accumulated by those born into poorer families cannot compete with those from higher classes. In the job market, the confidence, networks, and professional skills of a college graduate who grew up in a lower-class household are

²⁴ Socioemotional skills are also known as “noncognitive skills,” “soft skills,” or “behavioral skills.” See World Bank (2017) *Developing Socioemotional Skills for the Philippines’ Labor Market* for further discussion.

little competition for those who grew up in the middle class or higher. Therefore, while educational mobility is high, the weak quality of education limits the competitiveness of graduates in the labor market and therefore limits the jobs they can get and wages they can earn.

3.11 Third, the dependency patterns within Filipino families may be a factor. The dependency ratio for youth declined in the Philippines, but more slowly than in many other countries in the region. In 2018, the dependency ratio for youth was 48 percent in the Philippines, similar to Cambodia but higher than Indonesia (39 percent), Vietnam (33 percent), and Thailand (24 percent). Poor households also have a higher fertility rate than richer ones (the poorest 20 percent average five children and the richest 20 percent average less than two). Children from families with a poor background often say that as soon as they get a decent job they intend to help their siblings achieve a higher level of education, try to support their parents, and build a house for the entire family. This means that college graduates from poor households, even those without children, may already have multiple dependents. A college graduate in a decent job without dependents for the first five years, may be more likely to break into and maintain middle-class status than one with dependents—if they get there at all. In this respect, the dependencies within Filipino families might affect upward income mobility. For those that provide for the family, it might slow the move into the middle class; while for those who receive the support from an older sibling, it might facilitate more rapid upward mobility. Meanwhile, such obligations would not necessarily prevent someone from aspiring for middle class status or wanting higher wages, so those obligations might even make people want to work more and harder, not less.

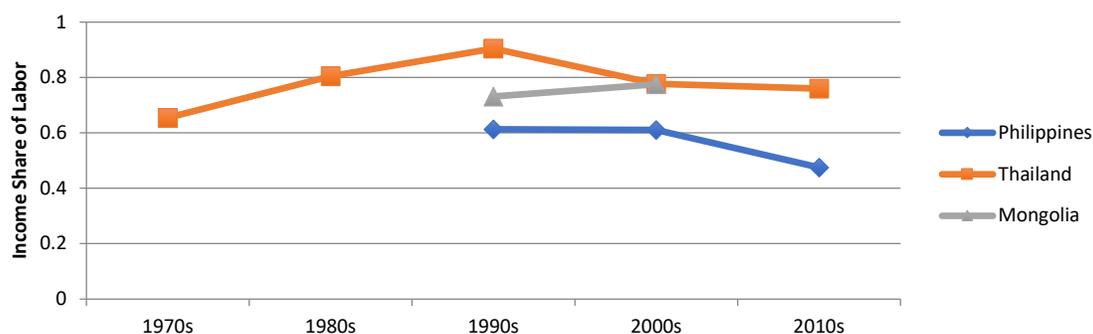
Challenges in the Labor Market

3.12 The average labor share of income in the Philippines is low and declining (Figure 3.4). According to estimates by the Asian Development Bank Institute, the labor share of income averaged 59 percent in the period 1992–2012, with a maximum of 68 percent in 2006 and a minimum of 46 percent in 2012.²⁵ This is low compared with several countries in the East Asia region, such as Mongolia and Thailand. The decline of the labor share of income in the Philippines is faster than that in Thailand while Mongolia trended upward in the 1990–2000 period. With a low and declining labor share, even though GDP grew rapidly, it provided little benefit for workers.

²⁵ See Guerriero (2019) for details. In the estimate, the labor share of income is estimated using data on workforce composition:

$$LS = \frac{\text{compensation of employees} + \frac{\text{total workforce} - \text{employers}}{\text{number of employees}}}{\text{value added} (-\text{indirect taxes} - \text{fixed capital})}$$

Figure 3.4 Average Labor Share of Income in the Philippines, Thailand, and Mongolia



Note: Annual data are not available, figures are averages for each decade.

Source: <https://www.adb.org/sites/default/files/publication/484346/adbi-wp920.pdf> Table 6.

3.13 A lack of product market competition is likely contributing to real wage stagnation in the Philippines. While the country’s labor supply is abundant and flexible, due to the high level of informality, product markets are not competitive in many sectors, and many markets have high entry costs. The share of capital in the national income growth has been increasing, however, rising from 43 percent in 2000 to nearly 70 percent in 2016.²⁶ To a large extent, productivity gains result mainly in an increase in profits rather than in increases in real wages. In the private sector, the discrepancies in the compensation packages between the management/executive and regular/low-rank staff are wide (Boubaker and Nguyen 2014).

3.14 The Philippines labor market faces multiple challenges. While a large number of jobs were created absorbing the increasing number of workers in the labor market, underemployment is high and most of the job expansion was in the low-paid services sector. The share of jobs that can offer wages for workers to support middle-class living for their households is small. In addition, the labor market segmentation between urban and rural as well as between NCR and the rest of the country has persisted over time. The most disadvantaged among the population are those who are most vulnerable. The ethnic minorities and indigenous populations, for example, have weaker access to basic services and lower literacy rates (Reyes and others 2017). The youth and those with less education have great difficulty finding employment with a decent wage. And women, though more educated than men, earn less than men at every level of education (World Bank 2018).

LABOR PARTICIPATION AND EMPLOYMENT

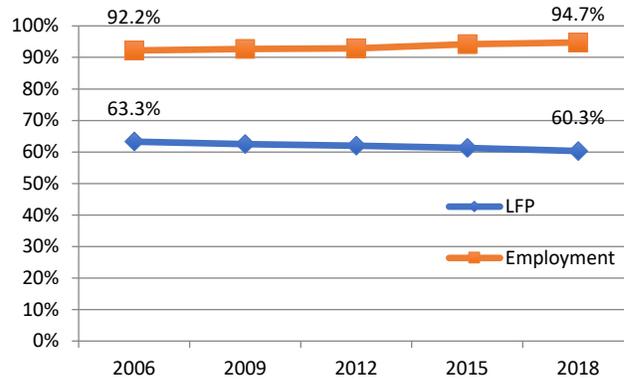
3.15 Structural transformation has been taking place over the past decade with more jobs created outside of agriculture. Each year, about one percent of the workers shifted from agriculture to non-agriculture jobs. The share of the total labor force working in agriculture declined from 35 percent in 2006 to 26 percent in 2018, the share working in industry increased only from 15 percent to 18 percent, and the share working in services increased from 50 percent to 56 percent. In absolute numbers, 0.33 million fewer worked in agriculture, while 2.7 million more worked in manufacturing and industry jobs and 7.4 million more worked in services. Employment growth was on par with

²⁶ Staff calculation drawing from World Bank World Development Indicators, IMF World Economic Outlook, and Penn World Table version 9.

growth in the working-age population (both about 20 percent over the period), and even slightly faster than growth in the labor force (about 16 percent), resulting in a decline in unemployment.

3.16 The Philippines still face multiple labor challenges, including labor participation and under employment (Figure 3.5-Figure 3.7), despite a high employment ratio. In the period 2006–18, the employment rate increased from 92 percent to 95 percent and unemployment declined from 8 percent to 5 percent. However, labor force participation is still low, declining by 3 percentage points from 63 percent in 2006 to only 60 percent in 2018.

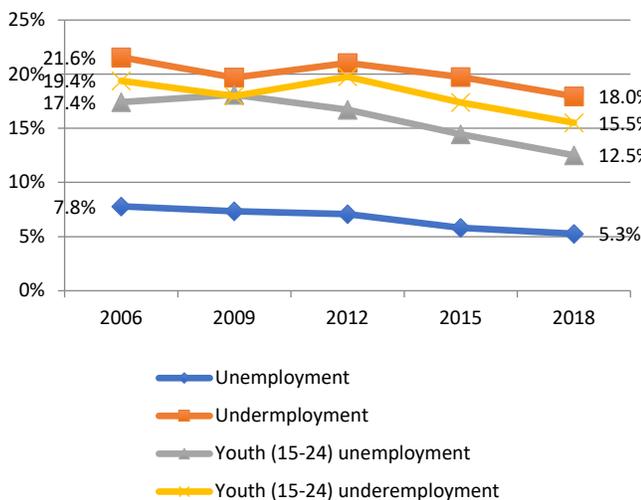
Figure 3.5. Employment and Labor Force Participation, 2006–18



Source: LFS various rounds

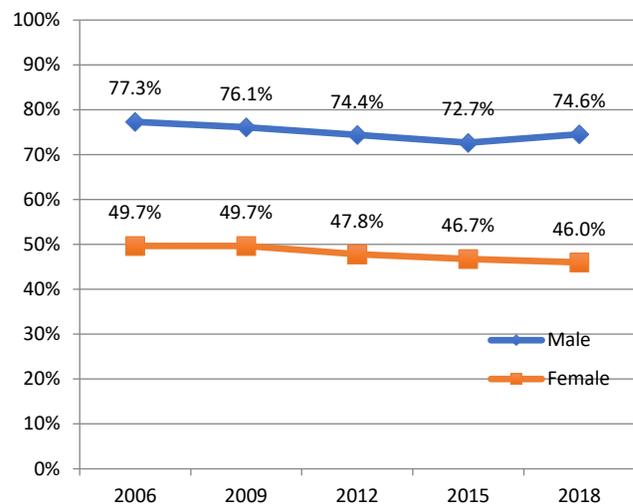
3.17 In particular, the labor participation rate for females is significantly lower than for males. In 2018, about 75 percent of the male and 46 percent of the female population was in the labor force. Not only is the labor force participation low, it has also declined for females—from 50 percent in 2006 to 46 percent in 2018. Although with slight improvement, underemployment remained high at 18 percent in 2018, only a few percentage points down from 22 percent in 2006.

Figure 3.6. Unemployment and Underemployment, 2006–18



Source: LFS various rounds

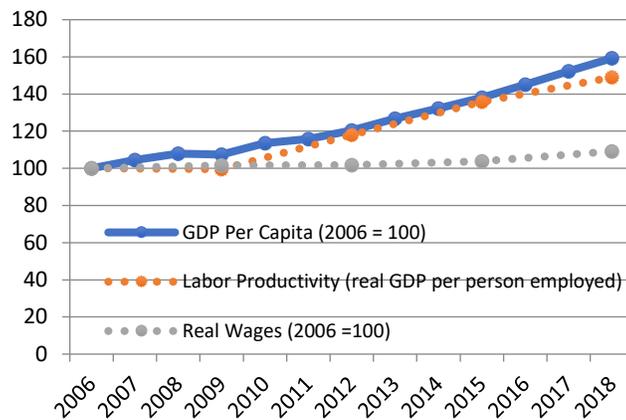
Figure 3.7. Labor Force Participation by Gender, 2006–18



Source: LFS various rounds

3.18 The key issue for labor is the limited wage growth resulting from the movement out of agriculture (discussed further in chapter 4). During 2006–18 Real GDP per capita increased nearly 60 percent and labor productivity increased by almost 50 percent (Figure 3.8). However, real wages stagnated, growing at less than 10 percent. The discrepancy between labor productivity growth and real wage growth points to the pervasiveness of market power and rigidities that exploit workers and undermine upward mobility. During the period of 2006–15, while GDP per capita grew at 3.6 percent per annum, mean income grew only at 1.6 percent and median income at 2.2 percent. Meanwhile, according to Forbes wealth estimate, the wealth of the richest 15 Filipinos has expanded 9.1 percent per annum in the period of 2006–18, far exceeding overall economic growth and average household income increase. The Credit Suisse Wealth Report from 2014 estimates that the top 1 percent in the Philippines owns more than half of the nation’s wealth. This is fourth highest after the Russian Federation, Turkey, and Hong Kong, SAR China. The gap between the super-rich and the rest of the population in the Philippines is one of the largest in the world (World Bank 2019a).

Figure 3.8. Growth in Real GDP Per Capita, Labor Productivity, Real Wages



Source: Philippines Statistical Authorities and World Development Indicators

LOW-QUALITY JOBS

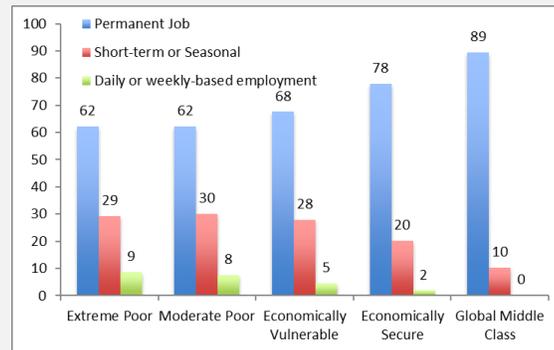
3.19 Economic growth is a necessary factor to facilitate upward mobility and prevent downward mobility, while the creation of more good-quality jobs is key to translating the fruits of aggregate growth to household and individuals (Box 3.2). Wages are the most important source of income for most households in the Philippines. Higher wage rates are a key factor that facilitates economic upward mobility (Fuwa 1996). In 2015, more than 80 percent of the population lived in families that received wage incomes, and over 45 percent of their total household income comes from wage income. The slow real wage growth limited the improvement of household livelihood and the prospects of stepping into the middle class. The lack of good-quality jobs—as reflected in labor market performance data, was a major concern of focus group participants.

Box 3.2. Good-Quality Jobs Are More than Good Wages

Good-quality jobs go beyond wages and include job security and a steady stream of decent income. This is important not only for household consumption but also for supporting human and other productive capital investment (World Bank 2012, Galunic and others 2000, Bertola 1994).

In the Philippines, however, the real wage increase was limited, even for those with high education, and a large share of the poor and vulnerable were stuck in unstable jobs. In the period of 2006–18, real wages increased slowly—only 9 percent for all workers and just 6 percent for the college educated. One-third of workers in the economically vulnerable and lower-income classes have temporary or short-term employment compared to 20 percent of the economically secure and only 10 percent of the middle class (see figure). Stable employment is an important driver of upward mobility.

Nature of Employment by Economic Class



Source: FIES-LFS 2015

Job stability, as a unique dimension of job quality besides the size of compensation, is valued highly among the poor and economically vulnerable interviewed. Although some had jobs with limited benefits, the most stable jobs in this group were six-month contracts, known as *Endo*, with limited benefit packages (PhilHealth and social security contributions). For many of the poor and vulnerable, employment is never regular or conventionally stable, they are constantly on the job market for low-skill jobs in services or the informal sector. Focus group participants said that even if a job is at or below minimum wage, knowing that they have a constant income stream will allow them to plan for things over a longer time horizon. A stable job also gives them access to finance, which they can use to start a small business. However, the instability that comes with informal jobs is yet another burden for most poor workers.

“In these days there are no more regular jobs. The political promises (of getting rid of [*Endo*]) are not being fulfilled.”
—*Shirley, economically vulnerable*

“We are always on “end of contract” (short-term) arrangements, when you’re old and you still need to apply for work you don’t get accepted because you’re old.”
—*Terry, economically vulnerable*

“For a six-month contract, it is hard, because, for example, you apply for a 4 or 6 month contract, you still have to submit complete requirements. When you go to city hall to get requirements you won’t finish it in one day, you have to go back repeatedly. After you complete it and submit it to the company, you don’t know if you’ll get the job or not.”
—*Anne, economically vulnerable*

“Sometimes we borrow the money (for the requirements). When you have to borrow the money for requirements only to get a short-term job, most of the time there is no money to complete the requirements. Our budget runs out.”
—*Rommel, economically vulnerable*

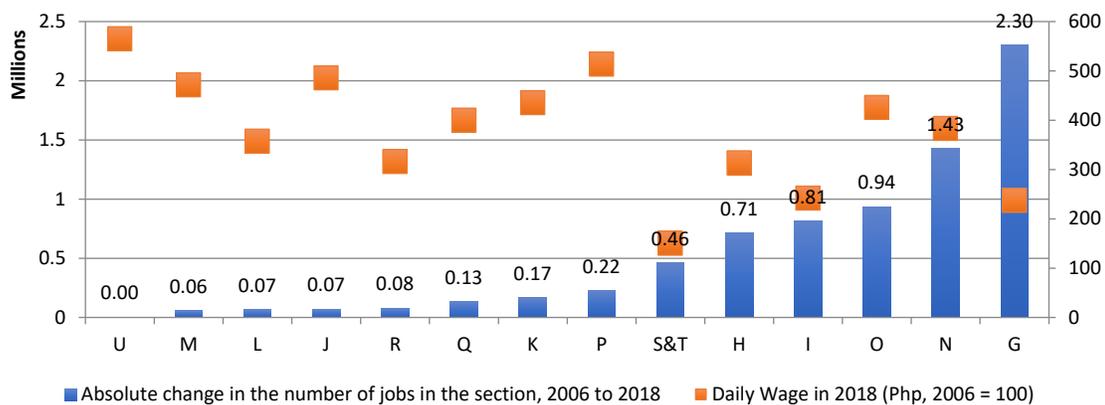
Source: Focus groups; names have been changed to preserve anonymity.

3.20 The 9.9 million new jobs created in 2006–18 were concentrated in lower-paying subsectors,²⁷ primarily the services sector. Within the services sector, which accounts for three-

²⁷ The subsectors refer to each of the 21 sections of agriculture, manufacturing and industry, and services of the 2009 Philippine Standard Industrial Classification (PSIC) by the Philippine Statistics Authority (PSA), which are mutually exclusive and exhaustive.

quarters of the new jobs, there is a significant negative correlation between daily wage and employment growth (Figure 3.9). The services subsectors with the higher wages—“education;” “professional, scientific, and technical activities;” and “information and communication”—increased slowly compared to the subsectors with lower wages—“activities of households as employed or other services;” “wholesale and retail trade;” and “accommodation and food service activities.” The pattern is similar in manufacturing and industry: 75 percent of the new jobs were in construction (2.05 million out of a total increase of 2.75 million), the second lowest paid of the manufacturing and industry sector jobs, while employment in higher-paying subsectors, such as electricity and water, changed little. The manufacturing subsector provided 0.61 million new jobs, which accounted for only 22.3 percent of the (limited) job growth in the manufacturing and industry sector. Of all the new jobs created, only 91 percent were permanent; 6 percent were short-term (such as seasonal/casual job/business/unpaid family work),²⁸ and 3 percent were day jobs (odd job workers/stevedores not on payroll and multiple different employers).

Figure 3.9. Low-Paying Jobs Increased Faster in the Services Sector, 2006–18



Note: Section G. Wholesale and retail trade; Repair of motor vehicles and motorcycles; Section H. Transportation and Storage; Section I. Accommodation and food service activities; Section J. Information and Communication; Section K. Financial and Insurance activities; Section L. Real estate activities; Section M. Professional, scientific, and technical activities; Section N. Administrative and support service activities; Section O. Public administration and defense; compulsory social security; Section P. Education; Section Q. Human health and social service activities; Section R. Arts, entertainment, recreation; Section S. Other service activities; Section T. Activities of households as employers; Section U. Activities of extra-territorial activities and bodies.

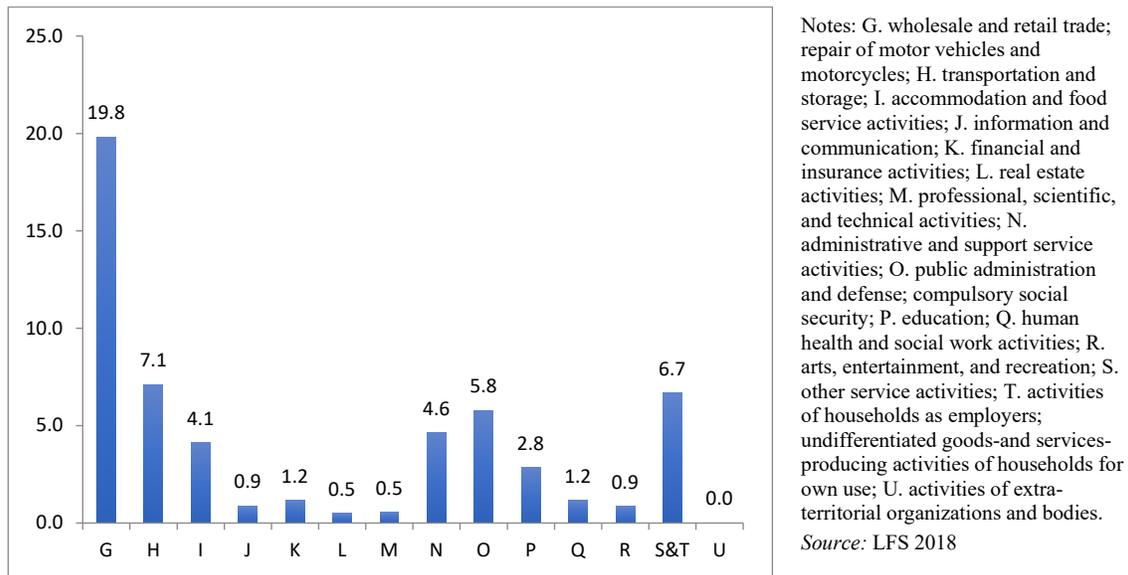
Source: LFS, various rounds.

3.21 The share working in services increased from 50 percent in 2006 to 56 percent in 2018.

A large share of employment concentrate in the low-paid services sector, of which 19.8 percent in Section G (Wholesale and retail trade; Repair of motor vehicles and motorcycles), 7.1 percent in Section H (Transportation and storage), and 6.7 percent in Sections S and T (Activities of households as employers and other services). Relatively few workers are employed in higher-end FIRE sectors (finance, insurance, and real estate, sectors K, L, and M).

²⁸ Based on the LFS, short-term or seasonal/casual job/business/unpaid family work: when employment lasted or expected to last less than one year since it started or for less than 10 calendar months in a year in the case of farm operators and fishermen and their unpaid family workers.

Figure 3.10. Share of the Total Employment in Services Subsectors, 2018

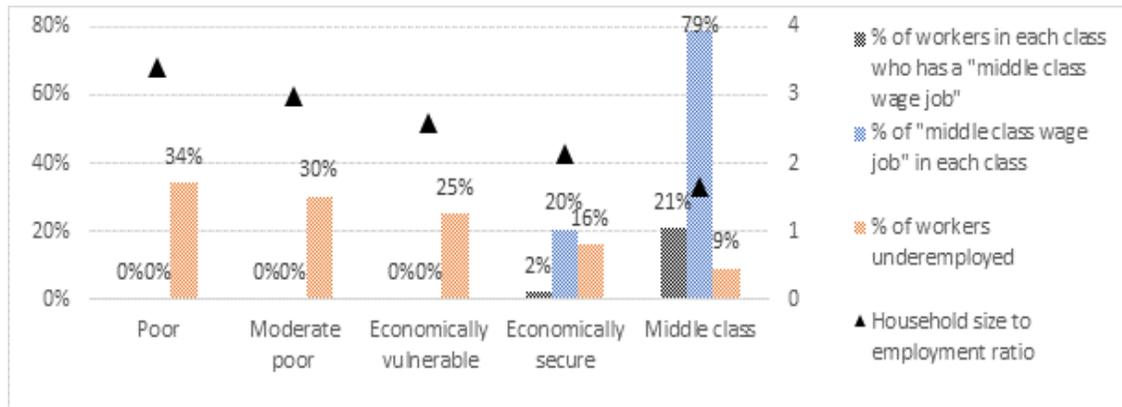


FEW JOBS PAY MIDDLE-CLASS WAGES

3.22 Becoming a middle-class family in the Philippines relying on wage income is extremely difficult because of the scarcity of jobs that pay high enough wages. If a household of five has one wage earner, the single-earner “middle-class wage” needs to earn at least \$2,300 (2011 PPP) a month for the household to have a middle-class living standard of at least \$15 a day (2011 PPP) per person.²⁹ Having a household member who has a good job earning such “middle-class wage” is important. In 2015, among all jobs that pay single-earner “middle-class wage,” nearly 80 percent are held by the individuals in the middle class, the remaining 20 percent are in the economically secure and almost none are in the other categories (Figure 3.11). Accounting for the number of workers in each class, 21 percent of all workers in the middle class hold a single-earner “middle-class wage,” compared to 2 percent of all workers in the economically secure class and almost zero in other poorer income groups. In contrast, underemployment is more prevalent for the poor and vulnerable.

²⁹ The “middle class wage” of \$2,300 (2011 PPP) is about PhP 52,000 (2018 price) per month for each wage earner if the household has one wage earners and PhP 26,000 per month if the household has two wage earners.

Figure 3.11. Scarcity of “Middle-Class Jobs”



Note: Underemployed workers are those who are willing to take on additional hours or seek additional jobs.

Source: Staff calculation based on 2015 FIES and LFS

3.23 Even among individuals in firms with at least 20 workers in the formal sector, which typically pays more than small and informal firms, most do not have a “middle-class salary.” Only ten occupations across five sectors had average monthly wage rates greater than the single earner middle-class threshold of PhP 51,000 (see footnotes 30 and 31) out of 429 occupations across agriculture, industry, and services sectors surveyed in the Occupational Wage Survey (OWS) in 2016 (Figure 3.12).³⁰ About half of these well-paid occupations were in financial and insurance services (securities and finance dealers and brokers, actuaries, computer programmers, accountants, and auditors). Others included computer programmers and systems analysts and designers in computer programming and consultancy and business processing outsourcing; aircraft pilots; civil engineers in the water sector; production supervisors in electricity, gas, steam, and air conditioning supply.

3.24 Even if two members of the household work full-time, the number of jobs that pay enough to support a middle-class family is still limited. In 2016, drawing from the OWS data, there were 67 occupations across 24 sectors with an average monthly wage rate greater than PhP 25,500, which is about a half of the PhP 51,000 required to support a middle-class family of five (see footnotes 30 and 31). These occupations accounted for about 16 percent of 429 occupations across agriculture, industry, and services sectors (Table 3.1, page 41). Managers and professionals in manufacturing sectors (engineers and production supervisors and general supervisors) accounted for 15 percent of these occupations that earned a monthly wage of PhP 25,500. Other groups of occupations included professionals in the financial and insurance services; information and communications; and professional, scientific, and technical sectors (economists, statisticians, engineers, and architects). Professors, medical doctors, and dentists were also included. This implies that salaries of an average Filipino medical doctor, chemical engineer, university professor,

³⁰ Philippine Statistics Authority. 2016 Philippines OWS is a nationwide survey of establishments with 20 or more workers in 51 agriculture, industry and services sectors and thus presents higher-wage occupations from some SMEs and large firms in formal economy only. This represents a small segment of all working Filipinos and weighs heavily toward workers with higher wages. The 2016 OWS covered the pay period that includes July 2016 and included occupational wage rates, median basic pay, and median allowance of time-rated workers on full-time basis. Here, PhP 51,000 is considered as the single-earner “middle-class wage” threshold, taking into account the benefits, to be consistent with the preset wage income brackets as listed in Table 3.1.

or construction project manager were not high enough for his or her family to be considered a middle class, unless another member of the household working full-time in a similar occupation. In the agriculture, forestry, and fishing sectors, supervisors of farms, plantations, or forests, who are paid the highest in the sector, earn a quarter to a third of the monthly average salary needed to support a middle-class family.

Figure 3.12. Average Monthly Wage Distribution Across Occupations in the Philippines in 2016 and Middle-Class Income Threshold of PhP 51,000 Per Household (2019 prices)



Note: The upper panel shows the 10 occupations across five sectors that had average monthly wage rates greater than the single-earner middle-class threshold of PhP 51,000. The lower panel shows the wage distribution of the 429 occupations across agriculture, industry, and services sectors surveyed in the Occupational Wage Survey in 2016. The orange line is the single-earner middle-class threshold (PhP 51,000).

Source: Occupational Wage Survey in 2016.

3.25 Workers in the formal sector account for only half of all working Filipinos and are paid more compared to non-wage workers and workers in informal firms, who are often paid less than the minimum wage.³¹ The OWS does not cover workers from micro-sized establishments which account for 29 percent of the total employees by private establishments. Average wages of workers in micro-sized establishments are lower than those in larger establishments, as they are mainly in wholesale and retail trade; repair of motor vehicles and motorcycles sector and accommodation and food service sector whose workers earn lower than the average wage compared to those in other sectors. Therefore, the wages represented by the OWS survey are likely to be on the higher end of the wages across Filipino workers.³²

3.26 Most Filipinos work in sectors that pay low wages. According to the LFS, which includes wage income information for all wage earners (formal and informal) but not the self-

³¹ Non-wage workers are self-employed and contributing family members. Workers in informal firms are employed by households or unregistered private establishment.

³² Republic of the Philippines, Department of Trade and Industry (2018). 2018 MSME Statistics. Accessed on February 12, 2020. <https://www.dti.gov.ph/business/msmes/msme-resources/msme-statistics>

employed, 40 percent of 43 million Filipino workers were in agriculture, hunting, and forestry (20 percent) and wholesale and retail trade; repair of motor vehicles and motorcycles sectors (20 percent).³³ Most of the 17 million Filipino workers in agriculture and retail sectors—94 and 82 percent, respectively—earned less than PhP 18,800 per month, which is little more than a third of the PhP 51,000 per month needed for a family to be considered middle class (Table 3.1).³⁴ Across all sectors, two-thirds of full-time workers earned up to PhP 18,800 per month.

Table 3.1. Percent Distribution of Full-Time Workers by Monthly Basic Pay and by Sector in the Philippines, July 2016 (in percentages)

Average monthly wages in PhP (2019 prices)	Below 5,500	5,500–8,900	8,900–12,200	12,200–15,500	15,500–18,800	18,800–22,200	22,200–25,500	25,500–28,800	28,800 or above
All sectors	1.0	13.0	25.0	24.0	11.0	6.0	4.0	3.0	12.0
Agriculture									
Agriculture, hunting, & forestry	5.1	52.1	28.3	5.1	3.5	1.7	0.9	0.8	2.5
Fishing	2.9	25.0	9.5	49.4	7.3	2.0	1.0	0.7	2.2
Industry									
Mining & quarrying	0.3	24.2	25.6	14.6	11.8	3.8	3.5	2.0	14.2
Manufacturing	0.4	8.5	45.3	20.4	7.8	4.0	3.1	2.3	8.2
Electricity, gas, & water	0.0	5.7	5.1	7.4	13.3	16.9	11.8	9.2	30.8
Water supply	1.4	12.6	19.5	20.3	12.9	7.3	6.9	3.3	15.8
Construction	0.5	10.8	22.5	46.1	7.9	3.4	2.5	1.5	4.9
Services									
Wholesale & retail trade, repair of motor vehicles & motorcycles	0.9	23.3	21.1	26.8	9.9	4.9	3.6	2.0	7.4
Transportation & storage	0.1	12.7	16.9	29.8	15.2	6.9	4.6	3.0	10.8
Accommodation & food service activities	1.0	23.5	27.5	31.1	7.3	2.9	2.0	1.3	3.5
Information & communication	0.1	5.9	7.5	13.4	11.8	7.3	7.3	4.9	41.8
Financial & insurance activities	0.1	4.5	15.8	19.1	11.0	9.9	5.9	4.8	28.9
Real estate activities	0.0	4.4	13.3	21.7	15.0	8.8	8.2	4.8	23.9
Professional, scientific & technical activities	0.0	2.0	8.7	20.3	11.7	8.0	5.5	7.9	35.8
Administrative & support service activities	0.1	10.7	15.9	26.7	16.7	8.5	5.5	4.4	11.5
Public administration & defense, compulsory social security	0.1	10.7	15.9	26.7	16.7	8.5	5.5	4.4	11.5
Education	1.1	10.3	21.2	17.6	13.2	9.2	6.8	4.8	15.9
Human health & social work activities	0.8	13.7	31.4	24.5	15.0	4.6	2.9	1.9	5.3
Arts, entertainment & recreation	1.8	11.8	43.3	12.6	12.2	5.8	2.4	3.3	6.9

Source: Philippines Statistics Authority (PSA). Percent distribution of time-rate workers on full-time basis by monthly basic pay and by industry in the Philippines is from the 2016 OWS. Time-rate workers on full-time basis refer to those paid on the basis of an hour, day, or month and who work at jobs with hours of work equal to or more than those considered normal or regular to the establishment.

³³ Philippines Statistics Authority (PSA). July 2019 LFS

³⁴ Philippines Statistics Authority (PSA). 2016 Occupational Wage Survey.

3.27 Nevertheless, there are pockets of opportunities for Filipino workers to earn middle-class wages in newly growing sectors such as the business process outsourcing (BPO) services. The BPO industry has created roughly 90,000 new jobs each year since 2004, which directly employed more than one million Filipinos in private establishments.³⁵ The Tholons Service Globalization Index ranks the Philippines second only to India as the most preferred destination for outsourcing digital services.³⁶ The fast growth of the BPO services sector also brought well-paying jobs to the Philippines: computer engineers and programmers in the call center activities (voice) sector had the 8th and 15th highest average monthly wages in the 2016 OWS with PhP 54,156 and PhP 41,565, respectively. Customer service representatives across different industries (including financial, insurance, telecommunications, electricity, and water) had an average monthly wage of PhP 23,680, which is comparable to the average monthly wage of accountants in auditing companies or marine engineers in shipbuilding sector.

IMPACT OF COVID-19

3.28 The COVID-19 pandemic triggered a global health and economic crisis. The resulting shocks to both demand and supply are leading to the projection of the worst economic downturn since the Great Recessions of the 1930s. Despite efforts to ameliorate the effects, the June 2020 edition of the Global Economic Prospects report indicates a baseline contraction of 5.2 percent in global GDP for 2020. This has the potential to push 71 million into extreme poverty, measured at the international poverty line of \$1.90 per day; and with the downside scenario, this increases to 100 million.³⁷

3.29 The global downturn due to COVID-19 will undermine the projected continuation of economic growth for the Philippines in 2021–22 as well as continuation of the increasing trend in real wages and nonagricultural wage employment. The June 2020 edition of the Philippines Economic Update projects a 1.9 percent contraction, the first contraction since the 1997–98 Asian Financial Crisis (World Bank 2020c). In the short run, the Philippine government policies put in place to control the transmission and spread of the virus (community quarantine) and the preventive behavior of individuals have already had high economic costs and significantly disrupted supply and sharply reduced demand for goods and services (Box 3.3).

3.30 The disruptions in both demand and supply sides of the value chains in the domestic market and global arena will unavoidably lead to challenges for the private sector and pressures on employment in the short run. Informal workers, who account for a large share of Philippine’s workforce, are particularly vulnerable to income loss and layoff from the pandemic. Lacking the basic protection that formal jobs usually provide, such as social security, with typically limited access to health care services and no income replacement if they stop working in case of sickness, they are at risk of falling deeper into poverty during the outbreak and recovery phases and

³⁵ World Bank (2019a). Systematic Country Diagnostic of the Philippines: Realizing the Filipino Dream for 2040.

³⁶ Tholons (2018). Tholons Services Globalization Index (TSGI) 2018.

³⁷ See Mahler and others (June 2020) for discussion of the impact on poverty <https://blogs.worldbank.org/opendata/updated-estimates-impact-covid-19-global-poverty>. based on the forthcoming Global Economic Prospects. That analysis is based on World Bank (2020). Global Economic Prospects Chapter 3: Lasting Scars of the COVID-19 Pandemic. <http://pubdocs.worldbank.org/en/112641588788257004/Global-Economic-Prospects-June-2020-Topical-Issue-1.pdf>

trapped from moving upward. Formal workers, including middle-class wage earners, are more likely to be able to work from home, keeping their existing wage and benefits,³⁸ and they are more likely to have liquid assets to allow them to practice social distancing and buffer health shocks in case they fall ill.

Box 3.3. Impact of COVID-19 on Firms

The effects of the COVID-19 pandemic on firms follow multiple channels:

- On the demand-side, firms lose sales from a drop in domestic consumption, particularly in the tourism, hospitality, and entertainment sectors. Firms may experience lower demand from other firms that are themselves experiencing a drop in demand. This may take the form of payment delays and defaults as buyers and customers go into bankruptcy.
- On the supply-side, firms stay closed (mandatory or voluntary) or deal with reduced availability of labor as workers are affected by travel restrictions, illness, and childcare or household duties. Firms may also experience declines in productivity as workers are less efficient as they adapt to new working hours and modalities of work and firms use new combinations of inputs, all of which may require adjustments to organizational or production processes. Firms that rely on imported inputs are further disrupted from lack of intermediate goods with trade and mobility restrictions.

Funding strains for firms are multifaceted and likely to affect firms of all sizes. MSMEs that rely on funds from personal sources or banks may see those sources dry up. Large firms may have difficulty managing high debt levels or accessing new loans. Some firms may be prematurely forced into liquidation as other firms or banks seek to collect debt for their own financial stability.

As a result of these shocks during the outbreak phase, firms may reduce output, lay off workers, or become unable to pay creditors. Furthermore, uncertainties related to the length and impact of the COVID-19 pandemic may lead to lower investments in firms and lower appetite for risks associated with innovation and entrepreneurship.

Even as the epidemic is contained and economic conditions gradually return to their pre-crisis level with the lifting of mobility restrictions and businesses are allowed to reopen, firms and workers may continue to experience the hardship from the outbreak. Private sector demand may recover too slowly, and there may be delays and difficulties in rehiring workers. Working capital may remain scarce and credit restraints may delay investment. Uncertainty may prevail and the appetite for new investment may decline.

3.31 In the medium and long term, the pandemic will continue to affect the private sector/employment and different segments of the population. An investment contraction and export growth deceleration amid a recovery in private consumption may result in an economic slowdown. The pandemic may exacerbate structural constraints, including challenging the health care system, undermining macro and fiscal sustainability and resilience, threatening financial sector stability, and demanding an effective and responsive social protection system, and resulting in losses in the real sectors and in employment and earnings. In relative terms, the poor and vulnerable will suffer more due to their less secure jobs, limited capacity to cope, and high exposure to the health risks (due to, for example, poor housing conditions and the need to be physically present at the workplace). The middle class, while their wage income might be less severely affected at the beginning given the nature of their jobs, are not shielded from the economic downturn imposed by

³⁸ A survey of workers in the United States showed that 71 percent of workers in the top wage quintile worked from home in March 2020. This is compared to 35 percent of those in the lower-middle quintile who reported being able to work from home (Reeves and Rothwell 2020).

the pandemic, and will suffer asset and income losses due to the uncertainty and the risks channeled through the economy in multiple ways.

3.32 The economic effects of COVID-19 will likely lower growth and aggravate the existing challenges in the labor market in the short term, although productivity may be enhanced in the medium and longer term. As firms face extraordinary challenges with operations and solvency due to the COVID-19 pandemic, millions of workers will be vulnerable to income loss and layoff. A sharp decline in employment, both in number of jobs and aggregate hours of work, is most severely affecting services sectors, such as wholesale and retail trade, accommodation and food services, and real estate, as well as manufacturing sectors (ILO 2020). The dampening of demand for labor (fewer job offers and with lower pay) will likely have a negative effect on upward mobility. However, if the crisis is appropriately leveraged, it may also bring forth productivity enhancing changes such as the improvement in human capital through the strengthening of the health and social protection system, as well as innovation through the increased use of digitalization in many sectors.

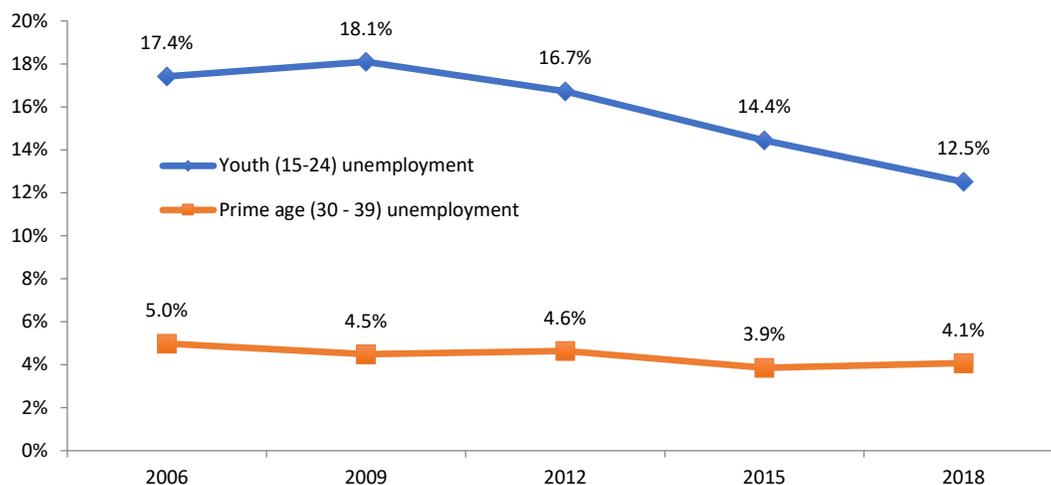
Particular Challenges for Youth

3.33 As in many other countries, youth in the Philippines faced even greater challenges in the labor market, particularly when good-quality jobs are scarce. Compared with prime age workers, youth have a higher unemployment rate, including those with tertiary education, and one out of five are not in employment, education, or training.

YOUTH UNEMPLOYMENT AND UNDEREMPLOYMENT

3.34 The employment rate for young people (age 15–24) is low compared to the prime working age group (age 30–39). Youth unemployment improved slightly from 17.4 percent in 2006 to 12.5 percent in 2018 (Figure 3.13). In comparison, unemployment for the prime working age group hovered around 4 to 5 percent across the years. This indicates, as in many other countries, getting their first jobs is often a daunting challenge for the younger workers.

Figure 3.13. Youth (15–24) Unemployment, 2006–18



Source: LFS various rounds

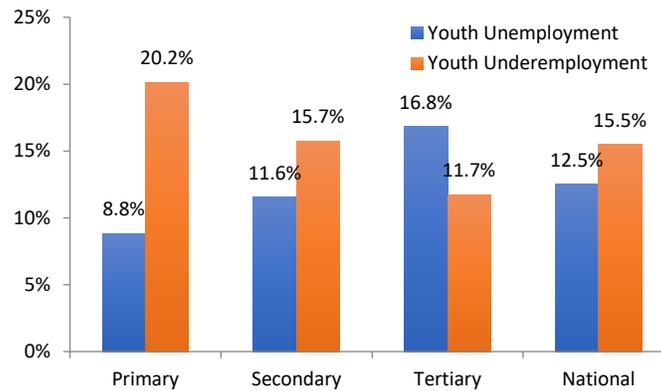
3.35 The youth face high unemployment, particularly those with a tertiary education. Those with tertiary education are having a harder time getting employed than those with only secondary and primary education (Figure 3.14). Seventeen percent of youth with tertiary education is unemployed compared with 12 percent of youth with secondary education and 9 percent of youth with primary education.³⁹

This suggests a college education might not be sufficient in securing a well-paying job in the labor market. Besides the tough job market competition, the reasons for their high unemployment might include unrealistically high reservation wage and lack of work experience, including internship experience. However, for youth who have a job, those with tertiary education are less likely to be underemployed compared to those with only secondary and primary education. Twelve percent of youth with tertiary education are underemployed, compared with 16 percent and 20 percent for youth with secondary education and primary education, respectively.

3.36 While unemployment among prime age workers is lower compared to the youth, they are more likely to face underemployment. This is probably due to the necessity of

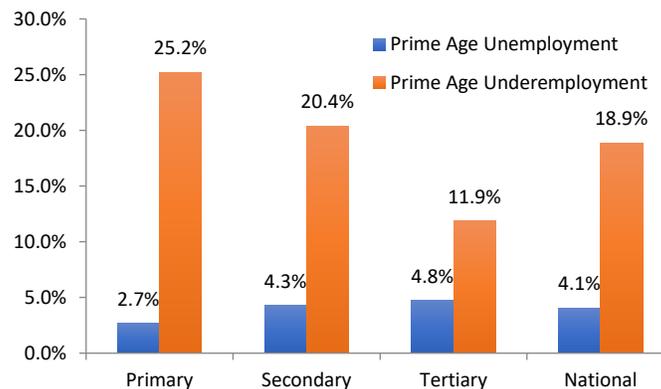
getting a job for living regardless the quality of the jobs the prime age workers can get. Similar to the patterns of the youth group, underemployment of the prime age is higher among those who only have primary education compared to those with secondary and tertiary education (Figure 3.15). This pattern of unemployment and underemployment reflects the dire challenges of job quality in the Philippines.

Figure 3.14. Youth (15–24) Unemployment and Underemployment by Education, 2018



Source: LFS various rounds

Figure 3.15. Prime Age (30–39) Unemployment and Underemployment by Education, 2018

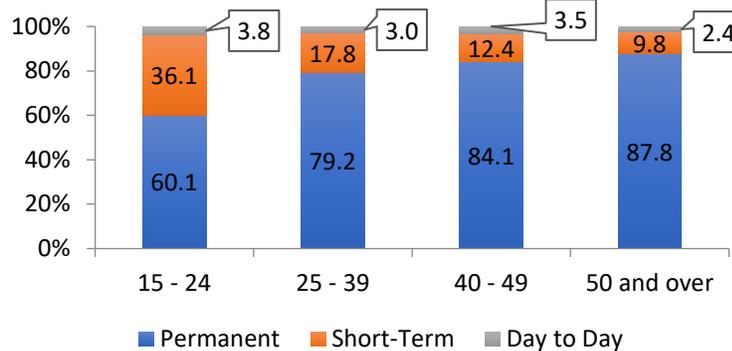


Source: LFS various rounds

³⁹ The difference in unemployment rate across the youth with different education might also reflect the difference in their reservation wage, which is likely related to their household income (or the need to settle with a less than satisfactory job). Similar factors might affect the underemployment ratios as well.

3.37 Finally, youth employment is likely to be informal or temporary. Two out of five of working youth are either short-term or day workers (Figure 3.16). This is in contrast with other age groups, where in at least four-fifths have permanent jobs. The temporary and informal nature of jobs results in limited social protection, or opportunities for training and career progression. Having fewer opportunities for career progression and training hampers potential upward mobility in the future. Youth are also at high risk of losing their jobs during economic downturns, such setbacks could bar them from progressive mobility.

Figure 3.16. Nature of Employment by Age Cohorts, 2018



Source: LFS 2018

YOUTH NOT IN EMPLOYMENT, EDUCATION, OR TRAINING

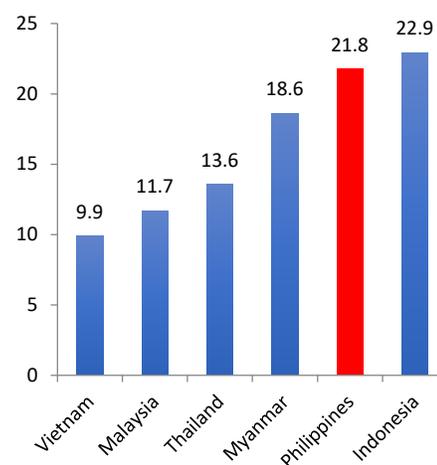
3.38 The rate of youth not in employment, education, or training (NEET) is, though declining, high in the Philippines. While the NEET ratio declined by 3 percentage points from 25 percent in 2006 to 22 percent in 2015, still more than 4 million young Filipinos are not in school, employment, or training (Table 3.2). Neighboring countries in East Asia are doing better: in 2015, in Vietnam, Malaysia, and Thailand, NEET rates were lower than 15 percent (Figure 3.17).

Table 3.2. Rate of Youth Not in Employment, Education, or Training

For all youth				
	2006	2009	2012	2015
NEET rate (weighted)	24.56	25.42	24.79	21.77
Male NEET rate	18.59	19.88	18.83	16.67
Female NEET rate	30.69	31.13	30.98	27.06
NEET magnitude	4,047,122	4,653,807	4,566,231	4,205,538
For youth in bottom 20 percent of households				
	2006	2009	2012	2015
NEET rate (weighted)	25.48	26.00	28.14	25.26
Male NEET rate	15.82	16.07	17.05	16.61
Female NEET rate	37.85	38.08	40.92	35.12
NEET magnitude	890,693	1,062,740	1,266,427	1,236,324

Source: FIES-LFS various rounds.

Figure 3.17. NEET Rates for East Asia and Pacific Countries, 2015

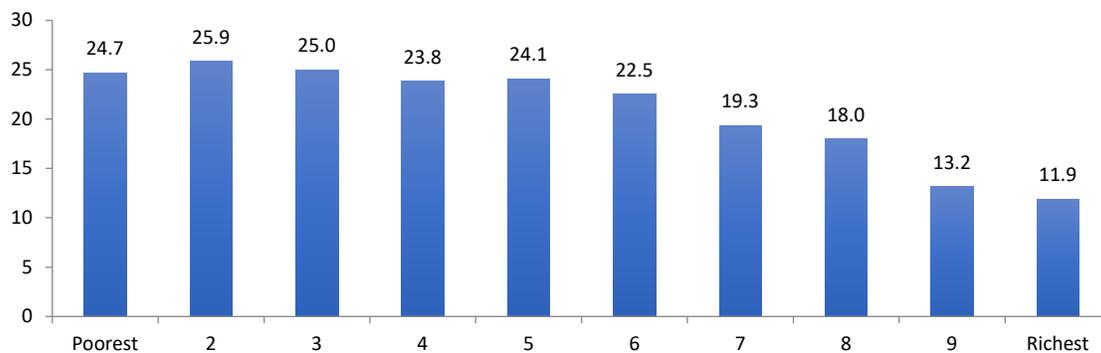


Source: FIES-LFS 2015, World Bank World Development Indicators

3.39 The NEET ratio differed by gender and income groups:

- More females classify as NEET compared to males (Table 3.2). In 2015, about 27 percent of female youth are classified as NEET compared to only about 17 percent for males. The NEET rate reduced to about 20 percent in 2018 (14 percent for male and 26 percent for female).
- The NEET rate is also slightly higher for the youth in the bottom 20 percent of the wealth quintile (Figure 3.18). About a quarter of the youth in the poorest households are classified as NEET. The combined poorest 60 percent of the households have a NEET rate greater than 20 percent. The NEET rate only declines significantly for those in the ninth and richest income decile. Females in the poorest households have a NEET rate of more than 35 percent. The high NEET rate has persisted since 2006.

Figure 3.18. NEET Rate by Income Decile, 2015



Source: 2015 FIES-LFS

SKILLS-JOB MISMATCH AND SLOW SCHOOL-TO-WORK TRANSITION

3.40 About a third of Philippine employers report an inability to fill vacancies because of a lack of applicants with requisite skills. Most of these missing skills are not academic knowledge or technical acumen but socioemotional skills, also known as behavioral skills. Socioemotional skills are associated with large income increases for women, young workers, less-educated workers, and those employed in the service sector. Higher levels of socioemotional skills are also correlated with a greater probability of being employed. However, the education and vocational training sector of the country has been slow to meet the demand for socioemotional skills development (World Bank 2017).

3.41 Employers identified teamwork and interpersonal skills among the important skills being considered in their recruitment process (DOLE 2017). The top five behavioral skills employers look for are willingness to learn, initiative, honesty, integrity, self-motivation, and self-confidence. Meanwhile, the top five functional skills employers look for are communication skills, trainability, competence, problem solving and analytical skills, and technological knowledge. In addition, internship and part-time job experiences is preferred for recent graduates who would like to be hired. Youth were observed to have poor organization, planning, critical and creative thinking, and decision-making skills, all of which are valuable for employers.

3.42 The skills mismatch, among other factors, contributes to a prolonged school-to-work transition, which also affects upward mobility. Many young Filipinos face extended periods of unemployment and underemployment after completing school. Early unemployment increases the likelihood of subsequent unemployment (DOLE 2013). Such prolonged unemployment impedes the upward mobility of youth. In addition, the first job they do get influences lifetime employability. If a former student's first job is a regular wage job, they have a 50 percent chance of staying in formal employment. If a former student's first job is self-employment, they have a 70 percent chance of remaining self-employed and only a 12 percent chance of finding a job in the formal sector (DOLE 2013). While entrepreneurship can be an alternative, particularly where it might lead to building a successful business, helping youths to land a regular wage job as their first job is important to raise their likelihood of future formal employment. Chapter 5 discusses the implications of the prolonged school-to-work transition.

4. Why Well-Paying Jobs Are in Short Supply

4.1 The previous chapters have documented the shortage of well-paying jobs in the Philippines and explained the importance of such jobs to economic mobility and expansion of the middle class. This chapter discusses three reasons why, despite strong economic growth, the private sector did not create enough well-paying jobs: first, lack of dynamism due to restrained competition and high regulation costs; second, premature deindustrialization that hindered the gains from structural transformation; and third, limited and uneven access to finance that constrained the establishment and expansion of productive firms. The chapter also describes the links between the lack of well-paid jobs and remittances, exploring the link between migration, skilled labor supply, and deindustrialization.

Factors Limiting Private Sector Dynamism

4.2 **Despite recent improvements, the business environment in the Philippines remained weak.** According to the Doing Business Report 2020, the Philippines ranked 95th among 190 countries in the world, far behind regional peers such as Malaysia (12), Thailand (21), China (31), Vietnam (70), Indonesia (73), and Mongolia (81). While the business environment has improved in previous years, significant barriers for market entry remained, hindering competition and job creation. Rigid labor market regulations, such as high minimum wages and high costs of employment termination, impede the free movement of labor in the market, making firms reluctant to expand and innovate.⁴⁰ Restrictive labor regulations also contribute to the growth of a large informal sector, which erodes the country's much-needed tax base. Low public investments due to limited fiscal capacity further discourages private sector investment and the creation of quality jobs.⁴¹

4.3 **Lack of competition and constraints in regulation limited the dynamism of the private sector and hampered the ability of the economy to generate good-quality jobs.** Economic competition has been restricted in the Philippines, favoring existing conglomerates. The effect is acute in key economic sectors such as transport, agriculture, wholesale and retail, and manufacturing (IFC 2020). As the 2016 WDR *Digital Dividends* highlighted, absence of competitive pressure leaves market leaders with little incentive to reduce costs by investing in technologies new to the firm, while laggard firms are too far from the frontier to bridge the cost gaps to enter the market. Existing anticompetitive restrictions include regulatory protection of incumbents. This includes such measures as price controls on 40 products deemed as staples, public ownership of firms in competitive sectors, and administrative burdens for startups due to cumbersome registration procedures (IFC 2020). Nye (2012) presents a systematic assessment of the political economy of reform in the Philippines and discusses the merits of promoting competition in a way that makes corruption less likely to grow.

⁴⁰ World Bank. 2019a. *Philippines – Systematic Country Diagnostic: Realizing the Filipino Dream for 2040*.

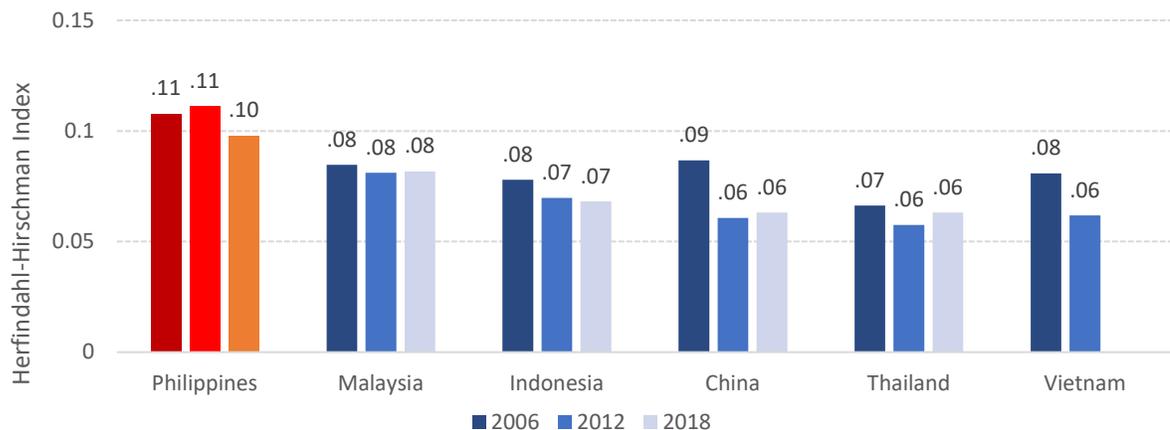
⁴¹ According to World Development Indicators from the World Bank, the level of public investment as a share of GDP in the Philippines is among the lowest in the region and significantly low relative to structural peers. Out of 140 countries included in the 2017–18 World Economic Forum's Global Competitive Index, the Philippines has the worst quality of overall infrastructure in East Asia.

4.4 The high level of market concentration and oligopoly power resulted in high barriers to firm entry hindering entrepreneurship. The Philippines is a difficult country for launching a new business (World Bank Group 2020b).⁴² Many sectors are dominated by a small number of firms. The barriers particularly impede the growth of MSMEs, limiting entrepreneurship and job creation.

4.5 The costly and difficult process of securing property rights has also restricted the access of firms to domestic and foreign capital. Land is both a significant component of costs of conducting business for many firms and required by many financial institutions as collateral for loans. Furthermore, land tenure issues have limited the rollout of infrastructure investment because of the difficulty of legally acquiring rights of way (World Bank Group 2020a). The resulting private sector landscape—dominated by national conglomerates—leaves little room for new entrants.

4.6 Philippine markets are among the most concentrated in the developing East Asia and Pacific region, resulting in a labor market that is more susceptible to monopsony power and low wage growth. The Herfindahl-Hirschman Index,⁴³ a common measure of market concentration, shows that markets in the Philippines are more concentrated than in regional peers such as China, Indonesia, Malaysia, Thailand, and Vietnam (Figure 4.1). Higher market concentration means more market power in the hands of the dominant firms and results in low competitiveness. According to the Enterprise Survey (World Bank 2015), the Philippine manufacturing sector has a higher and increasing proportion of monopoly and duopoly markets.⁴⁴ Market imperfections—the presence of monopolies, market frictions, and the uneven enforcement of property rights—can result in misallocation of resources. Such misallocations can prevent the expansion of productive firms and promote the survival of unproductive ones. They can also discourage firms from investing, growing, and increasing productivity (World Bank 2018a)

Figure 4.1. Herfindahl-Hirschman Index in East Asia and Pacific Countries 2006–18



Source: Based on World Integrated Trade Solution database in available countries, World Bank.

⁴² Philippines ranks 124th out of 190 countries worldwide and outranks only Cambodia and Lao PDR among ASEAN countries.

⁴³ The Herfindahl-Hirschman Index (HHI) is a commonly accepted measure of market concentration. It is calculated by squaring the market share of each firm competing in a market and then summing the resulting numbers. If the market shares are more evenly spread in the market, the index value will be lower. As a result, the higher the index is, the more concentrated and less competitive the market.

⁴⁴ World Bank. (2017b). *Fostering Competition in the Philippines*. Washington DC: World Bank.

4.7 Filipino firms are also burdened by stringent labor regulations that drive up the cost of hiring workers formally and lead them to use temporary employment contracts instead. Labor regulations make it difficult and costly to dismiss regular employees. This results in large amounts of informal employment or short-term “Endo” contracts without benefits and job protections (also see Box 3.2 on page 36). These have benefited only the existing workers with formal wage jobs—less than a quarter of the workforce—but deprived the majority of workers, particularly the poor and vulnerable, of gainful job opportunities (World Bank 2019b). According to a PIDS study (Paqueo and Orbeta 2016), more than 50 percent of first-time temps do not gain regular employment and are let go after two quarters of work as temps. It takes 4-8 quarters for 50 percent of temps to become permanent. Individuals from disadvantaged groups with poor credentials, including women, youth, and workers with less than high school education, faced more difficulties in transitioning to regular jobs. Compliance with minimum wage in the Philippines is low (about 55 percent) compared to countries like Vietnam (about 95 percent) (see Rani and others 2013, Figure 5). According to the World Economic Forum’s Global Competitiveness Report 2017–18, the Philippines ranks 84th out of 137 countries for labor market efficiency and 77th for ease of hiring and firing workers. Redundancy costs—27 weeks of salary—are high, putting the Philippines 118th out of 136 countries.

4.8 Moreover, trade costs in the Philippines are among the highest in the Association of Southeast Asian Nations (ASEAN) (World Bank Group 2020b). While the country has a liberalized trade regime, importing and exporting firms need to comply with a wide range of nontariff costs such as technical regulations, product standards, and customs procedures (World Bank Group 2020a). The costs and time associated with compliance discourage Filipino firms from trading and reduce their opportunities to access larger markets. Moreover, their opportunity to improve productivity by meeting demand for high quality products for foreign markets is reduced.

4.9 Improving competition to allow new businesses to enter the market is key to creating jobs in the Philippines, as new firms can contribute to job creation. Limiting restrictions to trade, which would allow firms to become more competitive and access larger markets, and improving infrastructure, which would lower business costs, would give firms an incentive to improve productivity. This, in turn, would allow Filipino firms to grow and generate good-quality jobs. Improvements are already under way.

4.10 The Philippines government has been reforming its business regulatory and licensing environment. The main vehicle for this reform is the Ease of Doing Business and Efficient Government Service Delivery Act of 2018. The law led to the establishment of the Anti-Red Tape Authority (ARTA), which is responsible for implementing the law to reduce the regulatory burdens of the private sector. The effectiveness of this effort remains to be seen as the Director General of ARTA and the Implementing Rules and Regulations have been in place only since July 2019. The government is also reducing infrastructure gaps at the national and local level through its “Build, Build, Build” program and an amendment to the Public Service Act that is currently under consideration by the Congress. Along with complementary reforms, such as a common-tower policy in the telecommunications sector, the infrastructure improvement could lower private sector costs, increasing the commercial viability of firms in sectors such as tourism, information technology, and business process outsourcing. Ultimately, these reforms could fuel the creation of good-quality jobs that could support upward mobility and growth of the middle class. There is still

significant room to improve the quality of design and implementation of governance processes to make public support to MSMEs more impactful (World Bank 2019b).

4.11 In addition to improvements of resource allocation efficiency, better flow of knowledge across firms through links to external markets and stronger firm capabilities—including innovation, managerial, and entrepreneurship—could give rise to high-growth firms. Such firms are powerful engines of job and output growth and will therefore be key to growing and sustaining the middle class. A study of high-growth firms in 14 developing countries shows that they make up about 20 percent or less of firms in manufacturing and services, yet they create up to 80 percent of all new sales and jobs in these sectors (Grove Goswami and others 2019).

Premature Deindustrialization Limits Structural Upgrade and the Creation of Well-Paying Jobs

4.12 Economic transformation, shifting from lower-productivity to higher-productivity activities, facilitates inclusive and sustainable growth by increasing productivity within sectors and by shifting employment to more productive sectors, as noted in the Jobs and Economic Transformation paper of IDA19.⁴⁵ While higher-end services can become a pathway for growth under specific circumstances, they may not be sufficient to absorb large movements of labor out of agriculture and sustain long-term growth, leaving large labor shares to lower-end services. Services, particularly the lower-end services that predominate in the Philippines, are often less productive than manufacturing, and have lower prospects for growth in productivity in the long-run (Atolia and others 2017).

4.13 The manufacturing sector is not only good for growth, but historically, as shown in the East Asia Miracle, also made possible the existence of the middle class and may be necessary to sustain it (Rodrik 2015; Rodrik and Sabel 2019). Rodrik’s finding on the relationship between manufacturing and growth echoes a classic piece by Baumol (1967), who suggests that economic growth may be distributed unevenly across sectors in an economy, especially between productive sectors that drive growth (such as manufacturing), and less-productive or redistributive sectors that do not (such as services). Meanwhile, as the economy grows, demand for services grows, causing growth to slow as more resources are driven toward the less-productive services sector. Premature deindustrialization may hurt growth (Box 4.1).

Box 4.1. Premature Deindustrialization

“Premature deindustrialization” is a pattern among certain developing countries that would be expected to have increasing employment in productive sectors, such as manufacturing, but instead have decreasing employment in these sectors. In these countries, both the manufacturing share of employment and GDP peak at lower levels of income compared to the experience of more advanced economies. This may hurt growth because manufacturing is more productive and better able to absorb large amounts of unskilled labor than less-productive sectors like services.

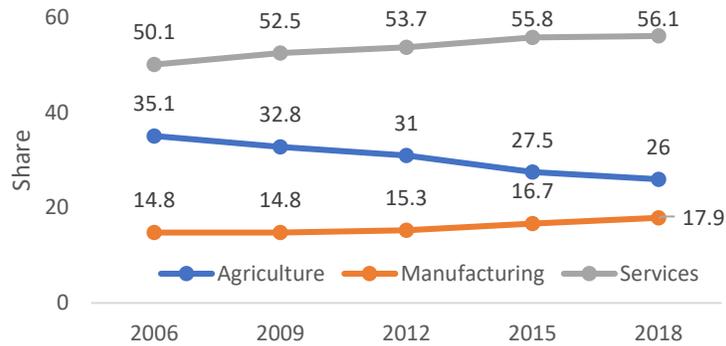
Source: Rodrik (2016)

4.14 Premature deindustrialization is a major reason the Philippines has not created the kind of job growth needed for rapid expansion of the middle class. Whether the boundary between manufacturing and service has been thinning and whether manufacturing can deliver the

⁴⁵ See more information in <https://ida.worldbank.org/theme/jobs-and-economic-transformation>

same productivity gains and well-paid employment opportunities for unskilled workers in the future as it has in the past are subjects of ongoing debate. In the era of the fourth industrial revolution, the path to better jobs in a country like Philippines might also hinge on the “servitization” of manufacturing, draw on the comparative advantages of the country, use the young and increasingly educated labor force with an abundance of intermediate education, and adapt to global and regional challenges.

Figure 4.2. Share of Employed Population by Sector, 2006–18



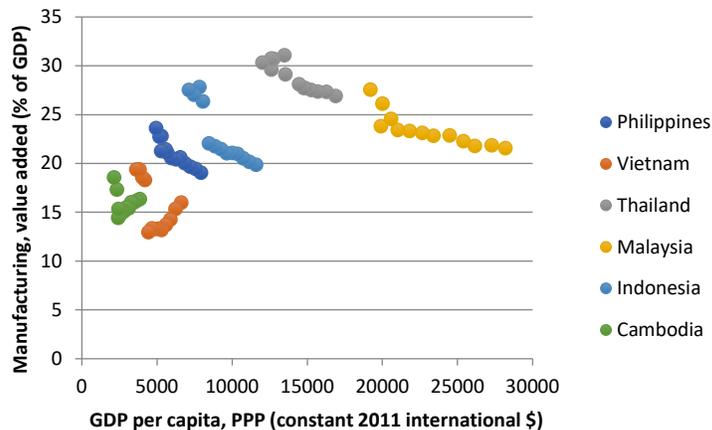
Source: LFS various rounds

PREMATURE DEINDUSTRIALIZATION IN DOMESTIC PRODUCTION AND EMPLOYMENT STRUCTURE

4.15 Manufacturing is not only a low share of the Philippines GDP, but its growth has stagnated and the economy has started shifting toward the services sector at a low level of development. In the past decade, a significant portion of labor moved out of agriculture—nearly one percent of workers per year shifted from agriculture to non-agriculture jobs (Figure 4.2). This resulted in a decline in the share of the total labor force working in agriculture from 35 percent in 2006 to 26 percent in 2018. The shift was to the services sector, which grew from 50 percent in 2006 to 56 percent in 2018. The manufacturing and industry sector grew only from 15 percent in 2006 to 18 percent in 2018.

4.16 The share of the manufacturing sector in the Philippines is not only lower than in many other East Asia and Pacific countries but also started to decline at a lower level of income (Figure 4.3). While Cambodia and Vietnam witnessed a sharp increase in the share of manufacturing to GDP after the global economic crisis in 2008, the Philippines witnessed a continuous decline in the same ratio starting at a lower development level compared with Indonesia, Malaysia, and Thailand. As

Figure 4.3. Manufacturing and GDP Per Capita in East Asia and Pacific Countries, 2006–18



Source: World Bank World Development Indicators

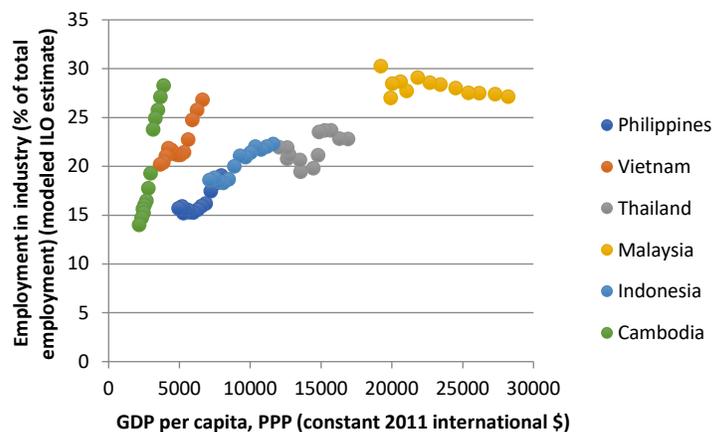
of 2018, the manufacturing sector accounted for only 19 percent of GDP in the Philippines, significantly lower than the ratio for many East Asia countries, including Indonesia, when they were at the similar income level.

4.17 The employment share in the manufacturing and industry sector in the Philippines is also low compared with other countries in the region (Figure 4.4). In Cambodia and Vietnam, a boom labor-intensive industry was accompanied by a sharp increase in the share of employment in manufacturing. In Cambodia the share doubled from 14 percent to 28 percent in a 12-year period 2006–18; in Vietnam, which started at a higher level, the share increased by a third from 20 percent to 27 percent. In the Philippines, the ratio increased only three percentage points, from 16 percent to 19 percent in the same period. As a result, the employment share of manufacturing in the Philippines lags many regional peers, including those with higher or lower income levels.

4.18 Compared with other East Asian countries, including China, Indonesia, Malaysia, and Thailand, labor productivity growth in the Philippines disproportionately relies on within-sector productivity growth. In other words, the reallocation of labor toward sectors with higher productivity (or “static reallocation”) or faster productivity growth (or “dynamic reallocation”), including from agriculture toward non-agricultural activities such as manufacturing, construction, and services, was more limited in the Philippines over the past decade than in many other East Asian countries (Figure 4.5).

4.19 Labor gains due to worker movement out of agriculture to low-end services are lower than those due to movement from agriculture to manufacturing (Figure 4.6). Daily wages in agriculture were \$11 (2011 PPP) in 2017, with little dispersion in the sector. Industrial jobs averaged \$20 per day. Although services jobs offer higher average wages (\$24) than both agriculture and industry, they are more dispersed,

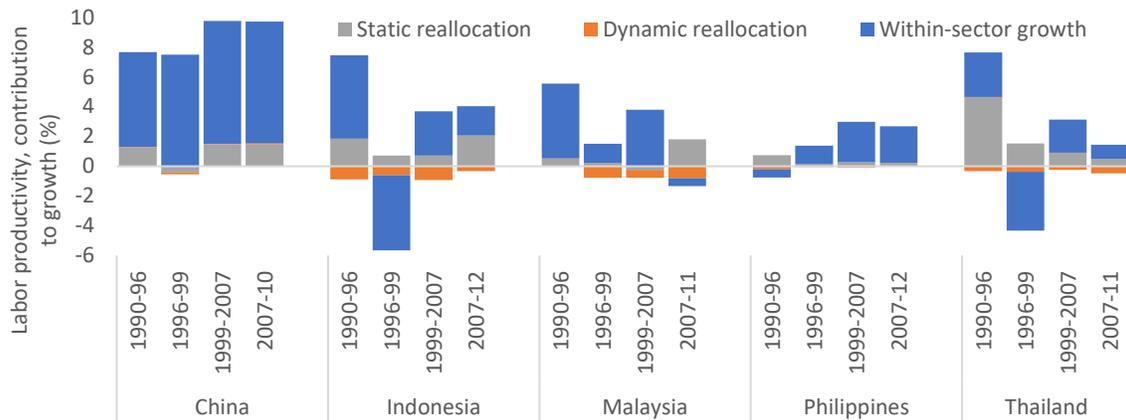
Figure 4.4. Employment in Manufacturing and Industry and GDP Per Capita in EAP Countries, 2006–18



Source: World Bank World Development Indicators

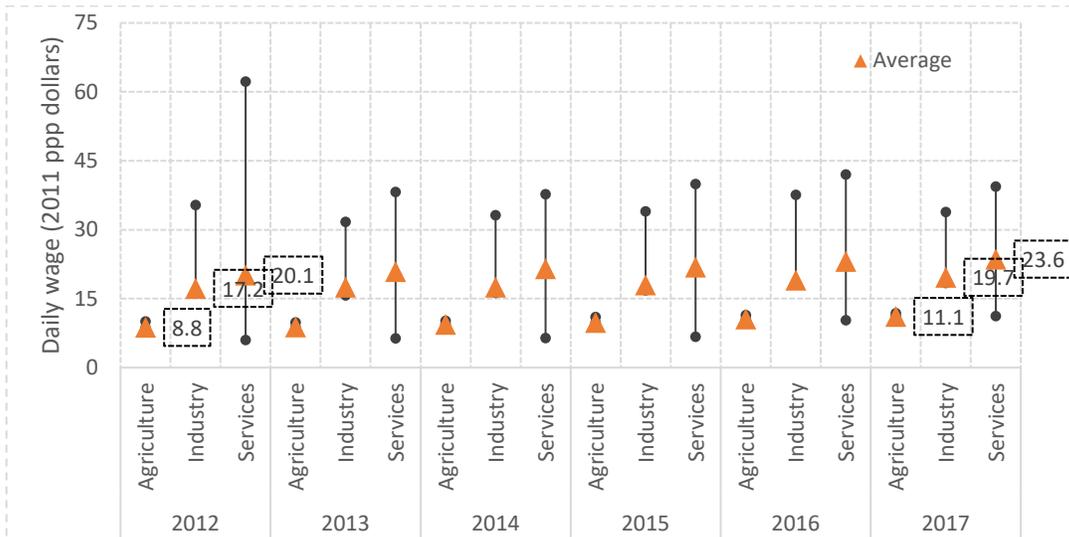
with a long tail in the lower end. Some low-paid services jobs pay the same or even less than agriculture jobs. Industry jobs, including those that require low levels of skills and education, offer higher wages than the low-end services sector. Manufacturing jobs, many in formal sector firms unlike many services jobs that are self-employed and informal, offer workers with low levels of education opportunities for “learning-by-doing” to accumulate human capital and prepare to compete for better-paid jobs. The limited movement of labor into the industry and manufacturing sector could negatively affect the long-term competitiveness for the Philippines. As the previous chapter noted, only a small share of workers in the Philippines are employed in higher-end finance, insurance, and real estate, sectors.

Figure 4.5. Intersectoral Labor Allocation in Selected East Asian Countries



Source: Cited from EAP update, April 2017, p. 68. Staff estimates based on data from the Groningen Growth and Development Centre 10-Sector Database; www.rug.nl/ggdc/productivity/10-sector.

Figure 4.6. Wage Level and Dispersion Across Sectors, 2012–17



Note: Philippine Statistics Authority. Upper and lower end dots represent the maximum and minimum of wages in the sector.

4.20 To achieve higher growth and create more jobs for the poor, the Philippines needs to reshape the transformation process. This process entails transforming the economy from one that is currently driven by narrow high-skill and capital-intensive sectors to one that is driven by labor-intensive, but relatively high value-added manufacturing (World Bank 2013). At the same time, the Philippines needs to seize the new opportunities in the regional and global arena exploring areas that the Philippines has the most comparative advantages in the supply chain.

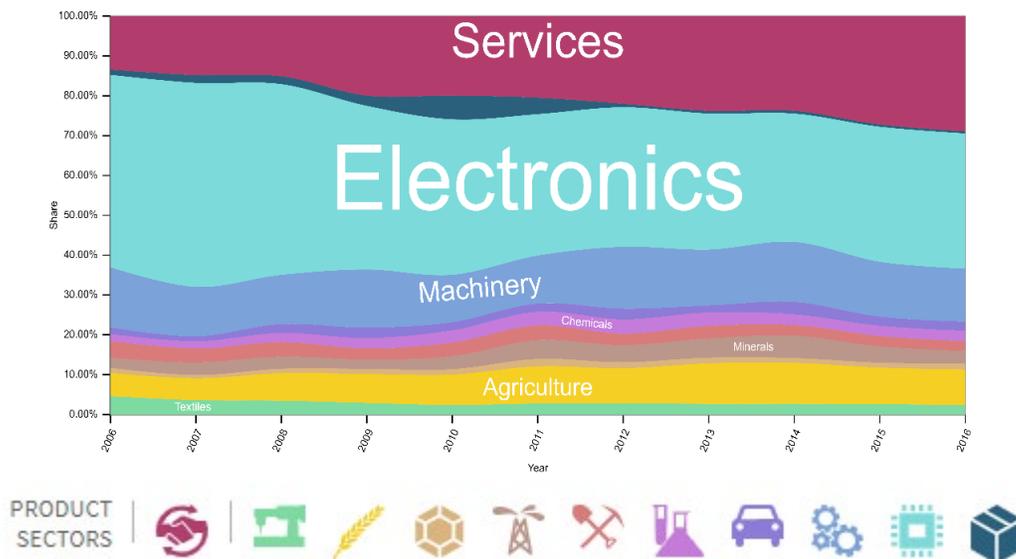
PREMATURE DEINDUSTRIALIZATION IN EXPORT COMPOSITION AND VALUE CHAIN PARTICIPATION

4.21 The premature deindustrialization is also reflected in the significant structural transformation in the composition of its exports in the Philippines. A substantial part of this transformation was a shift toward service exports, slight growth in agriculture exports, and stagnation in manufacturing exports. This is in stark contrast to the export composition of selected

countries in the region, with Vietnam displaying a sharp growth in manufacturing exports in recent years. While electronics exports remain a dominant share of manufacturing exports in the Philippines—its high-technology share of manufacturing exports is the highest in the world—this masks the low value-added nature of the exports, a weakness that has persisted for decades.

4.22 The export composition over the past decade shows a rising share of service exports and a stagnant share of manufacturing.⁴⁶ Between 2006 and 2016, agriculture represented a small share of exports and the share increased only slightly, from about 6 percent to 9 percent (Figure 4.7).⁴⁷ In contrast, the value of services exported tripled from \$11.1 billion in 2006 to \$31.2 billion in 2016. The largest subset of services, ICT, rose as a share of exports from about 13 percent in 2006 to 29 percent in 2016. This growth means that the service share of exports is now three times that of agriculture and nearly as large as that of manufactured electronics (Figure 4.7). Meanwhile, growth in manufactured electronics exports stagnated. Over this same period, the value of manufactured electronics exports⁴⁸ from the Philippines has stagnated and even contracted slightly (Figure 4.8).

Figure 4.7. Philippines Export Composition, 2006–16



Note: From left to right, the sectors are: Services, Textiles, Agriculture, Stone, Minerals, Metals, Chemicals, Vehicles, Machinery, Electronics, and Other.

Source: Atlas of Economic Complexity, Harvard Growth Lab. See footnote 47 for details.

⁴⁶ The agriculture share includes wood; fruits and nuts; animal or vegetable fats, oils, or waxes; articles of leather; fish; preparations of vegetables, fruit, or nuts; preparations of meat or fish; tobacco; preparations of cereals, flour, starch, or milk; among others. Manufactured electronics includes electrical machinery and equipment. Services includes information and communications technology (ICT), travel and tourism, transport, insurance and finance, and unspecified services.

⁴⁷ The data source for Figures 9–14 is the Atlas of Economic Complexity developed at Harvard’s Growth Lab (<https://atlas.cid.harvard.edu/what-is-the-atlas>). This data source contains information on imports and exports for 250 countries covering more than 6,000 products. Trade data on goods from the UN Statistics Division COMTRADE dataset and trade data on services comes from the IMF Direction of Trade Statistics dataset.

The classification codes used in this report are the SIC 1-digit codes for Services, Textiles, Agriculture, Stone, Minerals, Metals, Chemicals, Vehicles, Machinery, Electronics, and Other. Gross trade flows are reported in current U.S. dollars.

⁴⁸ Electronic and integrated circuits, semiconductor devices, insulated electrical wire, electronic transformers, some electrical machines and apparatus, electrical capacitors, sound storage media, and telephones, among others.

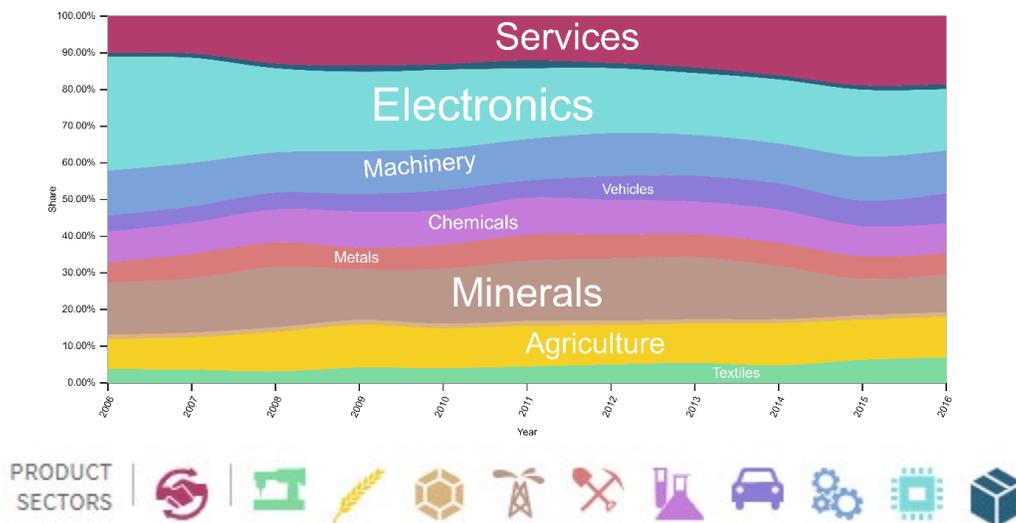
Figure 4.8. Value of Services Exports from the Philippines, 2006–16



Source: Atlas of Economic Complexity, Harvard Growth Lab. See footnote 47 for details.

4.23 The stagnation of the manufacturing exports contributed to that of the import of machinery and electronics. Imports of machinery and electronics, which may represent capital inputs to manufacturing, have been flat or shrunk slightly as a proportion of total imports due to the limited growth in manufacturing in the country (Figure 4.9). The contrasts with selected countries in the region.

Figure 4.9. Philippines Import Composition, 2006–16



Note: From left to right, the sectors are: Services, Textiles, Agriculture, Stone, Minerals, Metals, Chemicals, Vehicles, Machinery, Electronics, and Other.

Source: Atlas of Economic Complexity, Harvard Growth Lab. See footnote 47 for details.

4.24 Stagnant manufacturing exports growth in the Philippines contrasts with the rise of manufacturing exports in several other East Asia countries, such as Vietnam, China, and Malaysia.

- Vietnam has seen a large shift in the composition of exports and imports since 2006. The share of agricultural goods as exports has fallen since 2006 (Figure 4.10). Meanwhile, the

Chapter 4
Why Well-Paying Jobs Are in Short Supply

country exported increasing shares of electronics and clothing. Vietnam’s 2006 export composition is distinct from that of the Philippines, with a much smaller share of electronics and machinery. However, due to recent sharp growth in its electrical machinery and equipment exports, the share of those exports in 2016 now resembles that of the Philippines. At the same time, Vietnam’s services share of exports is only a fifth that of the Philippines.

- China underwent important transformations earlier in its history. During 2006–2016, its export and import shares changed slowly. As in the Philippines, electronic machinery and equipment account for a large share of China’s export goods (Figure 4.11). However, while the share of manufacturing in total exports declined, the share of electronics grew from 23 percent of exports in 2006 to 26 percent in 2016. Moreover, the services share of exports, 8 percent, is about one-quarter of the services share in the Philippines. Meanwhile, garments exports declined in China. The composition of goods imports in 2016 is similar to the Philippines, although China has higher imports of natural resources. China’s imports evolved differently over the period, with a decreasing share attributable to electronics and machinery.

Figure 4.10. Vietnam Export Composition, 2006–16

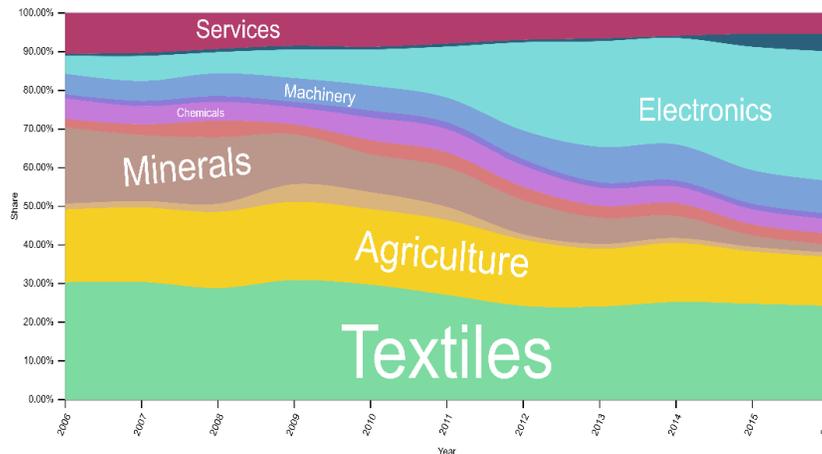


Figure 4.11. China Export Composition, 2006–16

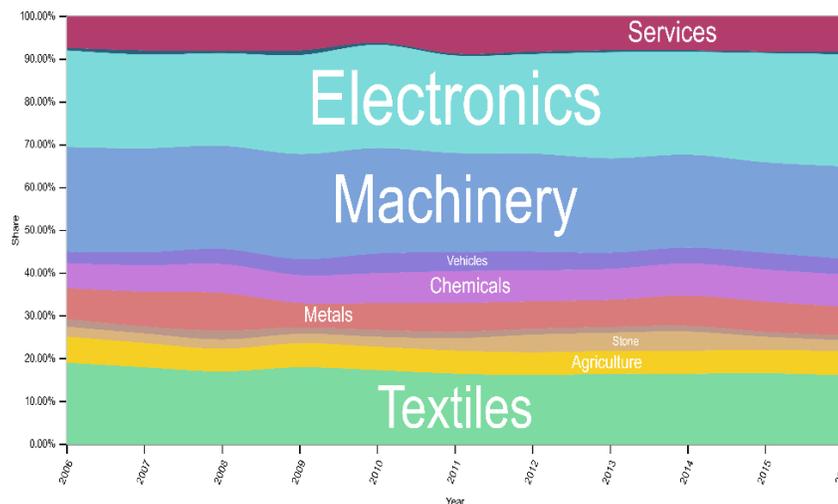
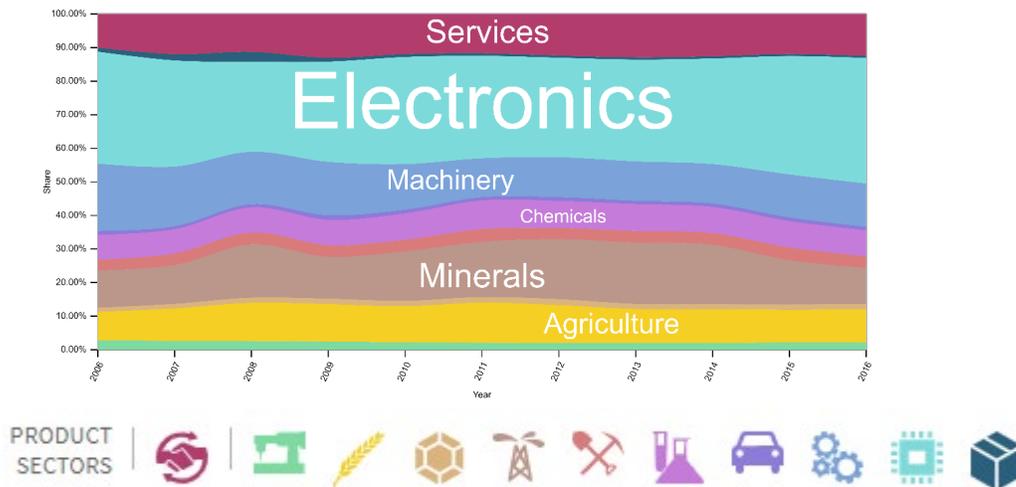


Figure 4.12. Malaysia Export Composition, 2006–16



Note: From left to right, the sectors are: Services, Textiles, Agriculture, Stone, Minerals, Metals, Chemicals, Vehicles, Machinery, Electronics, and Other.

Source: Atlas of Economic Complexity, Harvard Growth Lab. See footnote 47 for details.

- **Malaysia has had a steady and small share of services exports and a growing share in manufacturing.** Services exports have stayed nearly constant as a share of all exports, growing only slightly from 10 percent in 2006 to 13 percent in 2016 (Figure 4.12). This share is much smaller than that of the Philippines, reflecting Malaysia’s industrialization. However, manufacturing exports still make up a large portion, with the share of electronics exports growing from 33 percent to 37 percent over the period, even though Malaysia has already achieved upper middle-income status.

4.25 The patterns of exports of electronics in the Philippines in the past years contrast sharply with many neighboring East Asian countries. Although Vietnam entered the global electronics industry fairly late (around 2007), its exports now exceed those of the Philippines, reflecting significant transformation in recent years, partly made possible by its geographic proximity and economic ties to China (Frederick and Gereffi 2016). A World Bank report (World Bank 1999) found that the growth of electronic exports in the Philippines had been impressive in the late 1990s, surpassing even that of Malaysia and other neighbors. However, the value-added and local content were low—only 10–15 percent—much lower than that of Malaysia (45 percent) during this period. Moreover, the global financial crisis may have contributed to stagnated growth: exports of global value chain goods from the Philippines fell significantly and have not yet recovered (Li and others 2019).

4.26 The Philippines still has significant room to move higher in the global value chain. In 2018, 61 percent of manufactured exports from the Philippines were high technology (WDI 2018). While this is the highest in the world, it masks several underperforming aspects of those exports, as noted by a recent study (Frederick and Gereffi 2016). First, despite its strong performance, the Philippine electronics industry still contributes very little to the global market, accounting for just 1 percent of the global exports in electronics and electrical industry. Second, the industry contributes mainly to the component stage of the global value chain, rather than the more profitable subassemblies and final products segments. Where it contributes final products, it produces mainly office and storage equipment and computer peripherals rather than computers or industrial equipment, a rapidly growing

sector of the global market. Third, raw materials represent 80 percent of costs and are mostly imported, suggesting that local sourcing and “backward linkages” are limited and that the domestic value added of Philippine high-tech exports is low. Finally, the loss of engineers to overseas labor markets presents a challenge to upgrading to higher-value segments of the global chain.

Limited and Uneven Access to Finance Hindered the Start and Expansion of Business

4.27 While the financial system in the Philippines has grown in size in recent years and continues to be stable and resilient,⁴⁹ access to and usage of financial services remains relatively low compared with many countries in the East Asia region. The banking sector is well-established and profitable with its activity concentrating on basic lending and deposit-taking. There has also been an increase in financial access points through banks’ offices and branches, automated teller machines (ATMs), E-banking, and E-money services. As the financial services expand to include those that have not had access to traditional banking, pawnshops and money service businesses (MSBs) have become important tools. However, only one third of adults and only 4 percent of small firms and 17 percent of medium firms accessed bank credit.

LIMITED AND UNEVEN ACCESS TO FINANCIAL SERVICES

4.28 Access to transaction accounts in the Philippines is rising slowly but is significantly behind regional and global averages. According to Global Findex 2017, only 34 percent of adults had accounts; slightly up from 31 percent and 27 percent in 2014 and 2011, respectively. It is significantly lower compared to some of its peer economies, including Indonesia, Malaysia, and Thailand, whose account holder percentages in 2017 were 49 percent, 85 percent, and 82 percent, respectively. Compared with Cambodia (22 percent), Myanmar (26 percent), and Vietnam (31 percent), the adult bank account penetration in the Philippines is slightly higher. The same database shows that in 2017 the global average of account ownership was 69 percent, the regional (East Asia and Pacific) average was 71 percent, and the lower middle-income group (where the Philippines is included) average was 58 percent.

4.29 Access to financial services is limited and uneven for individuals and for firms in the Philippines.⁵⁰

- At the individual level, roughly two-thirds of adults remain unbanked. This translates into about 40 million adults without a transaction account. Among adults in the richest 60 percent of households, 45 percent have an account, against 18 percent of those in the poorest 40 percent of households. The unbanked in the Philippines cite various barriers to getting an account, including physical distance from financial institutions (41 percent), high costs of financial services (53 percent), and lack of necessary documentation that is required to open an account (45 percent). These numbers are roughly twice the developing world averages. Most banks require a minimum balance to open and maintain an account; even if individuals have cash that exceeds such minimum balance, if it is not a high sum of money they may not feel it is worth opening an account at a formal financial institution, given the perceived high

⁴⁹ See Appendix F for more details.

⁵⁰ See Appendix G for details.

- costs of financial services and hidden costs of preparing documentation and traveling the distance to access financial institutions. Sixty-nine percent of the unbanked in the Philippines stated that they do not have sufficient funds to save in an account.
- At the firm level, while over 90 percent of small and medium enterprise firms have bank accounts, only 4 percent of small firms and 17 percent of medium firms accessed bank credit. Less than 7 percent of the working capital of the country's firms is financed by banks, compared to an average of 18 percent in regional peers. The level of domestic credit to the private sector is low in the Philippines. According to IFC and the SME Finance Forum, the MSME finance gap in the Philippines is estimated at \$221.8 billion, equivalent to about 71 percent of the country's GDP in 2017.⁵¹ The Philippines is severely challenged in this area, lagging far behind its peers from the same income group in the region. Firms cite various constraints in getting access to finance, including absence of a national ID system, lack of credit history, and insufficient collateral for many smaller firms. This limits their growth, which leads to lower creation of jobs that support the economy and upward mobility.⁵²

4.30 In the conflict-affected areas of ARMM, the landscape of access to finance is extremely challenging. Only 8.5 percent of local government units in ARMM has at least one banking office compared to a 2018 national average of 67.2 percent. The number of banks per 100 square kilometers is 0.3 in ARMM and 8.68 in the country. The number of deposit accounts per 10,000 population is 549 in ARMM and 8,321 nationally (BSP 2018). Microfinance NGOs and pawnshops are widely available for small credit. Informal lenders offer informal credit with a high interest of 20 percent.

ACCESS CONSTRAINTS AS OBSTACLES TO BUSINESS EXPANSION AND JOB CREATION

4.31 Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs—transactions, payments, savings, credit, and insurance—delivered in a responsible and sustainable way. The limited financial access constrains day-to-day living and hinders the ability of individuals, families, and businesses to plan for everything from long-term goals to unexpected emergencies (Box 4.2).

Box 4.2. Role of Access to Finance

Access to financial services can have a strong impact on income and consumption growth. A growing body of financial inclusion research shows that when poor people have opportunities to better manage their money, over time their income and consumption will improve by:

- Making day-to-day transactions possible, including sending and receiving money;
- Safeguarding savings, which can help manage cash flow spikes, smooth consumption, and build working capital;
- Helping finance small businesses or microenterprises, enabling owners to invest in assets and grow their businesses;
- Supporting planning and paying for recurring expenses, such as school fees, electricity, and water access;

⁵¹ <https://www.smefinanceforum.org/data-sites/msme-finance-gap>

⁵² See more details in World Bank (2019b), Philippines: Assessing the Effectiveness of MSME and Entrepreneurship Support.

- Mitigating shocks and managing expenses related to unexpected events, such as medical emergencies, death in the family, theft, or natural disasters; and
- Improving overall welfare.

People who have accounts are more likely to use other financial services, such as credit and insurance, to start and expand businesses, invest in education or health, manage risk, and weather financial shocks, which can improve the overall quality of their lives. Evidence is building that financial inclusion is a key enabler for reducing poverty and for achieving the United Nations' Sustainable Development Goals of improved education, better health, food security, access to clean water, and more. Having more access to financial services helps improve the lives of the poor and support upward mobility and, over time, enable wealth accumulation. This would allow the poor and vulnerable to become more financially secure, thereby reducing poverty and expanding the middle class.

The Consultative Group to Assist the Poor (CGAP) presents some evidence from their experience: In Kenya, women-headed households with access to mobile money services increased their savings by more than a fifth. In Malawi, farmers with earnings deposited into a savings account spent 13 percent more on farm equipment and their crop values rose by 15 percent.

Source: Consultative Group to Assist the Poor (www.cgap.org).

4.32 Limited access to finance hinders upward mobility. Poor people, who less often have financial accounts, are more likely to face higher financial costs. As most of their income goes to food, during periods where the cash on hand is not sufficient, they are unable to meet the subsistence needs for the family and send children to school. After exhausting the possibilities for borrowing from personal networks, people turn to high-interest credit from informal money lenders, resulting in persistent debt and an erosion of the effective value of their incomes (Box 4.3).⁵³

Box 4.3. The Effects of High Financing Costs on Mobility Among the Poor

For the poor and economically vulnerable cash flow is often unpredictable and difficult, so they do not have any savings cushion to get them through a week or sometimes even a day. This means they are constantly in debt to the neighborhood creditor.

The terms of the informal loans are often referred to as “5/6”, meaning they are paying roughly 20 percent interest on the loan amount for a period of 30–45 days. If they borrow 1,000 pesos, the total amount to be repaid is 1,200 pesos at the end of the loan period. These loans are used regularly to purchase food during the week that the family is waiting for the breadwinner’s salary. Whatever the value of the minimum wage salary, it is already reduced by 20 percent due to debt servicing on loans taken out.

“Sometimes there would be a job where the salary is given every two weeks.” [To buy what we need] “We will borrow money.” It is really hard, sometimes you get work but you have to spend before salary comes in, but you need money.” “They work this week, they get paid next week.” You are buried in debt and cannot save. You have to buy one kilo of rice for the day just to have something to eat.”

—poor members of focus groups

4.33 Limited access to equitable finance is a major obstacle in the ability of people to start and expand their businesses, which is the engine to create more and better jobs. Firms often cite lack of access to finance as a major constraint on their performance and competitiveness. Lack

⁵³ Also see Appendix H.

of access to finance implies that firms cannot obtain funding from banks and the financial markets which is needed to start, innovate, grow, and develop their enterprises.

4.34 Challenges in access to finance result in a missed opportunity for creating more jobs in the Philippines, particularly for micro, small, and medium enterprises (MSMEs). Ninety-nine percent of the enterprises in the Philippines are MSMEs, which generate nearly two-thirds of the country's total employment (Box 4.4). Thirty percent of all jobs were generated by micro enterprises, 26 percent by small enterprises, and 7 percent by medium enterprises.⁵⁴ Firms often cite lack of access to finance as one of the major constraints affecting their performance and competitiveness.

Box 4.4. MSMEs

Economic growth has generated jobs in the Philippines, but the bulk of the jobs generated in the informal sector offer low-paying and poor-quality. Ninety-nine percent of the enterprises are MSMEs, which generate nearly two-thirds of the country's total employment. Of nearly 40 million jobs generated in the private sector, only 20 percent were created by formal registered business. Over 17 percent of the working population participates in early-stage entrepreneurial activity with a potential to innovate and generate jobs. New firms are typically responsible for most of the net job growth and a source of innovation and potential increase of productivity through competition. However, despite the high rate of entry into entrepreneurial activity, the rate of failure is also higher than regional comparators. As a result, new business formation is stagnant, and is much lower than Malaysia (Global Entrepreneurship Monitor), the top performer, and the Philippine economy had a low rate of firm birth (World Development Indicators 2018). The productivity of MSMEs in the Philippines lags significantly behind large firms and neighboring countries, which fundamentally limits the quality of jobs created.

Multiple constraints hinder the productivity of MSMEs and entrepreneurship. Improving access to finance, especially at the growth stage, and improving competition and making the country regulatory environment friendlier to investment can help firms to start and grow in the country.

A startup survey conducted with more than 100 CEOs and founders in the Philippines in 2017 found that current startup ecosystem challenges range from access to capital (88 percent), regulatory requirements (54 percent), business/economic conditions (50 percent), talent retention (36 percent), and competition (35 percent). According to the 2015 World Bank Enterprise Survey for the Philippines, 22.6 percent of small firms and 16.5 percent of medium firms found the 'practices of competitors in the informal sector' to be the main obstacle for their business, followed by access to finance (10.2 percent of small firms, 12.9 percent of medium firms), and corruption (9.7 percent of small firms, 12.9 percent of medium firm).

Note: Of the total establishments in the Philippines, 90 percent were microenterprises (1–9 employees), 10 percent were small enterprises (10–99 employees), and less than 1 percent were medium enterprises (100–199 employees).

Source: World Bank (2019b), Philippines: Assessing the Effectiveness of MSME and Entrepreneurship Support.

4.35 Digital technology could help overcome some of these challenges. Of the 41 percent of unbanked adults who cite distance as a barrier, 71 percent have a mobile phone. Moving routine cash payments into accounts could increase financial inclusion. If businesses paid unbanked employees digitally instead of in cash, the overall share of unbanked adults could drop by 29 percent—and 10 million of these workers have a mobile phone that could help facilitate the switch to electronic payroll. If the government digitized payments of wages, social benefits, and pensions, the share of unbanked women could fall by up to a fifth—including 3 million with a mobile phone.

⁵⁴ MSME Development Plan 2017–2022, Department of Trade and Industry, the Philippines

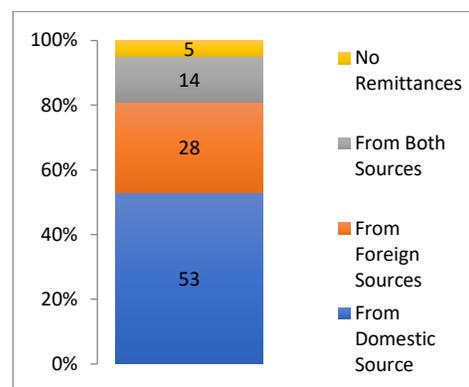
4.36 The agricultural supply chain also has financial inclusion potential if the use of mobile technology can be expanded. One out of five unbanked adults receive cash payments for the sale of agricultural goods—and 6 million of these recipients have a mobile phone. Even financially included adults use cash in the agricultural supply chain. Among adults who have an account, 19 percent receive agricultural payments in cash—including almost 5 million who have a mobile phone.⁵⁵

Links Between Migration and Limited Well-Paying Job Opportunities

4.37 The large emigration in the Philippines both reflects and contributes to the limited availability of well-paying jobs. The number of migrants increased steadily, from 3 percent of the population to 5 percent from 1990 to 2018 (World Bank 2019a). Remittances are an important pillar of the Philippines’ economy, with money sent from more than 10 million people working abroad (Overseas Filipino Workers, OFW). Remittances account for 10 percent of GDP and 18 percent of middle-income households rely on cash receipts or support from abroad as their most important source of income. In 2015, 15 million households, or two-thirds of the total household population, received remittances—12 million (or 53 percent) households from domestic sources, 6.3 million (or 28 percent) from foreign sources, and 3.2 million (or 14 percent) from both sources (Figure 4.13). The main upside effect of migration and remittances is a positive impact on the welfare of migrant-sending households. But migration also can have downside effects, taking a toll on relationships between migrants and the children they leave behind. Moreover, it can cause a version of “Dutch disease”—an appreciation of the real exchange rate that makes exports relatively expensive and therefore less competitive (World Bank 2019a). Emigration can also have implications for the labor market both from the job supply and demand sides.

4.38 Remittances may contribute to deindustrialization through their impact on exchange rates. Williamson and de Dios (2014 and 2015) point out that, along with trade liberalization, currency appreciation, and political instability, the Philippine industrial slowdown through the 1990s and 2000s might be attributed to increased emigration, leading to an enormous increased flow of remittances and an appreciated currency that caused exports to fall and industry to suffer (Dutch Disease). Empirical evidence from Latin American countries supports the role of exchange rates in slowing growth (Adams 2011). Several studies suggest the existence of the Dutch Disease spanning the 1980s through more recent years in the Philippines (Williamson and de Dios 2014; de Dios and Williamson 2015; Medalla, Fabella, and Dios 2014). With the post-war economic data, these studies argue the existence of the Dutch Disease in the Philippines, with migration, along with institutions, trade liberalization, and exchange rates, being the transmission channels.

Figure 4.13. Households Receiving Remittances by Type, 2015



Source: Staff calculations from FIES and LFS data

⁵⁵ See Appendix G.

4.39 **Migration may also link to a decrease in the skilled labor supply.** The same migration patterns that is linked to currency appreciation may also be associated with a shift in the domestic labor supply, drawing skilled and unskilled workers away from industry (Williamson and de Dios 2014; Dios 2013). These mechanisms may grow stronger as the global middle class grows, as previous work from the Philippines and elsewhere suggests that those with higher incomes may have better ability to migrate (Carlos 2002).

4.40 **Migration may also be associated with a decrease of the supply of labor available for manufacturing by affecting expected returns to various occupations in a separate but related mechanism.** Individuals may invest more in education to increase their chances of finding work overseas, but they choose specializations that prepare them for work in the services sector rather than manufacturing. For example, in the Philippines, the choice to enter the nursing profession appears to be closely related to the availability of U.S. visas and recruiters (Abarcar and Theoharides 2017). This suggests that, when choosing an occupation, individuals consider not only the potential returns to employment in each sector domestically, but also consider the potential for migration. This makes them more likely to choose services occupations than manufacturing. The recent rise of the business process outsourcing sector in the Philippines is arguably a related phenomenon—in that workers are making educational and occupational choices in response to the changing needs of high-income economies and labor market opportunities in their service sectors.

4.41 **This shift of the services-focused production structure and consumption-driven growth pattern may be related, in part, to a large remittance flows into the Philippines.** This may become stronger as the global middle class increases, if higher-income households are more likely to migrate. It may also be due to occupational choice in an economic context where individuals face higher returns to service-sector occupations, including through expected gains from the possibility of migration. These patterns are reflected and may be stronger for members of the global middle class, who are more likely than other classes to work in the services sector.

4.42 **The impact of migration on the economy is complex.** On one hand, remittances raise the welfare of the migrant-sending households and finance investment in human capital. On the other hand, in addition to adding stress for the migrants and the left-behind children and causing a version of “Dutch Disease,” migration may alter the incentive to pursue education and result in the uncertainty of “brain drain” or “skill flow.” The loss of manufacturing sector workers and investments in education in preparation for service sector occupations—both of which are a response to foreign labor demand—may help speed up premature deindustrialization and dampen domestic economic prospects. In addition, emigration may also affect institutions in the context of the domination of the domestic politics by conglomerates. In addition, as the middle class continues to expand, through multiple channels. As migration provides people with an option to exit, it might change the incentives to exercise voice and alter the pressures for reform through multiple channels.⁵⁶

⁵⁶ See more discussions in the Philippines Systematic Country Diagnostic (World Bank 2019a).

5. Why the Skills Supply Is Unprepared to Support a Middle-Class Society

5.1 This chapter identifies the key constraints to upward mobility from the perspective of the supply of skills. It discusses three interrelated issues. First, improved but uneven access to education limited the scope of economic mobility for the less advantaged. Second, while the number of years of schooling increased, the benefit of that increase was undermined by the low quality of basic education and mismatch between the skills learned in school and those demanded in the job market, including socioemotional skills. Third, slow school-to-job transition lowers lifetime earnings for youth and hinders upward mobility of the next generation.

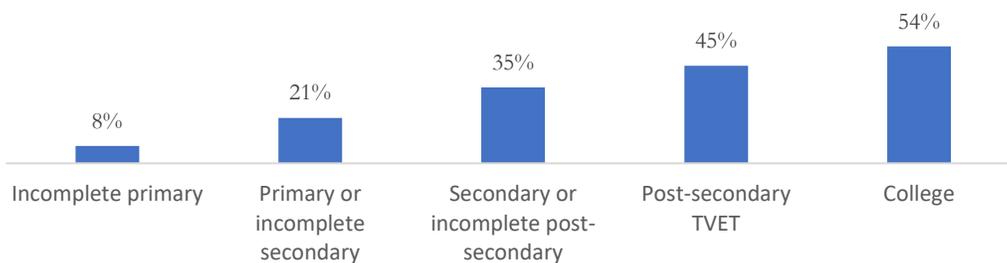
Rapid Improvement and Uneven Access to Education

5.2 **By some measures, the Philippines made important progress in education over the past decade.** The government increased the mandated number of years of education and more young Filipinos completed secondary education. However, the weak quality of basic education and mismatch between the skills students learned in school and those demanded in the job market made skills a binding constraint, particularly for youth, to getting quality jobs and to upward mobility and middle-class expansion.

5.3 **Most middle-class households are headed by individuals with tertiary education and a well-paid formal job.** Households headed by a high school or college graduates are less likely to fall into poverty and more likely to stay in or move up to the middle class. Forty-two percent of households headed by individuals who are college graduates and beyond are in the middle class, compared to 3 percent headed by individuals with primary education or less (see Figure 2.3 on page 17). If the household head works as an administrative, executive or managerial worker, sales worker, government official, manager or supervisor, or a professional in a non-agricultural sector, then it is more likely they will achieve upward mobility (Rivera 2011, Virola and others 2007).

5.4 **Education is vital to accessing good jobs, and thus to upward mobility.** Education, often tertiary education, is a ticket to better employment opportunities, particularly in the formal sector, and higher incomes, making it an important factor in upward mobility. The probability of employment in the formal sector goes up for those with higher education attainment (Figure 5.1). For college graduates, 54 percent are employed in formal jobs; the ratio is 45 percent for post-

Figure 5.1. Probability of Formal Employment by Education Level, 2017



Source: LFS Jan 2018

secondary technical and vocational education and training (TVET), while only 35 percent for secondary education or incomplete post-secondary, 21 percent for primary education or incomplete secondary, and only 8 percent for incomplete primary education.

RAPID IMPROVEMENT IN BASIC EDUCATION

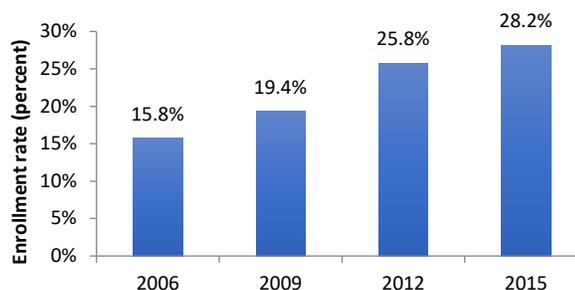
5.5 The Philippines has made progress in education in the past decade. The government has increased public spending on education considerably in recent years. The increased spending has helped expand access to basic education (K–12), especially for the poor. Education improved over the period 2006–18 as a larger percentage of workers had more schooling in 2018. The share of workers with only primary education decreased from 34 percent to 28 percent while the share of workers with secondary education increased from 40 percent to 47 percent after more than a decade.

5.6 Public education spending increased by 125 percent in real terms between 2005 and 2015. The increase was especially notable in 2016 (27 percent) and 2017 (25 percent).⁵⁷ As a share of GDP, spending on education rose from 2.9 percent in 2013 to 3.8 percent in 2016. The Department of Education (DepEd) receives the largest share of the national budget for education.⁵⁸ Between 2010 and 2015, public spending on basic education increased by 60 percent, enabling reforms that expanded access.

5.7 The increased spending has improved access to basic education, and the spending has been pro-poor.

Led by the Enhanced Basic Education Act of 2013 (RA10533), the Philippines has extended the basic education cycle from grades 1–10 to grades K–12 and rolled out universal one-year kindergarten and senior high school (grades 11 and 12). Kindergarten net enrollment of children aged five nearly doubled in absolute terms between 2006 and 2015

Figure 5.2. Kindergarten Net Enrollment Rate, 2006–15



Source: FIES-LFS various years

(Figure 5.2).⁵⁹ A benefit incidence analysis found that spending on kindergarten and primary education has been pro-poor. Those in the poorer income deciles capture a larger share of the government spending in primary education.⁶⁰ This is in part due to the preference of rich households for private schooling for primary education.

⁵⁷ World Bank. 2018b. *Making growth work for the poor: A poverty assessment for the Philippines*. Washington, D.C.: World Bank.

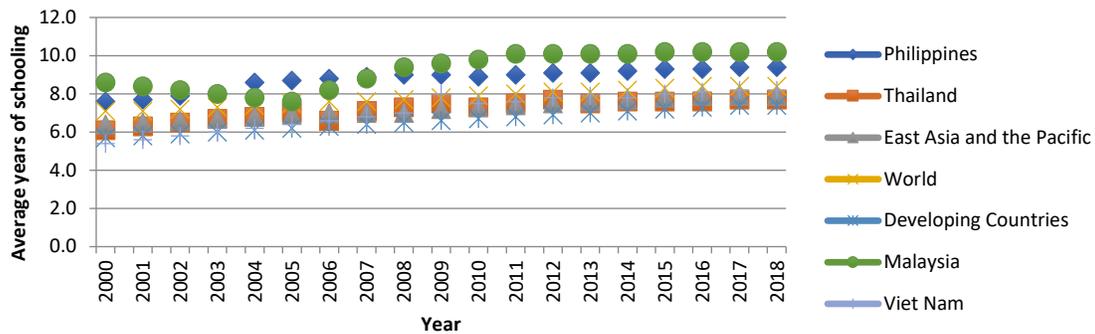
⁵⁸ World Bank. 2016. *Assessing basic education service delivery in the Philippines: Public education expenditure tracking and quantitative service delivery study*. Washington, D.C.: World Bank.

⁵⁹ World Bank. 2018b. *Making growth work for the poor: A poverty assessment for the Philippines*. Washington, D.C.: World Bank.

⁶⁰ Manasan, R., Cuenca, J., Villanueva-Ruiz, E. 2008. *Benefit Incidence of Public Spending on Education in the Philippines*. Discussion Paper Series no. 2008-08. Philippine Institute of Development Studies.

5.8 The average years of schooling in the Philippines is high relative to both structural and regional peers.⁶¹ The average years of schooling in the Philippines reached 9.4 years in 2018, which exceeded the East Asia and Pacific regional average of 7.9 years and was behind only Malaysia (10.2 years) among regional peers (Figure 5.3).⁶²

Figure 5.3. Regional Comparison of Average Years of Schooling, 2000–2018

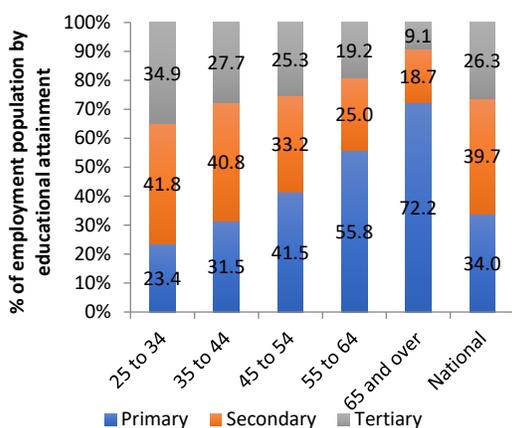


Source: Human Development Reports, UNDP

5.9 Despite the improvement in K–12 education, the share of workers with tertiary education remained around 26 from 2006 to 2018. This is not only valid for the work force in general but also for the younger cohorts. While a larger share of the younger cohort has completed more secondary schooling than older cohorts, the share of the younger cohort that has completed tertiary is similar as that of the older cohort (Figure 5.4). As it seems that post-secondary education is the ticket to obtain good jobs and move upward to the middle class, more effort is needed to improve education.

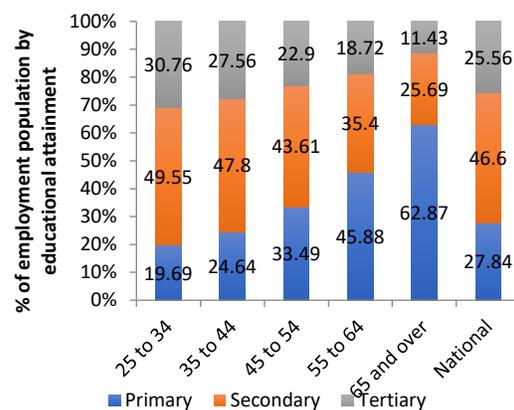
Figure 5.4. Distribution of the Population Across the Working Population

A. 2006 Cohort



Source: LFS 2006

B. 2018 Cohort



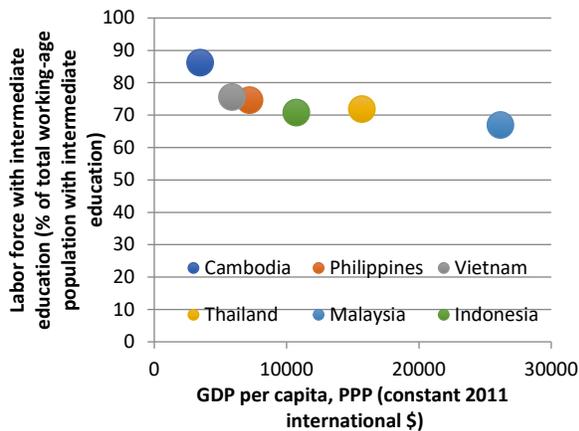
Source: LFS 2018

⁶¹ The structural peers include Bangladesh, Kenya, Morocco, Pakistan, Sri Lanka, and Vietnam, and the regional peers include China, Indonesia, Malaysia, Thailand, and Vietnam.

⁶² World Bank. 2018a. *Growth and productivity in the Philippines: Winning the future*. Washington, D.C.: World Bank.

5.10 **When compared to regional neighbors, the country has one of the highest shares of labor force with intermediate education** (Figure 5.5). However, it still has one of the lowest shares of labor force with advanced education. Cambodia and Vietnam, which have lower GDP per capita, have a higher share of labor force with advanced education (Figure 5.6). In 2016, about 63 percent of the labor force had some tertiary education. However, the country still lags its East Asia and Pacific neighbors. Indonesia, Thailand, and Vietnam all had more than 80 percent of their labor force with tertiary education, while Malaysia had close to 70 percent.

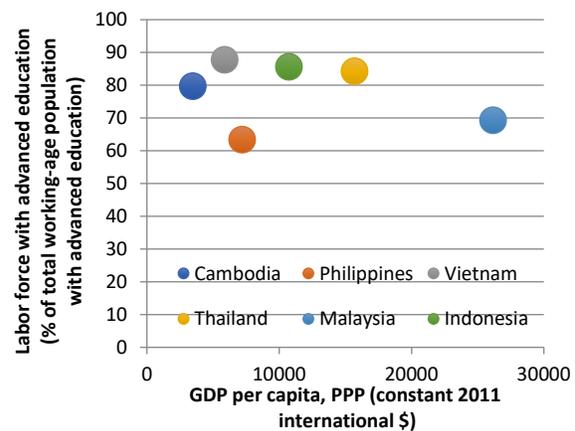
Figure 5.5. Labor Force with Intermediate Education and GDP per Capita, 2016



Source: World Bank World Development Indicators

Note: Intermediate education comprises upper secondary or post-secondary non tertiary education according to the International Standard Classification of Education 2011 (ISCED 2011).

Figure 5.6. Labor Force with Advanced Education and GDP per Capita, 2016



Source: World Bank World Development Indicators

Note: Advanced education comprises short-cycle tertiary education, a bachelor's degree or equivalent education level, a master's degree or equivalent education level, or doctoral degree or equivalent education level according to the International Standard Classification of Education 2011 (ISCED 2011).

UNEVEN PROGRESS IN ACCESS TO EDUCATION

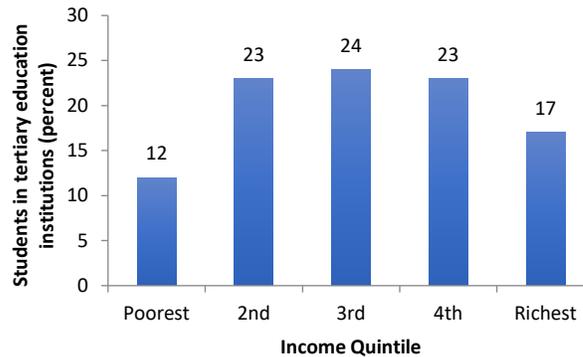
5.11 **Despite its recent increase in public education spending, the Philippines still spends much less than its regional peers by 2–3 percent of GDP.**⁶³ The Philippines spent only 3.2 percent of GDP on public education in 2016, which is much less than its regional peers (World Bank 2018a). Earlier studies of the Philippines's public education expenditure indicated that more than 6 percent of GDP would be necessary to implement a broad package of quality improvements. Pro-poor spending on basic education, though improved, is still insufficient to raise kindergarten enrollment and secondary completion among the poor. Most importantly, improved access has not led to improved learning outcomes.

5.12 **Expenditure for post-secondary education accounts for only a small share of government spending, and spending on tertiary education is not pro-poor.** The shares of public spending on post-secondary TVET and tertiary education have been limited. In 2016, public education spending on post-secondary non-tertiary, and tertiary education accounted for 0.01

⁶³ These regional peers include Indonesia, Malaysia, Thailand, and Vietnam.

percent and 7.54 percent, respectively, of total education budget.⁶⁴ A benefit incidence analysis of the Philippines found that spending on tertiary education is not pro-poor (Figure 5.7). This is due to low enrollment rates of those from poorer households. In 2014, the richest students outnumber the poorest students in tertiary education institutions. This implies that government spending on tertiary education involves using considerable funds supporting rich students whose parents are otherwise able to pay for their children’s public tertiary education.

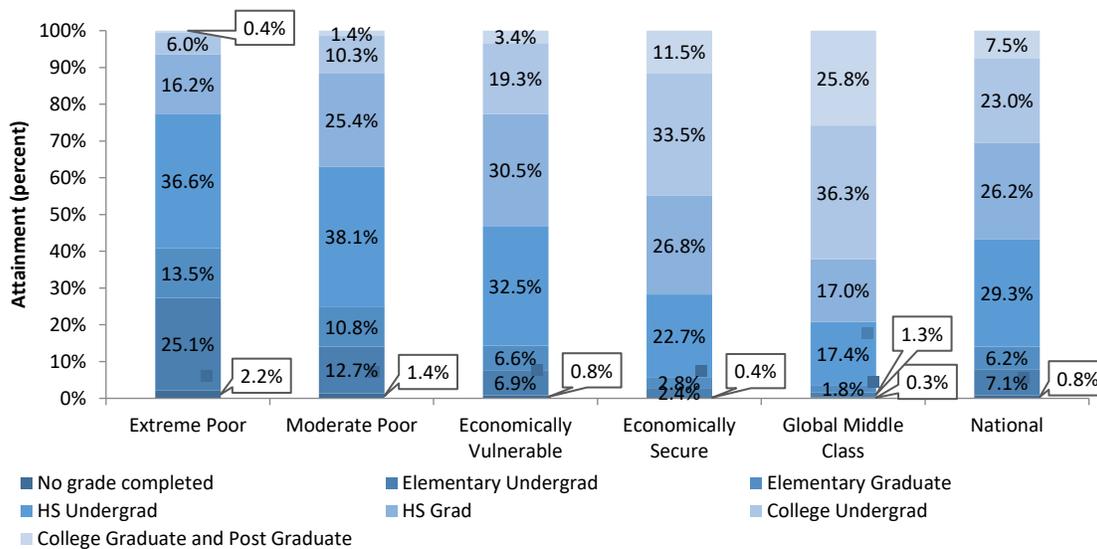
Figure 5.7. Tertiary Education by Economic Quintile,



Source: Orbeta and Pacqueo 2017

5.13 Despite the general improving trends, wide differences in access to good-quality education remained across socioeconomic groups (Figure 5.8). The poor still struggle more than wealthier families to complete a full cycle of basic education. In 2015, 26 percent of the population in the 15–24 age group had completed secondary education and 7 percent had completed tertiary education, compared to 20 percent and 14 percent of the oldest in the 65 and above cohort. However, among the extreme poor households, only 16 percent of the 15–24 age group had completed secondary education and less than 1 percent had completed tertiary education, compared to the national average of 26 percent and 8 percent, and to 27 percent and 12 percent of the same age group in the economically secure group, and 17 percent and 26 percent in the middle class, respectively.

Figure 5.8. Educational Attainment of the Population, Ages 15–24, 2015



Source: Merged FIES-LFS, 2015

⁶⁴ Department of Budget and Management. 2015. Technical Notes on the 2016 Proposed National Budget. Manila: DBM.

5.14 Poorer students in pre-primary education exhibit low attendance in school.

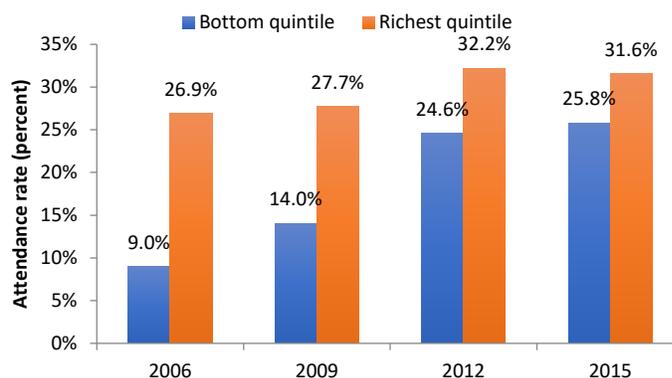
Despite the recent expansion of access to kindergarten under the K–12 reform and pro-poor spending on kindergarten, participation in any form of pre-primary education among children between ages 3 and 5 in 2015 remained at approximately 30 percent, which is among the lowest in the region (Figure 5.9).

5.15 The poor also have low secondary school enrollment and completion rates. Participation in secondary education remains low. Enrollment increased from 36 percent in 2006 to about

50 percent in 2015. Drop-out rates among the poor are consistently high beyond the primary level; only half of children in the poorest quintile enroll in secondary school (Figure 5.10).

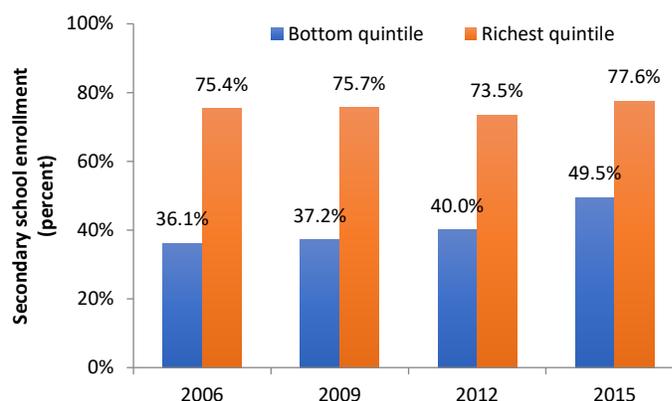
5.16 Interest in education among poor students is low. Households in the bottom income quintile, whose children notably face the highest drop-out incidence, cite “lack of personal interest” as a principal reason for dropping out in both the primary (Figure 5.11) and lower secondary (Figure 5.12) age groups; this propensity is especially high for lower secondary-level boys (65 percent).⁶⁵ A large share of students, particularly boys, indicate lack of personal interest in schools. This is likely due to the limited quality of education the students from poor households have access to, the financial pressure/opportunity costs, and other family constraints.

Figure 5.9. Attendance in Pre-Primary Education, 2006–15



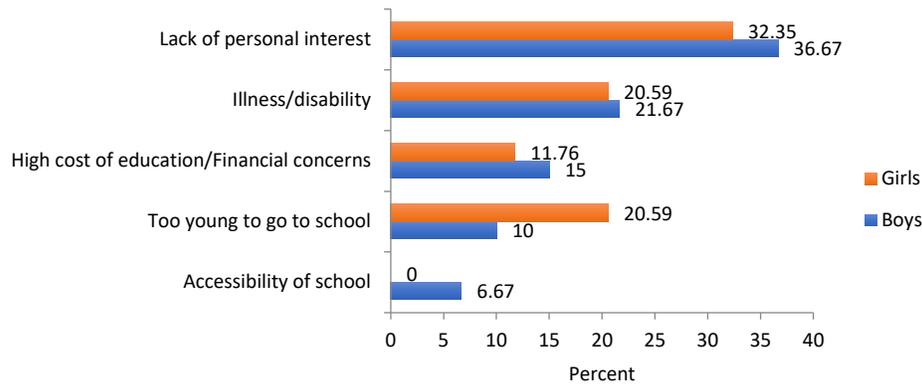
Source: FIES-LFS various years

Figure 5.10. Secondary School Enrollment, 2006–15

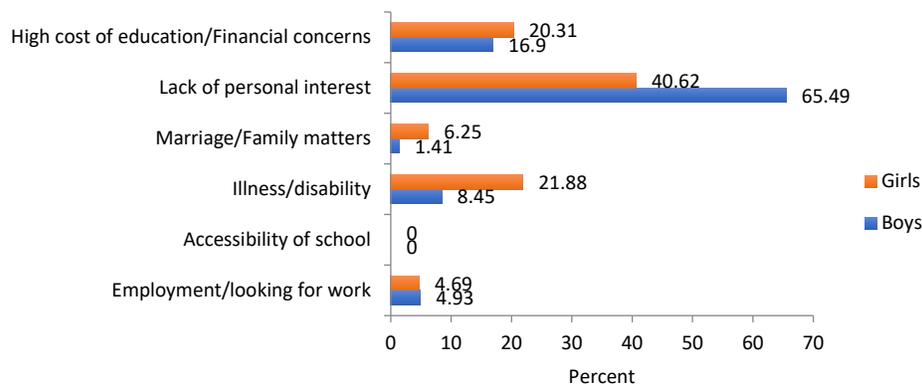


Source: FIES-LFS various years

⁶⁵ Annual Poverty Indicators Survey (APIS). 2017.

Figure 5.11. Reason for Not Attending Elementary School Among Poorest, Ages 6–11, 2017

Source: APIS 2017

Figure 5.12. Reasons for Not Attending High School Among Poorest, Ages 12–15, 2017

Source: APIS 2017

Weak Education Quality and Skills Mismatch

5.17 The effect of increase in the quantity of schooling on economic mobility is hampered by the weak quality of education and mismatches between the skills individuals have and those demanded by the employers/markets.

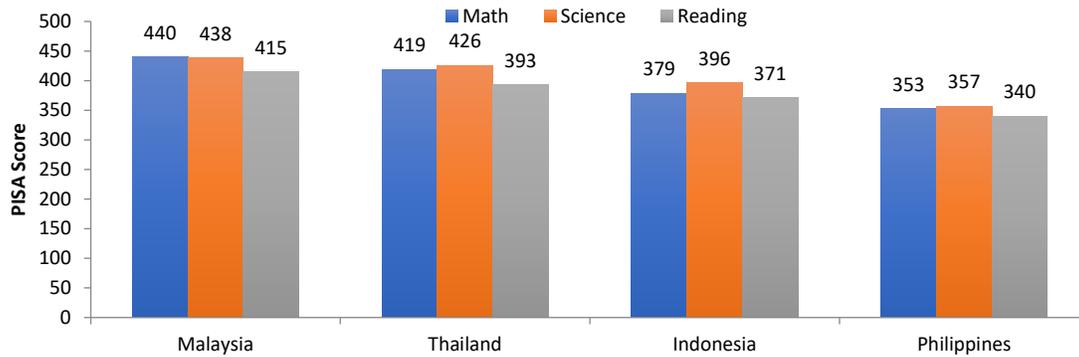
POOR QUALITY OF EDUCATION

5.18 Poor learning quality significantly reduced the effect of the improvement of the quantity of years spent in school. The 2018 PISA⁶⁶ results for the Philippines are dismal. Test

⁶⁶ PISA is the Programme for International Student Assessment (PISA) of the Organisation for Economic Co-operation and Development (OECD). It is a triennial international test first administered to 43 participating countries in the year 2000. PISA looks into “the extent to which 15-year-old students, near the end of their compulsory education, have acquired key knowledge and skills that are essential for full participation in modern societies, with emphasis on how well students can extrapolate from what they have learnt and can apply that knowledge in unfamiliar settings, both in and outside of school.” This approach differs from other assessments that focus on the students’ mastery of knowledge and

results for the country's 15-year olds randomly tested as a group scored the country lowest among the 79 countries tested in reading literacy and second lowest in science and mathematics literacy (PISA 2018: National Report of the Philippines). This is not only lower than the OECD countries but also lower than most other developing countries in East Asia (Figure 5.13).

Figure 5.13. PISA Scores by Subject in East Asia and Pacific Countries, 2018



Source: 2018 PISA

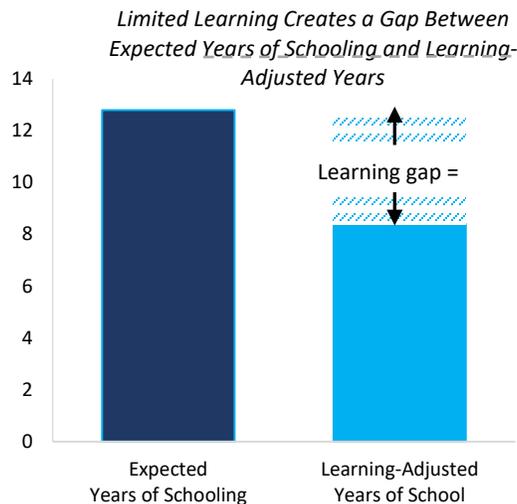
5.19 Measured by national level tests, the quality of learning also lags comparators. According to Tullao and others (2015), the National Achievement Test scores for grade 6 and fourth year of high school have remained low; and the passing rates in professional licensure examinations for various disciplines averaged only 33.8 percent in 2010. Passing rates for individual examinations were notably low for chemical engineers (54.7 percent), civil engineers (39 percent), electronics and communication engineers (23.5 percent), elementary school teachers (17.7 percent), and secondary school teachers (24.8 percent). Thus, it is no surprise that there was a 23 percent decrease in the proportion of college graduates practicing their profession between 1976 and 2000 (Orbeta 2003). Only 21.5 percent of the more than 2,247 higher education institutions have some form of accreditation. With regard to TVET, the issue is its failure to achieve good employment rates with its graduates despite its relatively high certification rate of more than 83 percent in 2010 (Tullao and others 2015).

skills from a specific curriculum. PISA assessments cover three foundational domains, namely Reading Literacy, Mathematical Literacy, and Scientific Literacy. See more details in <https://www.deped.gov.ph/wp-content/uploads/2019/12/PISA-2018-Philippine-National-Report.pdf>

5.20 The country’s progress toward improving learning outcomes has been slow.

The harmonized test score, developed by the World Bank’s Human Capital Project, shows that the quality of education in the Philippines is well below the average for the East Asia Region. Evidence suggests that limited learning takes place in Philippine schools. The data used for the HCI suggests in the Philippines, a child who starts school at age 4 can expect to complete 12.8 years of school by her 18th birthday. But this 12.8 years of schooling in the Philippines only generates as much learning as 8.4 years in schools in the highest performing systems (Figure 5.14).

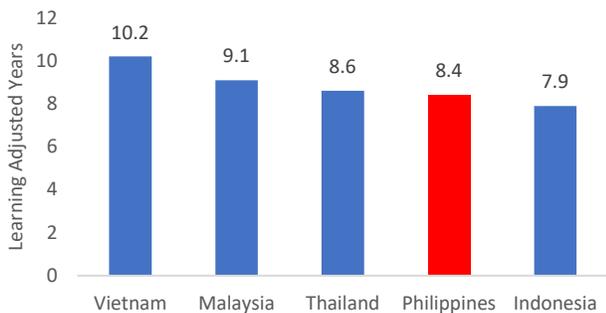
Figure 5.14. Absolute Number of Years in School and Quality-Adjusted Years of Learning



Source: World Bank, 2018. The Human Capital Project

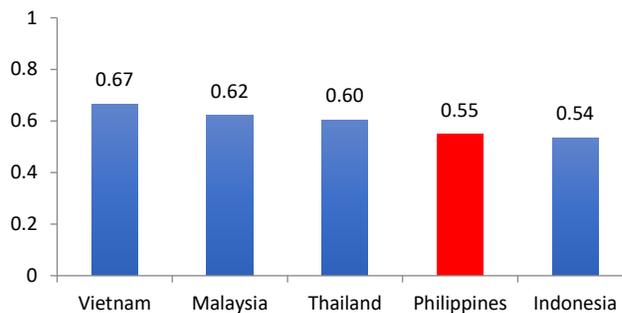
In relative terms, while the quantity measure of school—expected years of school—is close to the 75th percentile, quality-adjusted expected years of school is only the median level of world average (Figure 5.17). This poor quality of basic education is reflected in the country’s Human Capital Index (HCI),⁶⁷ where the Philippines is also ranked low compared to its neighbors. The country’s HCI score of 0.55 indicates that due to shortcomings in education, health, and nutrition, the future productivity of an average child born today in the Philippines will fall 45 percent below potential. Compared with many developing countries in East Asia, the Philippines is lagging in education quality and human capital development in general (Figure 5.15, Figure 5.16, and Figure 5.17).

Figure 5.15. Learning Adjusted Years of Education, Regional Comparison, 2018



Source: World Bank data

Figure 5.16. Human Capital Index, 2017

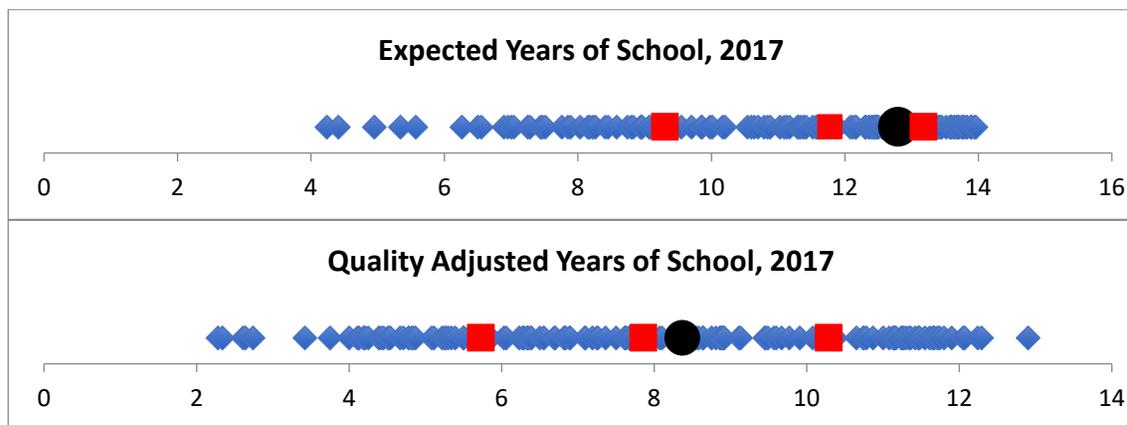


Source: World Bank World Development Indicators

⁶⁷ The Human Capital Index (HCI) provides a summary measure of the amount of human capital that a child born today can expect to attain by the end of secondary school, given the risks of poor health and poor education that prevail in the country where he or she was born. It consists of three components: 1) survival (under -5 mortality rate); 2) school (expected quality-adjusted years of schooling; and 3) health (under-5 stunting rate & adult survival rate).

5.21 **The Philippines urgently needs to improve the quality of its basic education.** As highlighted in the World Development Report 2018 *Learning to Realized Education's Promise*, schooling without learning is not just a wasted opportunity, but a great injustice. Education has long been critical to human welfare, but it is even more so in a time of rapid economic and social change. As emphasized in the World Development Report 2007 *Development and the Next Generation*, how an education system is preparing young people with the skills needed—expanding opportunities with a focus on increasing the quality (not just quantity) of education—and to cope with the demands of a changing economy are crucial for supporting today's youth and tomorrow's workers to fulfill their potential and the economy to move up the ladder.

Figure 5.17. Expected Year of School and Quality-Adjusted Expected Years of School in the Philippines



Noted: Black is the Philippines. Red are the 1st and 3rd quartiles and Median.

Source: World Bank, 2018. The Human Capital Project

5.22 **Teachers both affect education quality and are affected by it and require particular attention.** According to a Brookings study (2017) of teacher performance conducted in 2014, teacher quality is a main constraint to learning quality. The study finds that teachers at both elementary and secondary levels “could correctly answer fewer than half of the questions” on test of their knowledge of subject content. This would impair their ability to teach. Low education quality resulted in high drop-out rates, which have improved by less than 1 percentage point a year. According to a PIDS study (2009) cited in the Brookings report, “for every 100 children who enter grade 1, only 86 pupils will continue to grade 2. By grade 4, 76 will remain in school. By grade 6, only 67 of the original cohort of children are enrolled, with 65 graduating from elementary school. Of the 65 who graduate, 58 will move on to high school.” Of course, teachers are also a product of the education system and can only be as good as the education they receive. Strengthening the preparation (pre-service) and training of teachers throughout their careers (in-service) is key to addressing low student learning attainment (IEG 2019). A forthcoming World Bank study of PISA 2018⁶⁸ suggests that poor disciplinary climate and high incidences of bullying are highly correlated with poor student performance. The negative learning environment is seen more in disadvantaged schools, which keeps disadvantaged students from lifting themselves up.

⁶⁸ PISA 2018. 2020 (forthcoming). “Programme for International Student Assessment Philippines Country Report.”

SKILLS MISMATCH

5.23 There is a significant mismatch between the skills workers have and those needed by employers. In the Philippines, about one-third of surveyed employers said they were unable to fill vacancies due to the lack of applicants with required skills (Bodewig and others 2014). Besides academic and cognitive skills, which are often a weak point due to the low quality of education, many individuals also lack of the “soft” skills that the job market demands (Box 5.1). According to the Department of Labor and Employment (DOLE 2017), employers identified teamwork and interpersonal skills as one of the important skills being considered in their recruitment process. The top five behavioral skills employers look for are willingness to learn, initiative, honesty, integrity, self-motivation, and self-confidence; and the top five functional skills sought are communication skills, trainability, competence, problem-solving and analytical skills, and technology know-how. However, many job applicants, particularly youth, lack such skills.

Box 5.1. What Skills Are in Demand in the Job Market?

According to the Integrated Survey on Labor and Employment conducted by the PSA in 2014, which has employers as its respondents, teamwork and interpersonal skills are important skills in the recruitment process for entry level posts. The respondents (employers) considered jobseekers, mostly youth, to have poor organization, planning, critical and creative thinking, and decision-making skills.

A 2015 survey conducted by JobStreet.com, in which more than 400 companies participated, finds that internship and part-time job experiences are essential considerations during hiring. The survey also shows that behavioral and functional skills are important qualities sought by employers.

A HEAD foundation study (2016) found high demand for skills such as a combination of generic and job-specific skills; skills applicable to service sector including behavioral skills such as excellent literacy and client-orientation skills and communication skills; and skills supporting a more competitive manufacturing sector including problem-solving and creative thinking.

Source: Local Bureau of Employment (2017), Labor Market Trends; and HEAD Foundation (2016), Skills Issues, Sources of Skills Issues, Policy Responses in Five ASEAN Member Countries.

5.24 Employers perceive socioemotional and higher-order cognitive skills as having the greatest gaps in the Philippines (Acosta and others 2017, Cunningham and Villasenor 2016). Most of these missing skills are *socioemotional skills*, also known as “noncognitive skills,” “soft skills,” or “behavioral skills.” This is consistent with global observations. A recent McKinsey Global Institute report shows that demand for socioemotional skills like leadership and communication is expected to rise by 24 percent while demand for basic cognitive skills and physical and manual skills are each predicted to drop by 14 to 15 percent by the year 2030 (Bughin and others 2018). *Developing Socioemotional Skills for the Philippines Labor Market* (World Bank 2017) shows that two-thirds of employers or companies report difficulty finding workers with an adequate work ethic or appropriate interpersonal and communication skills. A higher level of socioemotional skills is associated with greater probability of being employed and with higher daily earning—higher levels of socioemotional skills command wages that are 10 percent higher than for workers with similar education but possess fewer of these behavioral skills. In particular, the lack of socioemotional skills is associated with the greatest wage disadvantage among workers with low educational levels, adding to the burden they have due to the lack of quality basic education for traditional technical skills.

5.25 As the economy moves up the ladder, skills shortages in the higher end, including STEM-related cognitive and technical skills, as well as management and communication skills, will be in increasing shortage. Innovative firms are six times more likely than traditional firms to cite inadequate workforce education as a major barrier to doing business (Acosta and others 2017). The Report on Employment Trends and Data Availability in the Philippines (APEC 2013) shows that many of the occupations and industries experiencing a shortage of suitable workers are those related to science and technology, and professional workers at the high-end category such as managers, supervisors, professional and technical, and associate professionals including specialists. The reason behind the vacancies may include the basic academic gaps, particularly in math and science, as well as the serious gaps in some generic skills such as problem-solving, initiative, and creativity (Gropello and others 2010).

5.26 However, several studies show another direction of skill-job mismatch in the Philippines. Mehta and others (2013) find that in the Philippines the labor force is overeducated, which suggest a shortage of demand for skills. Unlike in Thailand and India, the increase in the supply of a better educated workforce has not been matched by rising demand for skilled workers, which resulted in declining returns for secondary and tertiary education in domestic jobs. The oligopolist nature of the economy, its domination by a few conglomerates, may also constrain entry of more innovative firms, limiting the creation of more gainful jobs to absorb the skilled labor. With the presence of only a small number of employers, or the monopsony power, wage growth is repressed in the Philippines. In examining the qualification mismatch in seven countries, the ILO (2015) finds that it is only in the Philippines where the mismatch is primarily due to overqualification rather than underqualification, and where about one-third of the employed Filipino youth were in occupations that required less education than they acquired. As indicated in the previous chapters, more educated and better skilled youth are more likely to be unemployed. In 2015, unemployment rates for young workers 15–24 years old were 22 percent for those who completed at least a college education, 23 percent for graduates of post-secondary education, and 13 percent for those with secondary or lower level education Cabegin (2016).

Slow School-to-Work Transition

5.27 The weak quality of learning from basic education and the mismatch of the skills learned and that required in the job market resulted in the big challenge for school-to-work transition for many Filipino youth, with long waits and uncertainty. This adds to the multiple factors, including insufficient demand in a labor surplus economy, limited structural upgrade, and structural impediments such as restrictive labor regulations (minimum wage, employment protection), which already resulted in big challenges in the labor market.

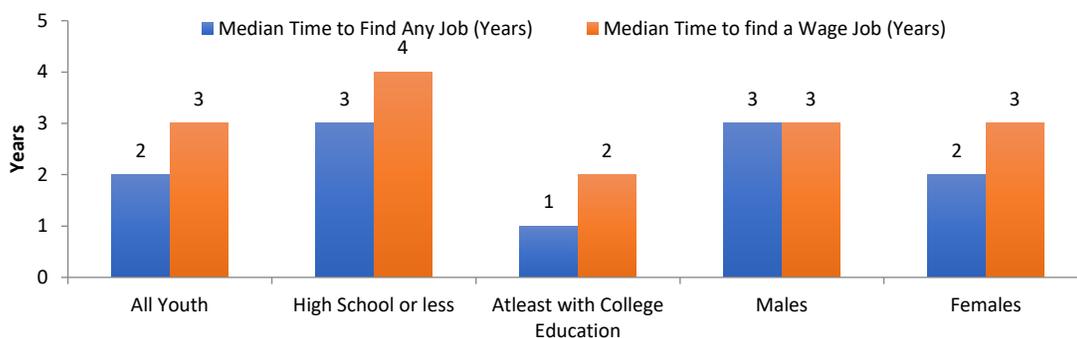
5.28 The school-to-job transition period is long for the youth in the Philippines, which may include an actual job search, short-term skills training, temporary work, household work, or total inactivity. According to a study (Bird 2012), it takes about two years for a youth to find any job and about three years to find a wage job.⁶⁹ Young Filipinos with less than a high school education are having the most difficulty integrating into the labor market. For instance, it takes a high school leaver a median time of three years to find a job and four years to find a regular wage

⁶⁹ Bird (2012) draws from a 2008 ADB household survey in Manila and Cebu, covering 500 households and over 1500 individuals (15 to 65 years).

job. On the other hand, a college graduate takes less time to transition to a job, with a median time of one year to find a first job and two years to find a wage job (Figure 5.18).

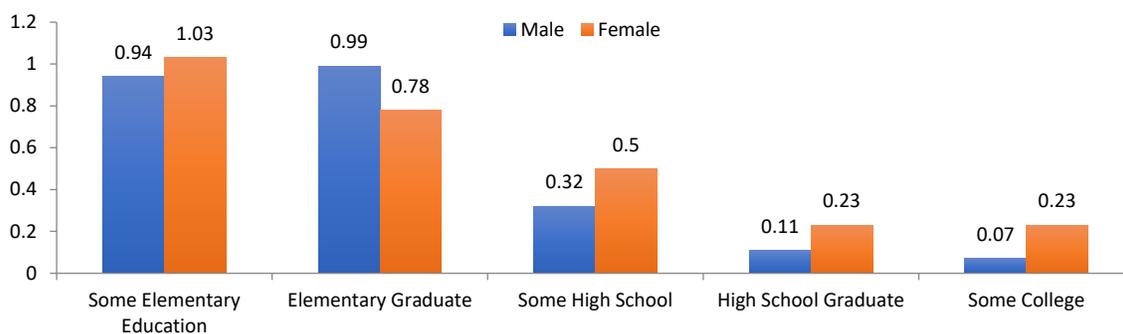
5.29 Educational attainment is associated the length of school-to-work transition, but there are differences between males and females. While those with better educational attainment spend less time in transition, males with completed high school have similar transition times as male college graduates; whereas females with a high school education have slower transitions compared to females with college education. Females also find a job faster than males (two years versus three years) to start but equal amount of time (three years) to find a permanent wage job (Figure 5.19). Other factors, such as age, behavior toward job searching, family background, social network, minimum wage, and regulations and restrictions on employment arrangements are also factors that influence transition from school to work (Bird 2012). The unrealistic aspiration and strong preference for a secure and well-paying job might lengthen the school-to-work transition. This likely would be even more common for youth with good educations from households with middle-class or higher incomes. Such youth may not be under pressure to take a job because their subsistence needs are being met.

Figure 5.18. Time to Find a Job, 2008



Source: Bird 2012; ADB 2008 TA Household Survey

Figure 5.19. Additional School-to-Work Transition Time Compared to College Graduates



Source: Bird 2012

5.30 A slow transition from school to work reduces the chances a youth will find a good job because his or her marketability to employers diminishes. The quality of the first job also matters in influencing their lifetime employability. If the first job is a regular wage job, then the

worker will have a 50 percent chance of staying in formal employment. If the first job is self-employment, then the worker will have a 70 percent chance of being confined to being self-employed and only a 12 percent chance of finding a job in the formal sector in the future (DOLE 2013). This is why investing in the employment of young people, in particular, helps realize the potential of human capital in terms of wealth and savings, leading to huge economic and, ultimately, social gains (ADB 2018).

5.31 The transition from school to work in the Philippines is slow compared with other countries. The OECD median is 1.1 years to find a wage job, with Australia, United States, Finland with less than 1 year and Italy, Greece, and Spain recording 2.3 years or more (Table 5.1).

Table 5.1. Time to Find a First Job, OECD Comparators

	Employment rate one year after leaving school	Employment rate 5 years after leaving school	Median time in years to find first job
Germany	75%	78%	0.1
Switzerland	82%	85%	0.7
United Kingdom	80%	85%	1.8
Netherlands	85%	90%	1
Italy	50%	70%	3
Spain	65%	80%	2.7
Greece	50%	75%	3.2
Philippines	60%	70%	2.0 - 3.0

Source: OECD, ADB (For Philippines) 2008

5.32 The slow transition not only reduces the youth’s chances of finding a good job in the short run because their “employability” diminishes, but also results in negative effects in the long run that may hinder the young workers from fulfilling their full lifetime potential. As these early years in work often set the precedent for future employment and earnings trajectories, a low-quality first job may trap young workers in low-pay activities. A difficult school-to-job transition may even have long-term mental effect. According to a recent UNICEF study (UNICEF 2019),⁷⁰ the Global Millennial Viewpoints Survey shows that three-quarter of youth believe they will get the kind of job they want while two-thirds feel they will be able to make as much money as they want. The unmet aspirations at the start may also lead to lowered job satisfaction in the future, increasing stress, anxiety, and other markers of poor mental health.

5.33 Education programs receive near-universal support across all income groups and strongest support from the middle class, according to ISSP data on policy preferences. Support for education in the Philippines is consistently higher than those of its comparator countries (Appendix D). This suggests that programs in aid of school-to-work transitions and the preceding policy recommendation on improving the quality of education more generally are likely to receive broad support.

⁷⁰ UNICEF (2019) Unpacking School to World Transition, Data and Evidence Synthesis.

6. Constraints to Upward Mobility and Potential Policy Suggestions

6.1 The Philippine economy has been on a strong growth path. With solid macroeconomic fundamentals and an increasingly more educated labor force, the economy is in a position to mitigate regional and global shocks and seize opportunities to continue to prosper. Strong growth will provide a foundation for productive job creation, which can fuel upward mobility of the population, unlock development potential, and propel the country toward becoming an upper middle-income economy and a middle-class society.

6.2 **Although economic growth averaged nearly 6 percent per annum over the past decade, the pace of upward mobility and expansion of the middle class was limited in the Philippines.** In the East Asia and Pacific Region, the economically secure and middle class increased from just over one-fifth in 2002 to nearly two-thirds of the population in 2015; meanwhile the ratio in the Philippines increased from 37 percent to 44 percent. As of 2015, only 9.2 percent of Filipinos had a global middle-class income while 6.6 percent remained in extreme poverty. The reduction of extreme poverty in the Philippines averaged 0.9 percentage points per year between 2006 and 2015 compared to 1.4 percentage points for the developing world overall and 2 and 2.5 percentage points in China, Indonesia, and Vietnam. In short, both ends of the class distribution in the Philippines lacked the dynamism apparent in similar countries. In the period of 2006–18, real wages increased less than 10 percent for the overall labor force.⁷¹ Less than 0.6 percent had a single-earner middle-class wage, and 4 percent had a double-earner middle-class wage in 2018

6.3 **Creating more jobs helps, but creating better jobs—jobs that offer stability and good pay—is a more effective route to building a predominantly middle-class society.** Productivity is fundamental for sustainable growth, which in turn can support the creation of more well-paying jobs. But improving productivity should involve more than creating conditions that encourage people to move out of agriculture into other sectors. It requires moving resources from such traditional low-productivity activities into modern, more productive industries, in other words, by upgrading and transforming the economic structure. Overcoming challenges to the private sector, such as competition, regulation, and access to finance is important to achieving such transformation. However, it also requires improvement in the skills of the labor force that will allow all individuals to raise their value in the marketplace. With both conditions in place upward mobility can increase and the expansion of the middle class can accelerate, realizing the dream of AmBisyon Natin: “a prosperous middle-class society free of poverty by 2040.”

Constraints on Upward Mobility and Middle-Class Expansion

6.4 **Both demand side and supply side factors have hindered upward mobility and middle-class expansion.** Constraints on competition and binding regulations limit the dynamism of the private sector; premature deindustrialization prevents upgrade of the production structure;

⁷¹ The analysis of real wage covers only workers who reported positive wages; the earnings of those who were self-employed or worked without pay are not included in the available statistics.

and the lack of access to financial services inhibits business starts and expansions. All this limited the creation of well-paying jobs. Meanwhile, the improved but still uneven access to education prevents the poor and vulnerable from fulfilling their potential; poor quality schooling and mismatch between skills learned in school and those required in the job market undermines the benefits of increasing the number of years of schooling; and slow school-to-job transition lowered expected lifetime earnings for the youth. All this limits the economic opportunities for people, particularly those from poor households.

6.5 In addition to general constraints in the business environment, including the existing oligopolistic structure that discourages entrepreneurship and growth of micro, small, and medium enterprises (MSMEs), two obstacles limited the economic transformation and creation of more and better jobs.

Obstacle #1 Limited economic structural upgrade

6.6 Despite continuous movement of labor out of agriculture to non-agriculture—one percent of the labor force each year in the past decade—the upgrade of the production structure has been limited, based on the share of high-productivity manufacturing and services over GDP and by well-paying jobs over total employment. Without continuous upgrade of the production structure, the number of well-paying jobs grew little. Premature deindustrialization, a large expansion in services jobs with much smaller growth in manufacturing, meant that labor gains in low-end services absorbed a large share of the surplus semi-skilled agricultural labor. This was markedly different than Cambodia, China, and Vietnam, all of which have booming labor-intensive manufacturing sectors that provide large amount of relatively well-paying jobs for the semi-skilled workers, leading to large increases in productivity and wages.

Obstacle #2 Weak access to finance for micro, small, and medium enterprises

6.7 Despite progress, financial services access and use remained limited: only a third of adults have a transaction account in any financial institution and only 4 percent of small firms and 17 percent of medium firms have access to bank credit. Lack of access to finance constrains day-to-day life and hinders the ability of individuals and families to plan, save, and invest. It also affects the performance and competitiveness of firms as they cannot obtain funding from banks and the financial markets that is needed to start, innovate, grow, and develop their enterprises. As a result, saving becomes difficult and costly for individuals and firms, and financial resources cannot circulate efficiently and flow to where they are needed. Challenges in access to finance are particularly severe for MSMEs, which account for 99 percent of enterprises in the Philippines and generate nearly two-thirds of the country's total employment, resulting in a missed opportunity for business ideas to materialize and profitable firms to expand hampering the engine of growth and job creation.

6.8 Besides general constraints to human capital development, two obstacles limited the supply of skills that could meet the demand for jobs that pay well.

Obstacle #1 Inadequate quality and relevance of foundational skills acquired in basic education

6.9 Despite the increase in years of schooling, the low quality and relevance of basic education mean that employers have difficulty finding workers with the foundational skills

needed to keep pace with technological changes and modern labor market needs.⁷² The Philippines' dismal PISA score—lowest among the 79 countries tested in reading literacy and second lowest in science and mathematics literacy—shows its slow progress toward improving learning outcomes, both at the primary and secondary levels. Its high rate of “educated unemployment”—unemployed people who have completed at least lower secondary education (80 percent)—suggests an urgent need to boost both the quality and relevance of basic education. In addition, an unrealistically high reservation wage for the skills that youth have or their desire to wait for secure and well-paying jobs might widen the gap between supply and demand for jobs.

Obstacle #2 Lack of socioemotional skills and technical knowledge required by the market

6.10 Despite a high association between socioemotional skills and income increases in the Philippines (especially for female workers, youth, less-educated workers, and those employed in the services sector), a growing share of firms report difficulty finding workers with the necessary socioemotional skills. In 2015, two-thirds of employers reported challenges in recruiting workers with an adequate work ethic or appropriate communication and people skills. While the global economy transitions to more technology-intensive manufacturing and service-oriented industries, demand for advanced skills will be high. In the Philippines, post-secondary education has not grown much and has been ineffective in imparting advanced technical knowledge and relevant and responsive skills. The trends in wage premiums show that higher education in the country undersupplies graduates in such fields as medicine, engineering and architecture, social science, business and law, and fast-growing service sectors. By contrast, it oversupplies areas like agriculture, the humanities, and theology.⁷³

6.11 The resulting challenges are evident in the large scale of emigration and slow school-to-job transition for the youth. Related to the lack of gainful job opportunity in the domestic market, a large share of skilled labor moves overseas where they can get higher return for the skills they have. This may be a boon for the middle class, as nearly 45 percent of middle-class households receive some foreign remittances and such remittances are the most important source of income for 18 percent of middle-class households. However, the impact of migration on the economy is complex. On one hand, remittances raise the welfare of the migrant-sending households and finance investment in human capital. On the other hand, in addition to adding stress for the migrants and the left-behind children and causing a version of “Dutch Disease,” migration may alter the incentive to pursue education and result in the uncertainty of “brain drain” or “skill flow.” Policies need to strengthen the positive impact of migration on the economy while controlling for its negative side. The loss of manufacturing sector workers and investments in education in preparation for service sector occupations—both of which are a response to foreign labor demand—help quicken premature deindustrialization and dampen domestic economic prospects. Philippine youth face daunting challenges in getting their first jobs. Due to the lack of professional experience, the low quality of education, and mismatched skills obtained in school, and sometimes unrealistic aspirations (resulting in unrealistically high reservation wage), it takes young individuals a long

⁷² Acosta, Pablo, Takiko Igarashi, Rosechin Olfindo, and Jan Rutkowski. 2017. *Developing socioemotional skills for the Philippines' labor market*. Washington, D.C.: World Bank.

⁷³ Orbeta Jr., Aniceto C., Kathrina G. Gonzales, and Sol Francesca S. Cortes. 2016. “Are Higher Education Institutions Responsive to Changes in the Labor Market?” *Philippine Institute for Development Studies Discussion Paper No. 2016-08*.

time—two to three years on average—to transition from school to work. This may erode their skills and lead to frustration, which limits the expected earnings over their lifetime or make the youth more prone to migration.

6.12 Addressing the challenges in upward mobility and supporting the expansion of the middle-class requires solutions on the demand side to upgrade the production structure to create more gainful job opportunities, and on the supply side to enhance labor force skills to meet the increasingly sophisticated requirements of the job market and to improve matching.

Policy Suggestions

6.13 Productivity is essential for upward mobility and is a key concern for upward mobility and middle-class expansion. As Paul Krugman argued in *The Age of Diminished Expectations*, “Productivity isn’t everything, but in the long-run it is almost everything.” Only if productive factors, including capital and labor, are effectively used, can long-term prosperity be assured; only if competitiveness is high can a country continue to grow sustainably, create more gainful opportunities for people, and support the transition of the society to middle-class status. Achieving a better economic transition requires a business environment conducive to attracting domestic and foreign investment, upgrading the value chain, and supporting the structural transformation of the economy. It also requires healthcare and education systems to support the development of human capital needed to meet the demand for the higher-level technical and socioemotional skills demanded by an advanced economic structure. In addition, it needs an efficient and equitable distribution system that can put resources to their best use. Finally, it requires a strong social protection system to help households manage risks from natural disasters and negative shocks that can trap people in low-level equilibrium. It is essential to strengthen insurance markets for middle class households and firms, while building strong systems to support the poorest and most vulnerable with public funds. The recent health and economic crisis created by the COVID-19 pandemic is yet another reminder that even the middle class is not isolated from negative shocks. Only when social protection systems are in place that protect the majority of the population will the Philippines become a true middle-class society.

6.14 Premature deindustrialization is a major reason the Philippines has not created the kind of job growth needed for rapid expansion of the middle class. Whether the boundary between manufacturing and service has been thinning and whether manufacturing can deliver the same productivity gains and well-paid employment opportunities for unskilled workers in the future as it has in the past are subjects of ongoing debate. In the era of the fourth industrial revolution, the path to better jobs in a country like the Philippines might also hinge on the “servitization” of manufacturing, draw on the comparative advantages of the country, use the young and increasingly educated labor force with an abundance of intermediate education, and adapt to global and regional challenges.

6.15 Creating more gainful job opportunities through structural upgrade, while also equipping all Filipinos with the needed skills are essential for supporting stronger upward mobility and faster middle-class expansion. The analysis in this report suggests four policy directions.

First, improve private sector dynamism and support a structural upgrade

6.16 Firms need a level playing field on which to compete and a good flow of knowledge across firms through linkages to external markets. Strengthening firms' capabilities in innovation, management, and entrepreneurship could give rise to high-growth firms that can support economic transformation. Attracting investments in labor-intensive manufacturing to target export markets could facilitate an upgrade of the economic structure and increase demand for labor with an intermediate level of education, where the country has comparative advantages. Such support can therefore help all business generate good-quality jobs to support upward mobility and expansion of the middle class.⁷⁴

6.17 Concrete measures to increase dynamism in the private sector and support structural upgrade in the medium term include three actions. Implement the Ease of Doing Business and Efficient Government Service Delivery Act (RA11032) to reduce the cost of doing business and promote job creation. Implement the Philippine Competition Act (RA10667) and capacity building of the Philippine Competition Commission to enable fair competition. Finally, implement the Customs Modernization and Tariff Act to reduce trade costs. These measures will likely receive broad political support. In addition, existing public support programs for MSMEs could be strengthened through increasing support for firm-led innovation.⁷⁵

Second, improve financial services access and use.

6.18 Well-functioning, readily accessible financial services are essential to facilitate more efficient resource allocation that can support the establishment and expansion of productive firms. It requires improving financial inclusion for individuals and for firms, particularly MSMEs, and deepening the diversification of the financial system to support inclusive growth.

6.19 Specific measures include implementation of the Secured Transaction Bill to expand access to finance to more MSMEs and rolling out the National Digital Identification System. Expanding the use of digital technology, such as moving routine cash payments into accounts, could help overcome some of the financial inclusion challenges and support firms, especially MSMEs to get greater access to finance. It is important to safeguard financial stability, so shocks to the financial system will not affect the savings and the financial access of the most vulnerable. Guarantee liquidity in the system, particularly while the impacts of COVID-19 are ongoing, to ensure financial intermediation and access to financial services for the population, in particular to be able to reach out to the most needed (for example, with financial support for MSMEs and households in the most affected sectors, such as services, tourism, and travel industry).

Third, improve the quality of education and enhance skills match.

6.20 Individuals need the right skills to support a growing market with well-paying jobs. The required reforms include raising teachers' effectiveness and competences to improve the quality and relevance of basic education and reduce high dropout rates among the poor. Also needed are curriculum reforms both to provide demand-driven post-secondary training and skills and to foster

⁷⁴ See more discussion in the Philippines Country Sector Diagnostics (IFC 2020).

⁷⁵ See more specific recommendations in the Philippines: Assessing the Effectiveness of MSME and Entrepreneurship Support (World Bank 2019b).

a well-educated and skilled workforce that can support productivity growth. Finally, more training in socioemotional, technical, and cognitive skills needs to be provided to reduce skill gaps and mismatches between the workforce and employers.

6.21 Concrete measures include improvement in the “employability” skills of senior high school students by integrating job readiness skills and labor education in school curriculum and enhancing the quality of work immersion program with longer training periods and clear training plans. Fully implement the UNIFAST program for higher education (free tertiary education tuition and subsidies). For TVET, invest in higher qualifications (diploma level) and university courses leading to professional licenses as these will produce graduates with higher STEM skills and would most likely end up in higher wage, higher quality jobs. To fill the knowledge gaps, the education system will need to continually analyze labor market trends and forecast the need for specific skills in key industries, as new occupations emerge in the labor market and as others become obsolete. Support for education in the Philippines is consistently high (Appendix D). This suggests that programs in aid of school-to-work transitions and improving the quality of education more generally are likely to receive broad support.

Fourth, support school-to-work transition

6.22 The lifetime earnings and upward mobility of youth depend on gaining early employment in a well-paying job. Improvement in this area requires helping students and jobseekers make informed training and career decisions, providing them with information on employment trends not just current job vacancies to prepare them for the jobs that will be available when they complete training or graduate from school. It is also important to provide incentives, such as tax cuts, or passing a legislative measure to encourage firms to hire more youth and new graduates, particularly senior high school graduates.

6.23 Concrete measures include improving the branding and increasing the institutional capacity of public employment service offices (PESOs) to cater to the unique needs of young jobseekers, increasing the effectiveness of the matching mechanism, and encouraging these young workers to use various government employment programs. Implement the First Time Jobseekers Assistance Act (RA11261) to waive the fees for government certificates and clearances for first-time jobseekers, estimated to benefit more than 1 million new labor market entrants annually. Youth employment programs should not be a standalone or single service. DOLE’s JobStart program has been successful not only because it puts a premium on soft skills and development of training plans with partner employers, it recognizes that employment facilitation should offer a “menu of complementary services” ranging from job search/matching assistance, career counselling/coaching, provision of LMI, internship, job fairs, and online support service. Offering one service without (at least linking with) the other important ingredients for getting “job ready” would be inadequate and ineffective.

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Appendix A. Subjective Versus Objective Middle-Class Status

Households with similar income level may have different subjective perceptions of their economic and social status. This appendix, drawing from ISSP information, details the surface differences in subjective versus objective status of the middle class.⁷⁶

Box A.1. Subjective Views of Middle-Class Status

The ISSP, an annual cross-country household survey focusing on various social and economic topics, provides insights into how people see themselves and their social class and financial positions in the following areas.⁷⁷

Perceived social status. To gauge how individuals assess their position in society, the ISSP asks: “In our society, there are groups which tend to be towards the top and groups which tend to be towards the bottom. Below is a scale that runs from the top to the bottom. Where would you put yourself on this scale?” Possible responses range from 1 (bottom) to 10 (top).

Perception of current financial situation. Although perceived social status may take account of many factors that influence social standing, we might expect to get a better understanding of an individual’s perception of their economic status by considering how they assess their financial situation. ISSP 2015 asks: “How would you generally rate your current financial situation?”

Perception of past and future financial situation. The ISSP also offers insights about whether individuals feel as if their economic situation is moving in a favorable direction, that is, whether they feel optimistic about the trend in their financial situation, both from the most recent five years to the present and predicting for the next five years. ISSP 2015 asks about both of these: “Compared to five years ago, how do you think your financial situation has changed?” and “What will your financial situation likely be in five years?”

Entrepreneurship and occupation. Differences in the working lives of those in each income class are evident in whether those surveyed are more likely to be self-employed or start a business, and what kinds of occupations they have. ISSP 2015 asks: “Over the past five years, did you experience any of the following changes in your working life? I started my own business/became self-employed.” Occupations were categorized using ISCO-08 codes, which have been aggregated into the 10 major groups used by the ISCO.⁷⁸

Perceptions of other job characteristics. Whether individuals see themselves as having a high-quality job are also considered, including whether they see their job as secure, whether they think they could find another job of the same quality, and whether they are likely to start looking for a new job. ISSP 2015 asks about all three: “For each of these statements about your (main) job, please tick one box to show how much you agree or disagree that it applies to your job: My job is secure.” “How difficult or easy do you think it would be for you to find a job at least as good as your current job?” And “All in all, how likely is it that you will try to find a job with another firm or organization within the next 12 months?”

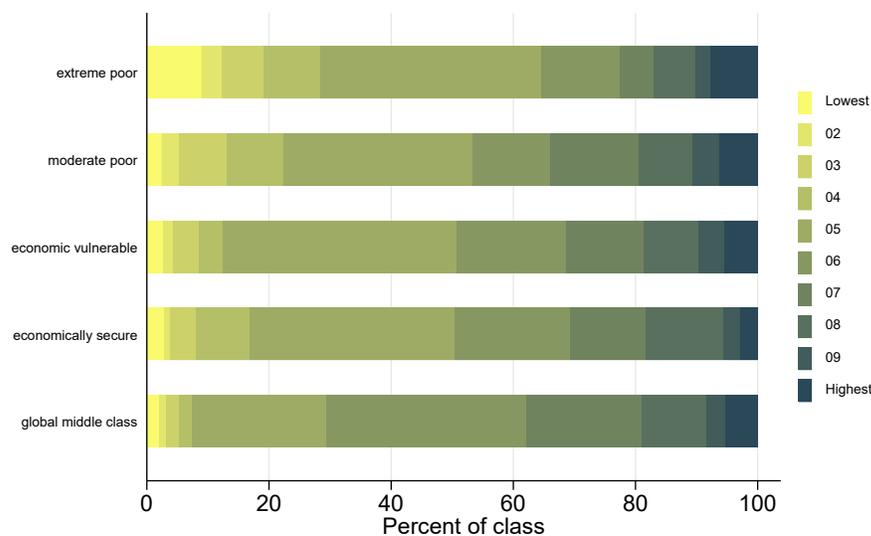
⁷⁶ ISSP respondents have been classified using the same income thresholds used in the preceding section.

⁷⁷ This analysis uses data from the International Social Survey Programme for 2017, 2016, 2015, and 2002. ISSP is nationally representative and comparable between and within countries across the different rounds. Each round has a common set of variables representing individual and demographic characteristics along with a set of variables representing the specific topic of a particular wave. The topic for 2017 is Social Networks and Social Resources; 2016 is Role of Government; and 2015 is Work Orientations.

⁷⁸ The ISCO-08 major groups are 1. Managers; 2. Professionals; 3. Technicians and Associate Professionals; 4. Clerical Support Workers; 5. Services and Sales Workers; 6. Skilled Agricultural, Forestry, and Fishery Workers; 7. Craft and Related Trades Workers; 8. Plant and Machine Operators and Assemblers; 9. Elementary Occupations; 10. Armed Forces Occupations.

Perceived social status. While the perceived social status is often strongly clustered around the middle, a positive association remains between objective income and subjective perceived social status. In nearly all income classes the most commonly reported self-assessed position is 5, the middle position. The only exceptions are for the global middle class, whose most common response is sometimes 6. Seventy-one percent of the global middle considering themselves above the middle of the distribution (Figure A.1).⁷⁹ The proportion that report below 5 declines with income, reaching less than 10 percent for the global middle class in 2017. This pattern of positive association between income level and perceived status and strong clustering around the middle values has also been found for the Philippines in 2001, as well as for several other Asian countries, where the range of individuals who saw themselves as having “middle” status reached from income decile 3 to 8 (ADB 2010).

Figure A.1. Self-Assessed Position by Class, 2017



Source: ISSP 2017
 N=1,139

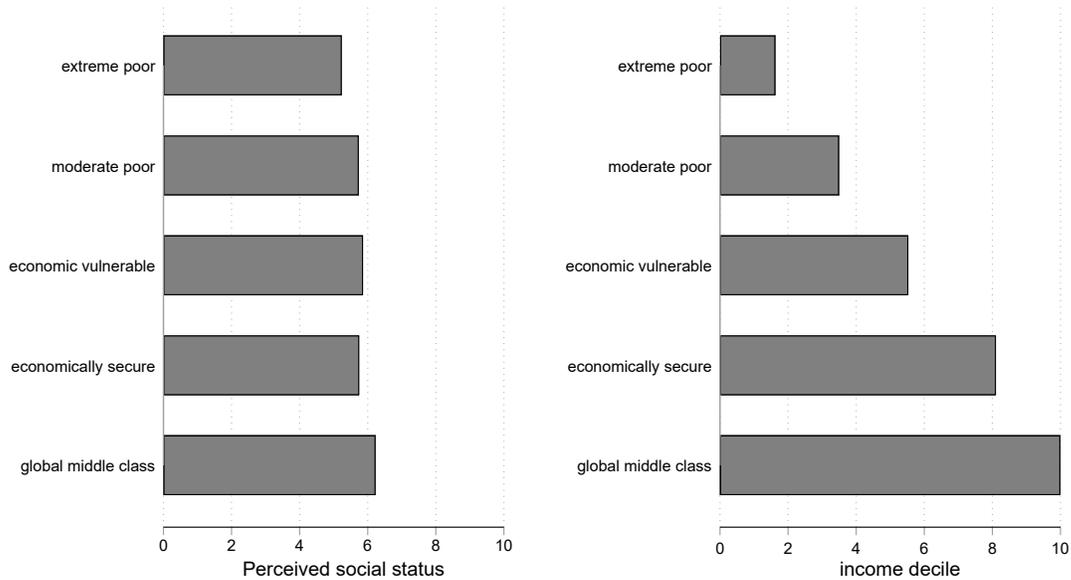
Note: The following survey question corresponds to self-assessed position: *In our society, there are groups that tend to be toward the top and groups that tend to be towards the bottom. Below is a scale that runs from the top to the bottom. Where would you put yourself on this scale?*

Self-assessment of social standing versus income decile. Although members of the middle class have higher income than those in other classes, members of the global middle class may not see themselves so differently in terms of social status (Figure A.2). This is likely because people tend to compare themselves with people they interact most with, which often have similar status as they do. The average social status reported by each class is similar, ranging from 5.2 for the extreme poor to 6.2 for the global middle class. This means that, interestingly, the extreme poor

⁷⁹ In every year, ISSP asks individuals where in society they believe they fall on a scale from top to bottom (in a 10-point scale). The question asked in the survey is: “In our society, there are groups which tend to be towards the top and groups which tend to be towards the bottom. Below is a scale that runs from the top to the bottom. Where would you put yourself on this scale?”

tend to see themselves as having a higher position than their income would suggest, while the global middle class see themselves as having a lower position.

Figure A.2. Perceived and Actual Household Income Per Capita

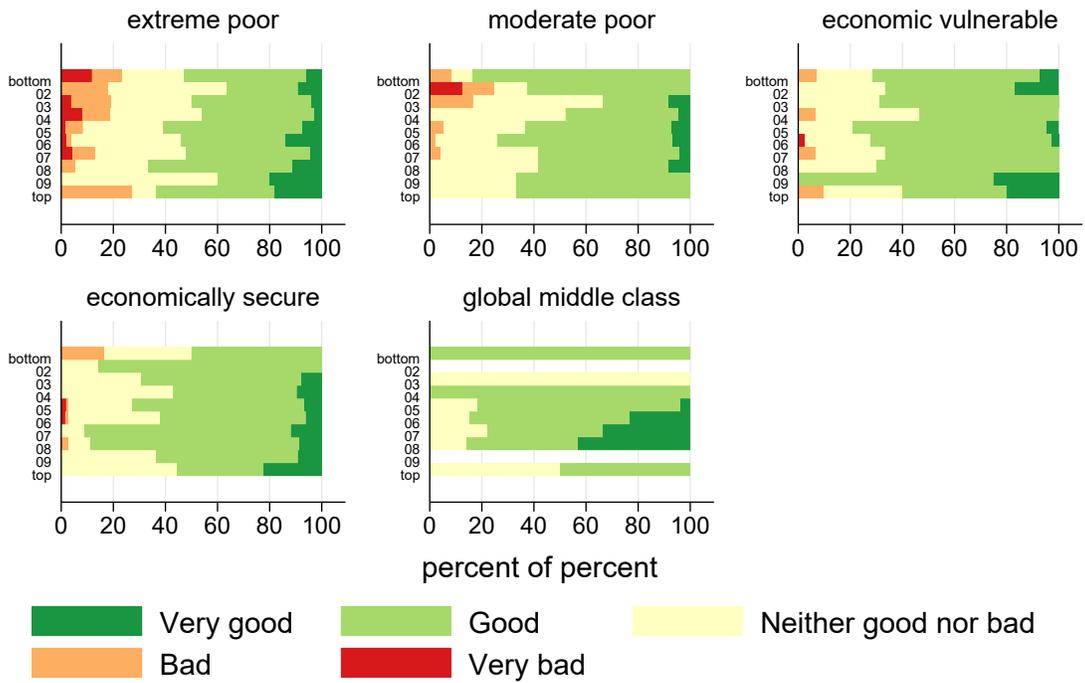


N=1,139
 Source: ISSP 2017

6.24 Assessments of financial situation. The global middle class are optimistic about their current financial status, with 80 percent saying it is either “good” or “very good” (Figure A.3). The perceived financial situation is positively related with income level, though the correlation is weak. Perceptions of one’s own financial situation is more strongly connected to income. For example, among the extreme poor who see themselves as having the bottom social position (top left bar), about 20 percent feel their financial situation is “bad” or “very bad,” while those in the global middle class might see themselves as having the bottom social position, everyone sees their financial situation as “good.” In general, very few individuals report a bad or very bad financial situation, but this is most common among the extreme poor. Having a very good financial situation is most likely in the global middle class. Within a given income class, those who perceive themselves as having higher social position also tend to be those who report having a very good financial situation.

Appendix A
 Subjective Versus Objective Middle-Class Status

Figure A.3. Self-Assessed Current Financial Situation Versus Self-Assessed Social Position



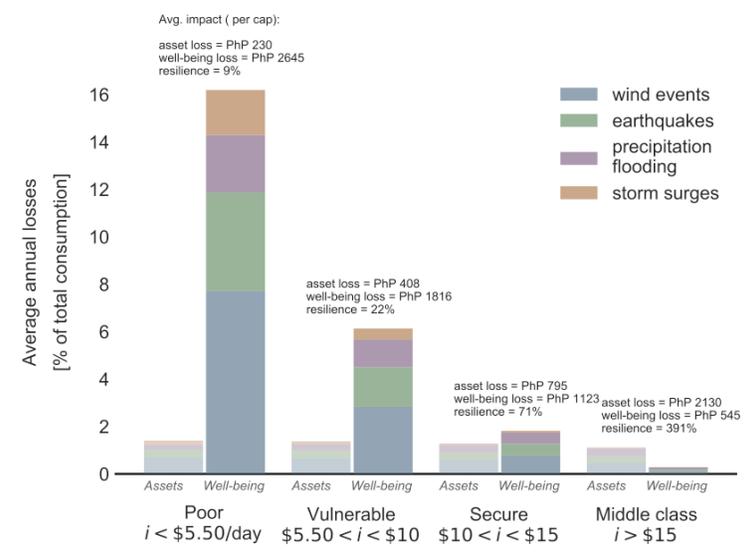
Note: The survey question used to evaluate self-assessment of current financial situation is *How would you generally rate your current financial situation?* Reading the chart vertically within a given income class shows the effect of self-assessed social position given objective income level. Reading horizontally across the charts gives the effect of income given self-assessed social position.

Appendix B. Impact of Natural Disasters

The Philippines is frequently hit by natural disasters. Household asset losses to natural disasters average PhP 70 billion (\$1.4 billion, 2011 PPP) per year in the Philippines. In an average year, wind events cause the most destruction, followed by flooding and earthquakes. By income class, poor households lose a total of PhP 5 billion per year, and the economically vulnerable lose PhP 10 billion. Economically secure households lose PhP 30 billion; and the remaining PhP 25 billion accrue to the middle class.⁸⁰

In absolute terms, the middle class suffers more damage in per capita terms (PhP 2,130) compared to the poor (PhP 230), mainly due to their higher level of asset ownership. In relative terms, the poor suffer more, due to a higher ratio of physical assets, and more fragile housing, compared to the middle class, who have more financial assets. Asset losses among households in the middle-class total 1.2 percent of annual consumption (PhP 2,130 per capita and year, Figure B1). These differences reflect the fact that poor households tend to store more of their wealth as physical assets (wealthy households tend to use financial instruments). In addition, poor households' domiciles and other assets are generally more fragile, and therefore more vulnerable to natural disasters, than those of wealthy households.

Figure B.1. Average Annual Asset and Well-Being Losses to Natural Disasters, Expressed as a Percentage of Total Consumption



Source: Staff calculation based on 2015 FIES data, and GoP Department of Finance Catastrophe Risk Model.⁸¹

⁸⁰ The analysis is based on the Philippines socioeconomic resilience model, which traces the distributional impacts of asset losses through income and consumption losses at household level, as detailed in World Bank Policy Research working paper; no. WPS 8723.

⁸¹ Deanna T Villacin. A review of Philippine government disaster financing for recovery and reconstruction. Technical report, PIDS Discussion Paper Series, 2017.

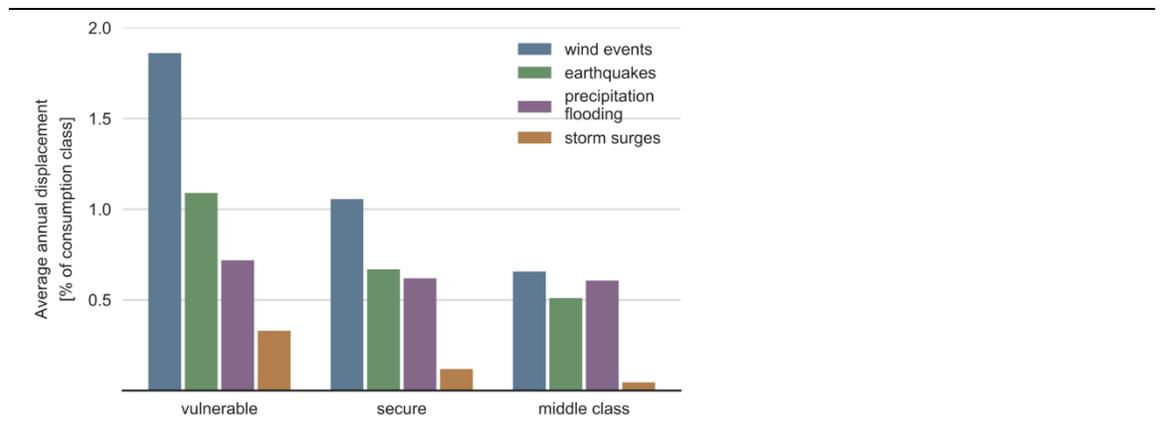
However, asset losses, the conventional metric for the magnitude of a disaster, are a poor predictor of household recovery dynamics. For a given value of asset losses, poor households are less likely than wealthy households to recover.

Well-being losses, which measure the utility loss associated with a household’s aggregate consumption losses (the marginal utility of foregone consumption, integrated over each household’s recovery path), may better measure the impact of disasters on households.

The middle-class suffer lower well-being losses than the poor. However, while the poor suffered disproportionately high well-being losses (16 percent), the middle class is not immune (0.5 percent, based on a larger absolute amount of consumption). The destruction and disruption of natural disasters are more consequential to poor households than their asset losses suggest. Due to disasters, the poor are more likely to have to make tough tradeoffs between spending on food, housing, education, and reconstruction, which might delay actual recoveries push poor households deeper into poverty, or prevent them from escaping it, and lower upward mobility. High well-being losses indicate these tradeoffs can be very severe, delaying actual recoveries.

Socioeconomic resilience, measured as the ratio of asset to well-being losses and signifying the capacity of households to cope with and recover from their losses, increases along with income. Poor households in the Philippines have a resilience of 9 percent (= PhP 230 in asset losses/PhP 2,645 well-being losses). In contrast, middle-class households lose just PhP 545 per capita and year, for a socioeconomic resilience of nearly 400 percent (= 2,130/545). Well-being losses are greater than asset losses for poor, vulnerable, and secure individuals, implying these households often have to scale back discretionary or even essential spending in response to disasters. These concessions can have severe long-term consequences, limiting their upward mobility.

Figure B.2. Individuals Displaced from Each Economic Class at Any Given Time, as a Result of Their Exposure to Natural Disasters



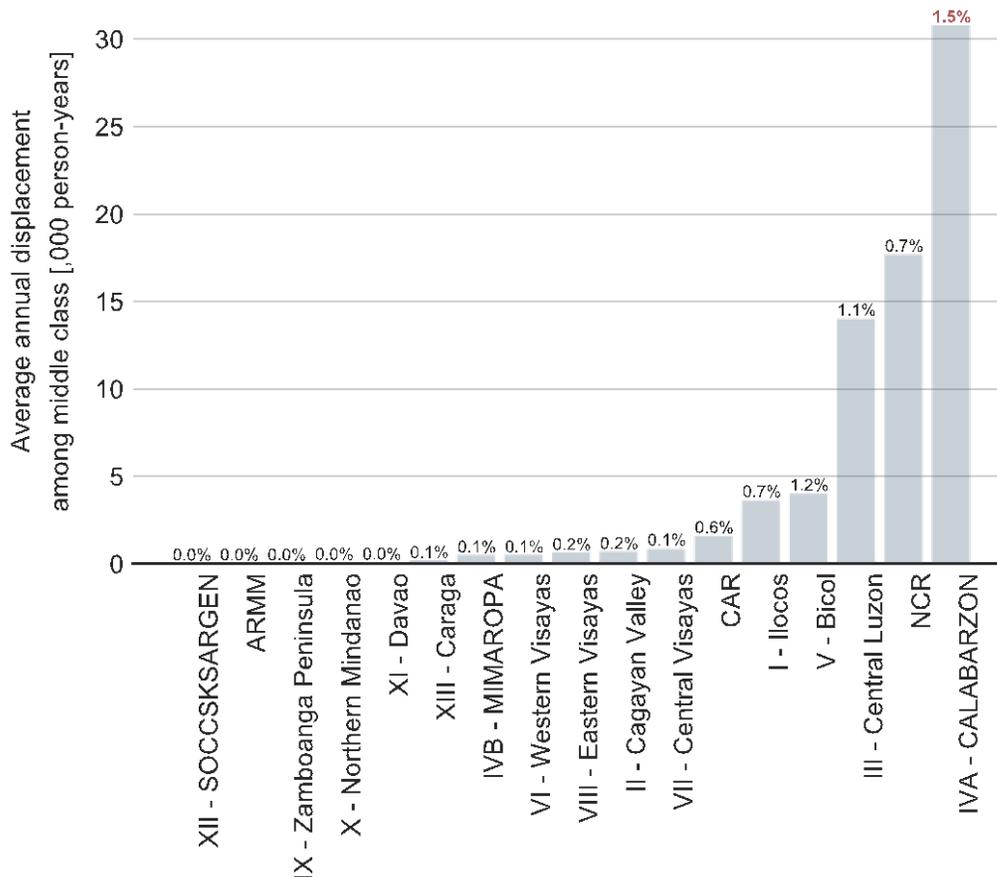
Source: Staff calculation based on 2015 FIES data, and GoP Department of Finance Catastrophe Risk Model.

Disasters present a challenge to staying in the middle class. Every year, 1.8 percent, or 200,000, of the middle class are demoted to economically secure or worse due to disasters. Disasters are also a challenge to upward mobility, with 1.1 million individuals (4 percent of vulnerable) pushed from

Appendix B
Impact of Natural Disasters

vulnerable to poverty each year. Figure B.2 presents the number of Filipinos displaced from each of the economic classes (vulnerable, secure, and middle class) at any given time, as a result of their exposure to natural disasters. These results can be interpreted as the expected increase, by class, if disasters could be prevented, or if affected populations were able to recover quickly when they occur. In addition, over 1.1 million individuals (4 percent) in economically vulnerable households are pushed into poverty each year. Across all income classes, tropical cyclones have the greatest displacing effect, followed closely by precipitation flooding (among the middle class) and earthquakes. Relative to the middle class, vulnerable households struggle to cope with and recover from their losses, leading to greater displacement, with attendant human and economic costs. Each year, tropical cyclones in Luzon alone push 0.6–1.5 percent of the middle class to lower levels (consume less than \$15 PPP 2011 per capita and day); similarly, 4 percent of the vulnerable end up in poverty (Figure B.3).

Figure B.3. Displacement of Individuals from the Middle Class by Tropical Cyclones



Note: The y-axis is plotted in person-years per year, which can for example be used to measure the marginal cost of class displacements to human capital and social safety nets. Each region is also labeled to show the magnitude of the effect as a percentage of the total population, by region, hazard, and economic class.

Source: Staff calculation based on 2015 FIES data, and GoP Department of Finance Catastrophe Risk Model.

Appendix C. The Middle Class and Economic Growth—A Case Study for the Philippines

Research Questions

Brueckner (2019) examines the relationship between the size of the middle class and economic growth. The size of the middle class is measured by the population share with PPP income per day above \$15, and economic growth is measured by real GDP per capita growth. The research questions are: What effects do redistribution-driven middle-class expansion have on economic growth? Do these effects change with the countries' level of real GDP per capita? What effects do exogenous growth in real GDP per capita have on middle class expansion? Has the past expansion of the middle class in the Philippines growth-driven or distribution-driven? Given the level of real GDP per capita in the Philippines, will redistribution-driven middle-class expansion policies be beneficial to real GDP per capita growth?

Econometric Model

The econometric model is a simultaneous equation. There is a two-way causality between the population share of the middle class and GDP per capita; that is, the population share of the middle class affects GDP per capita and vice versa. The simultaneous equation model is estimated using instrumental variables techniques; see Brueckner et al. (2018a, b) for details.

Equation (1) shows the econometric model for estimating the effect that the middle class has on economic growth:

$$(1) \quad \ln(\text{GDPp.c.})_{it} - \ln(\text{GDPp.c.})_{it-1} = a_i + b_t + \theta_1 \text{MiddleClass}_{it} + \theta_2 \text{MiddleClass}_{it} * \ln(\text{GDPp.c.})_{it-1} + \varphi \ln(\text{GDPp.c.})_{it-1} + u_{it}$$

In the above equation $\ln(\text{GDPp.c.})_{it}$ stands for the natural logarithm of real PPP GDP per capita in country i and period t . The variable MiddleClass_{it} is the population share with PPP income per day above \$15 in country i and period t (*PopShare15*), a_i are country fixed effects. b_t are time fixed effects. u_{it} is an error term. Note that equation (1) can be re-written as:

$$(1') \quad \ln(\text{GDPp.c.})_{it} = a_i + b_t + \theta_1 \text{MiddleClass}_{it} + \theta_2 \text{MiddleClass}_{it} * \ln(\text{GDPp.c.})_{it-1} + (\varphi + 1) \ln(\text{GDPp.c.})_{it-1} + u_{it}$$

The econometric model using five-year non-overlapping panel data. This means that the parameter φ measures the convergence rate over a five-year period.

The contemporaneous effect of the middle class on the natural logarithm of GDP per capita is $\theta_1 + \theta_2 * \ln(\text{GDPp.c.})_{it-1}$.⁸² If φ is significantly negative, so that $1 + \varphi$ is below unity in absolute value

⁸² The middle class variables are demeaned (i.e. MiddleClass_{it} minus the country average, MiddleClass_i) so that φ measures the convergence rate at sample mean of the Middle Class.

The Middle Class and Economic Growth—A Case Study for the Philippines

(i.e. there is convergence), then the cumulative effect after T periods on the level of GDP per capita is $(\theta_1 + \theta_2 * \ln(\text{GDPp.c.}_{it-1}))((1 - (1 + \phi)^T) / -\phi)$.

One issue in the estimation of equation (1') is the endogeneity of the middle class to GDP per capita:

$$(2) \quad \text{MiddleClass}_{it} = e_i + f_t + \alpha \ln(\text{GDPp.c.})_{it} + \varepsilon_{it}$$

If α is positive in equation (2) then the least squares estimate of θ in equation (1) is upward biased. That is, least squares estimation is biased toward finding a positive effect of the middle class on GDP per capita growth. The instruments for GDP per capita in equation (2) are lagged GDP per capita and the lagged terms of trade.

To correct for endogeneity bias of θ in the estimation of equation (1') I construct a measure of the middle class that is adjusted for the impact that GDP per capita has on this variable, i.e. $Z_{it} = \text{MiddleClass}_{it} - \alpha \ln(\text{GDPp.c.})_{it}$. This will be the instrument in the IV estimation of equation (1).

Data

Data on population share of the middle class (the share of the population with PPP income per day above \$15), and the mean incomes of the extreme poor, poor, economically vulnerable, and economically secure (the population with PPP income per day of \$1.90, \$1.90 to \$3.20, \$3.20 to \$5.50, \$5.50 to \$15, respectively) are from PovcalNet (2019). The data source for PPP constant price GDP per capita, domestic saving, domestic investment, and domestic credit to the private sector, life expectancy, adult mortality, infant mortality, and under-5 mortality are from the World Development Indicators (2019). Data on the average years of schooling of the population are from Barro and Lee (2013).

Results

First, growth in GDP per capita lead to a significantly larger middle class in the Philippines.

According to data from the World Development Indicators, the Philippines's constant price PPP GDP per capita increased between 1990 and 2015 by about 0.6 logs. The estimated econometric model predicts that due to growth in GDP per capita in the Philippines for the period 1990–2015 the population share of the middle class increased by 7 percentage points. This is close to what is observed in the data. According to PovcalNet, the Philippines's population share of the middle class increased for the period 1990–2015 by about 7 percentage points: from about 3 percent in 1990 to about 10 percent in 2015. Thus, according to the estimated model nearly all of the expansion in the middle class during the past decades is due to growth in GDP per capita.

Second, the growth impact of a redistribution-driven expansion of the middle class depends on the initial average income of the economy. The estimated coefficients in equation (1) are shown in Table YY.1 column (1). This yields the partial effects of middle class on log GDP per capita as in the following expression:

$$(3) \quad \partial \ln(\text{GDPp.c.}_{it}) / \partial \text{PopShare15}_{it} = -11.04 + 1.04 \ln(\text{GDPp.c.})_{it-1}$$

which shows that an expansion of middle class driven by redistribution increases with the initial level of average income of the economy, and the impact is negative when the initial level of average

Appendix C

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income is low but becomes positive passing a threshold. This threshold is \$40,757 (in 2011 PPP terms or ₱831,443 in 2018 PHP) and is obtained by equating (3) to 0. This relationship is also robust within ASEAN countries (as shown in column (2) of Table C.1) and restricting to the post-2000 periods (as shown in column (3) of Table YY.1).

Table C.1. Estimates of the Effects that the Middle Class has on Economic Growth

Dependent Variable is:	ln(GDPp.c.it)		
	(1)	(2)	(3)
Panel A: Population Share With PPP Income Per Day Above 15 Dollars			
PopShare15 _{it}	-11.04** (5.03)	-11.33** (5.08)	-10.96** (4.71)
PopShare15 _{it} *ln(GDPp.c.it-1)	1.04** (0.49)	1.07** (0.49)	1.06** (0.47)
ln(GDPp.c.it-1)	0.82*** (0.09)	0.82*** (0.10)	0.82*** (0.09)
PopShare15 _{it} *ASEAN _i		0.56 (0.42)	
PopShare15 _{it} *Post2000 _t			-0.19 (0.17)
Cragg Donald F-Stat	39	38	46
Controls and Observations in Panels A			
Country Fixed Effects	Yes	Yes	Yes
Time Fixed Effects	Yes	Yes	Yes
Observations	590	590	590

Note: The method of estimation is two-stage least squares. Standard errors (shown in parentheses) are Huber robust and clustered at the country level. *Significantly different from zero at the 10 percent significance level, ** 5 percent significance level, *** 1 percent significance level.

Third, average income in the Philippines is still too low for an expansion of the middle class to have significant positive growth effects. The estimated model predicts that an expansion of the population shares of the middle class that is not driven by growth in GDP per capita would have a significant negative effect on economic growth. Specifically, as shown in Table C.2, at 2015 levels of initial average income, a 5 percentage point increase in the Philippines's population share of the middle class would reduce per annum growth of 1 to 2 percentage points in the decades ahead. This means that by 2040, the Philippines's PPP GDP per capita would be lower by around 0.3 logs relative to the scenario of not changing the population share of the middle class. The mechanism operates through lower aggregate saving and investment. At current levels of initial average income, an expansion of the Philippines's population shares of the middle class that is not due to GDP per capita growth would be associated with a lower domestic saving rate, a lower domestic investment rate, and a decrease in domestic credit to the private sector.

Table C.2. Effects of a 5 Percentage Point Increase in the Population Share with Income Above 15 Dollars Per Day on the Philippines’s Log GDP Per Capita and Average Per Annum GDP Per Capita Growth

	(1)	(2)	(3)	(4)	(5)
Time Period	5 Years	10 Years	15 Years	20 Years	25 Years
Panel A: Initial Level of Economic Development is PPP GDP per capita in 2015					
Cumulative Effect on Log GDP per capita	-0.09	-0.17	-0.23	-0.28	-0.32
Average Effect on per annum GDP per capita Growth (in percent)	-2	-2	-1	-1	-1
Panel B: Initial Level of Economic Development is PPP GDP per capita in 2012					
Cumulative Effect on Log GDP per capita	-0.11	-0.18	-0.25	-0.30	-0.35
Average Effect on per annum GDP per capita Growth (in percent)	-2	-2	-2	-2	-1
Panel C: Initial Level of Economic Development is PPP GDP per capita in 2009					
Cumulative Effect on Log GDP per capita	-0.11	-0.19	-0.27	-0.32	-0.37
Average Effect on per annum GDP per capita Growth (in percent)	-2	-2	-2	-2	-2
Panel D: Initial Level of Economic Development is PPP GDP per capita in 2006					
Cumulative Effect on Log GDP per capita	-0.11	-0.20	-0.27	-0.33	-0.38
Average Effect on per annum GDP per capita Growth (in percent)	-2	-2	-2	-2	-2

Note: The calculated effects are based on the estimates in column (1) of Panel A of Appendix Table 1.

Appendix D. Attitudes of the Middle Class about Government Policy

Attitudes toward government policy of individuals from different income classes vary and evolve over time. The difference in attitudes between the middle class and the rest of the population would have a growing impact on the directions of government decision-making in the future, particularly as the middle class gradually expanded and their voter turnout increased. Using data from the International Social Survey Programme (ISSP) 1996, 2006, and 2016, this appendix analyzes how attitudes toward government policy have evolved for individuals across the income distribution, and what this might suggest for the policy landscape in the Philippines. Where relevant, we also provide complementary evidence from various waves of the World Values Survey (WVS).

Overall, compared to other income groups, the global middle class in the Philippines has been more likely to support government spending on education and health, less likely to support redistributive policies, and less likely to support government provision for the unemployed.

Political Participation

Voter participation for the middle class has grown. Although the middle class has had historically lower rates of voter turnout, with only 70 percent of those eligible to vote reporting that they did so in the last election before 2006 compared with a national average of 79 percent, their participation increased to 79 percent in 2016. This increase is somewhat larger than the national growth of 8 percentage points.⁸³ Overall voter participation in the Philippines is slightly higher than that in India and slightly lower than in Thailand, and both of these countries have a similar pattern of lower voter participation for the global middle class.

The middle class believes that people like them have influence in government policy. Although perceptions of having influence in political decisions fell across all income categories between 1996 and 2006, the global middle class is the only group that experienced substantial recovery from this decline in 2016. Fifty-eight percent of the global middle class believe that people like them have some say in government policymaking, compared with a national average of 42 percent.⁸⁴ For the global middle class, there may be a positive correlation between voter participation and the perception of influence over policy, with those who voted in the last election reporting more likely to feel they have influence over policy, although this difference is not significant in a t-test between

⁸³ The national average voter turnout rates are somewhat higher than the estimates by the International Institute for Democracy and Electoral Assistance, who find that voter turnout was 77.31 percent in the 2013 election and 76.97 percent in the 2004 election. These discrepancies could be due to measurement error in the survey, including error because the survey was conducted several years after the election. In 2012 in the Philippines, the World Values Survey asked how often people vote in the national elections, and found that 81.9 percent report always voting, 10.9 percent report usually voting, and only 6.8 percent report never voting.

⁸⁴ In a t-test, the difference between the global middle class and the rest of the country is significant at the 10 percent level in 1996 and 2016 and not significant in 2006.

the two groups. This pattern of increasing perceived influence over government decision-making is much less pronounced in Thailand and absent in India.⁸⁵

Together with rapidly growing voter turnout, this increase in perceived policy influence suggests that the growth of the global middle class may affect policymaking and government.

Policy Preferences

The middle class tends to support human capital investments. More than any other income group, the middle class is more likely to support government spending on human capital, specifically, education and health.⁸⁶ This support has grown since 1996 and has grown more rapidly for the global middle class than for other groups. Meanwhile, patterns of support are similar between those who voted and did not vote in the last election and a t-test between voters and non-voters shows no significant differences. Unlike the Philippines, in Thailand, the proportion of the global middle class who support more government spending in education and health is lower than the national average.

However, the middle class does not support redistributive policies. In 2016, the middle class was least likely of all income groups to support a government role for redistribution. For all income groups except the extreme poor, support for a government role for redistribution increased from 1996 to 2006 and fell somewhat in 2016. Only for the extreme poor, the moderate poor, and the global middle class did these values return nearly to 1996 levels or lower.⁸⁷ Support for redistribution was somewhat higher among those who voted than those who did not. However, across the board, support for redistribution in the Philippines is much lower than in other countries like India and Thailand.

Meanwhile, in 2016, the middle class was most likely among all income groups to believe that taxes on those with high incomes are too high. Over time, the trend for the period 1996–2016 appears to be different for the global middle class than for the other classes, as this is the only group that shows uniform increase over the years, perhaps reflecting the fact that the global middle class represents those with the highest incomes in society. Meanwhile, among the middle class, those who did vote were more likely to support this statement than those who did not vote in the last election, but the difference is not significant. This pattern is opposite the one seen in India, where

⁸⁵ Complementary evidence from the WVS Wave 6 (2012) suggests that 93.4 percent of those surveyed in the Philippines felt that having honest elections was important in determining the economic development of the country.

⁸⁶ The difference between the global middle class and other income groups is not statistically significant in a t-test. Again, complementary evidence from the WVS 2012 indicates that 89.7 percent of those surveyed in the Philippines felt that they worried “very much” or “a great deal” about not being able to give their children a good education.

⁸⁷ The WVS asked a similar question in 1996, 2001, and 2012, asking individuals to rate on a scale of 1–10 their attitudes toward income equality, with 1 representing “Incomes should be made more equal” and 10 representing “We need larger income differences as incentives.” If those who chose a value of 1, 2, 3, or 4 are considered to be in favor of redistribution, then 25.9 percent (1996), 21.5 percent (2001), and 25.5 percent (2012) support redistribution. Although these figures replicate the drop in preference for redistribution in the middle years of the surveys, they are substantially lower than the corresponding figures in ISSP, perhaps due to the fact that WVS has a middle option, which encompasses more responses than any other option in all three years. Of those who did not choose the middle option, those in favor of redistribution make up 31.9 percent (1996), 25.7 percent (2001), and 30.2 percent (2012). Again, these numbers replicate the general trend in ISSP across the years but are much smaller than the corresponding ISSP values. This may also be due to the wording of the questions, where the WVS gave reasons supporting both extreme responses, while ISSP only asked a single question.

Appendix D
Attitudes of the Middle Class about Government Policy

the extreme poor are more likely than the global middle class to believe that taxes for the wealthy are too high.

The middle class is also less likely to support government-provided unemployment benefits. Although support for unemployment benefits provided by the government has grown over time for almost all income classes and on average nationally, this has not been the case for the middle class. The middle class has been less likely than the rest of the country to support unemployment benefits, a difference that is significant at the 5 percent level in 1996 and 2016. Because support for unemployment benefit has declined among the global middle class in recent years, this group now has the lowest support of any group for these policies. For the global middle class, support was even lower among the subset of individuals who voted in the last election than those who did not vote. However, unlike the Philippines, in India and Thailand, support among the global middle class for these unemployment benefits is similar to or slightly higher than the national average.

Like other income groups, the middle class believes the government should reduce regulation of businesses. When asked whether they favor less government regulation of businesses, the majority responded that they did. Among the middle class in 2016, 53 percent of respondents felt that the government should loosen regulations on businesses, compared with a national average of 59 percent. Middle class support for deregulation was higher than the national average of 54 percent in 2006 and 1996. This support for less regulation of business may correspond also to support for policies that make it easier to start or run businesses.⁸⁸

However, confidence in the government is low. In the 2016 round of ISSP, only 42 percent of the middle class agreed that most civil servants could be trusted. This is substantially lower than the national average of 55 percent who would agree.⁸⁹

⁸⁸ Moreover, according to the WVS in 2012, 55 percent of respondents believe competition is good for the economy and society.

⁸⁹ This is similar to the proportion in the WVS, with 42 percent nationally stating that they have “not very much” or “none at all” confidence in the government.

Appendix E. Focus Group Discussions and Interviews

The focus group discussion and interviews were conducted in April–May 2019 with a total of 48 Filipinos in Manila.

Focus Group Discussions

Five focus group discussions were conducted. The individuals, who do not know each other, are grouped into four categories according to the household income level they reported. Each group has 6–8 participants. The focus group discussions were carried out separately with each income group. The topics of discussion in each group are similar, including family background, housing, education, jobs, access to financial services, health, and opinions/perceptions of constraints to upward mobility. One additional focus group discussion was conducted with individuals who are economically vulnerable and have experienced natural hazards or health shocks.

GROUP 1: Extreme poor and moderate poor

Income range per person per month is PhP 1,000–2,000. Usually those in this bracket have three or more children, have an elementary or incomplete high school education, are underemployed, when employed are self-employed or work for a private establishment, in agriculture sector or in services.

Typical types of employment in these groups include street vendors, domestic helpers who work in Manila but support families in the provinces, tricycle drivers/pedicab drivers, construction workers informally employed or supporting large families, unskilled laborers.

GROUP 2: Economically vulnerable

Income range per person per month is PhP 2,000–3,500. Those in this category often have 2–3 children, high school undergrad or have a high school degree, self-employed or work for a private establishment, likely in the services industry. Males head most households.

Typical types of employment in these groups include those on short-term contracts (Endo), wait staff in lower end restaurants, sales people in *tiangge*-type stores, informally employed, gas boys, employed by small and medium enterprises (SMEs).

GROUP 3: Economically secure

Income range per person per month is PhP 3,500–10,000. The economically secure are typically families with 2–3 children, about a quarter are female-headed, with the vast majority having at least a high school degree, one out of five will have some tertiary education, majority are employed in the services industry or are self-employed.

Typical types of employment: BPO, retail, food and beverage industry, hospitality industry, self-employed freelance online work (O-desk types), receptionists and assistants, hairdressers, Starbucks baristas, SME employees, sales personnel in malls, Grab/taxi driver, office work (non-Endo).

GROUP 4: Global middle class

Income range per person per month is PhP 10,000-50,000. These are households with two or fewer children, older household heads or females with higher education, many are receiving remittance income, for those employed locally they have better quality formal jobs, more likely to have their own business or work in the services sector for higher wages.

Possible types of employment: Income from business, mid-management in business process operations or other services sectors, jobs with stability and with benefits provided for health and retirement. Typically also have at least one family member who is a foreign worker providing remittances.

GROUP 5: Economically vulnerable who have experienced natural hazards or health shocks to income

Similar income level as Group 2 but recently experienced either natural hazards or health shocks in the family. Natural hazards include flooding, typhoons, heavy rains, and earthquakes, which resulted in damage to property. Health shocks in the family include a catastrophic illness such as cancer, stroke, heart attack, or any condition that required extended hospital stay of over a week.

Interviews

Interviews were conducted to with seven individuals with specific characteristics. The interviewees do not overlap with the focus group participants. They are the head of household or next responsible adult with knowledge of family finances and history:

- Economically vulnerable from poor background (that is, used to be poor but has grown up to economically vulnerable within same generation)
- Economically secure from poor background (that is, used to be poor but has grown economically secure within same generation)
- Global middle class from foreign worker income
- Global middle class from business process operation income
- SME employer with 20 and 50 employees

Appendix F. Financial Sector Development in the Philippines

The financial system in the Philippines has grown in size in recent years and continue to be stable and resilient. The banking sector in particular remains well-established and profitable with its activity concentrating in basic lending and deposit-taking. Access to and usage of financial services have continued to improve but the progress remains relatively slow in the East Asia region, with only 34 percent of adults having a bank account in any financial institution. As the financial services expand to include those that have not had access to traditional banking, pawnshops and money service businesses (MSBs) have become an important tool. There has also been an increase in financial access points through banks' offices and branches, automated teller machines (ATMs), E-banking, and E-money services.

Along with the sustained growth observed in the economy in recent years, the financial sector has also grown in size and relative importance, particularly the banking sector. Over the last decade total assets of the banking sector increased from being below 70 percent of GDP in 2009 to represent close to 100 percent of GDP in 2019, responding to the increasing needs of financial services as the economy has experienced sustained growth. Banks continue to dominate the financial sector in the Philippines, representing 81 percent of the total financial system assets as of end-June 2019. Total assets of the banking system reached a total of PHP17,589 billion at end-June 2019 (97 percent of GDP), most of which were peso-denominated (81.5 percent) while foreign-currency denominated assets made up only 18.5 percent (USD 62.3 billion equivalent). The banking sector is comprised of 554 banks, including 46 universal and commercial banks, 51 thrift banks, and 457 rural banks. Universal and commercial banks account for 91 percent of total system assets, and the four largest universal and commercial banks account for about 55 percent of total banking system assets as of 30 June 2019.

The asset structure of the banking sector reflects the demand from the active economic environment. The total loan portfolio (TLP) was PHP10,288 billion at end-June 2019 and represented 60 percent of the total assets of the banking sector, of which 83 percent was directed to corporates and 11 percent to households. The system's corporate loan portfolio appears diversified by economic sector with an important share directed to real estate (18.18 percent); wholesale and retail trade, repair of motor vehicles, motorcycles (13 percent); and manufacturing (11 percent).

Deposits are the main source of funding for the banking system in the Philippines. Total deposits accounted by 85 percent of total liabilities in the banking system as of end-June 2019, most of which were peso-denominated (83 percent). Total-loan-to-deposit ratio was 80 percent in the same period. The Philippines has a deposit insurance system in place to protect depositors. The Philippine Deposit Insurance Corporation (PDIC) was established by the government in 1963 and all banks operating in the country are required to be members of the PDIC. The PDIC guarantees savings up to PHP500,000 per depositor per bank.

The Philippines's overall financial system continue to be stable and resilient, and there are no signs of systemic financial risks. Banks remain well capitalized with satisfactory asset quality indicators.

Appendix F

Financial Sector Development in the Philippines

The banking industry is capitalized well above the minimum regulatory requirements. The total capital adequacy ratio was 15.81 as of Q3 2019. In addition, the share of non-performing loans to total loans remains low at 2.15 percent as of Q3 2019, with a lower rate for universal and commercial banks (1.66) and higher rates for thrift and rural banks (6.00 and 11.39 percent respectively). According to the latest outlook from Bangko Sentral ng Pilipinas, the Philippine banking system remains positive with good growth projections in terms of assets, loans, deposits, and net income in the short to medium term with strong liquidity indicators.

Appendix G. Limited and Uneven Access to Financial Services

Access to financial services for firms and individuals is limited and uneven in the Philippines.

Firm Level

Credit access for firms remains a severe challenge, although the Philippines enjoys high coverage of deposits and savings at banks with declining interest rates. According to the IFC and the SME Finance Forum, the MSME finance gap in the Philippines is estimated at \$221.8 billion, equivalent to 70.7 percent of the country's GDP as of 2017.⁹⁰ As Table G.1 shows, the Philippines is severely challenged in this area, lagging far behind its peers from the same income group in the region.

Table G.1. MSME finance gap for selected Asian lower middle-income countries

	GDP (2017, current US\$) ^a	MSME finance gap (2017) ^b	MSME finance gap (percent of GDP)
Philippines	313,619.75 million	221,793.42 million	70.7%
Indonesia	1,015,423.46 million	165,852.54 million	16.3%
Vietnam	223,779.87 million	23,609.83 million	10.5%
Bangladesh	249,723.86 million	38,972.71 million	15.6%
Pakistan	304,567.25 million	41,024.80 million	13.5%

Sources: a. World Bank, b. <https://www.smefinanceforum.org/data-sites/msme-finance-gap>

More detailed analysis by firm size reveals that SMEs are far less likely to have bank credit than large firms, although over 90 percent of Filipino SMEs have a checking or savings account at a bank (Figure G.1). The proportion of loans requiring collateral is lower for SMEs than for large firms, but SMEs are required to present a larger value of collateral for those loans, especially medium-sized firms, compared to large firms. The pattern in the Philippines is quite different from that in the region and across the world (Table G.2).

⁹⁰ Source: <https://www.smefinanceforum.org/data-sites/msme-finance-gap>

Figure G.1. Firms with accounts and loans

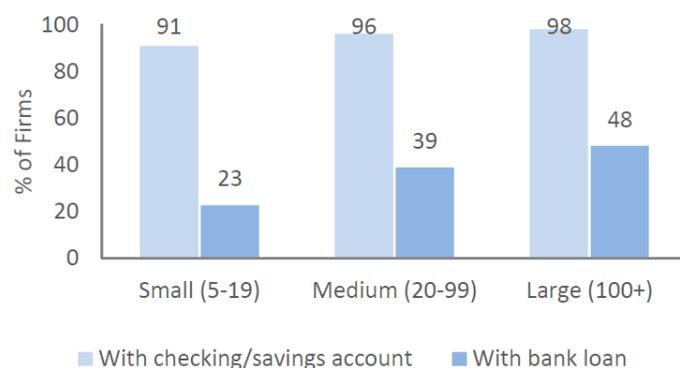


Table G.2. Access to bank finance

Indicator	Philippines	East Asia & Pacific	All Countries
Percentage of firms with a checking or savings account	93.2	77.0	86.5
Small (5-19)	90.9	74.6	84.1
Medium (20-99)	96.2	84.0	91.3
Large (100+)	98.0	86.4	93.9
Percentage of firms with a bank loan / line of credit	29.9	28.3	33.5
Small (5-19)	22.6	22.4	28.1
Medium (20-99)	38.9	36.2	41.4
Large (100+)	48.1	41.8	51.1
Proportion of loans requiring collateral	51.0	82.6	79.1
Small (5-19)	55.3	82.7	77.3
Medium (20-99)	42.9	84.8	81.2
Large (100+)	72.0	84.6	80.4
Value of collateral needed for a loan (percent of loan amount)	156.7	238.4	205.5
Small (5-19)	144.5	231.3	217.3
Medium (20-99)	191.2	239.9	197.2
Large (100+)	128.9	240.0	185.1

Source: World Bank Enterprise Survey 2015

Only 12 percent of Filipino firms are using bank loans to finance investments or working capital (Table G.3). This is much lower than the 20–30 percent average for the region and for all countries. The difference is much wider for supplier/customer credit to finance working capital, with only 7 percent of firms in the Philippines are using supply chain finance, in contrast with 21 percent of firms in the region and 32 percent of firms in the world. This shows that Filipino firms are relying less on banks and value chain finance to finance their investments and working capital needs, which means they would have more limitations in growing and maintaining their business and therefore improving the lives of the owners and employees.

Table G.3. Access to finance by use of funds

Indicator	Philippines	East Asia & Pacific	All Countries
Percent of firms using banks to finance investments	12.4	20.5	26.1
Small (5-19)	4.5	16.9	23.0
Medium (20-99)	20.5	23.3	28.8
Large (100+)	14.3	22.7	32.1
Percent of firms using banks to finance working capital	12.4	25.4	30.1
Small (5-19)	10.4	20.9	25.9
Medium (20-99)	14.9	33.5	36.9
Large (100+)	17.3	37.6	43.0
Percent of firms using supplier/customer credit to finance working capital	7.4	21.0	31.6
Small (5-19)	6.9	18.5	30.3
Medium (20-99)	9.5	24.2	33.2
Large (100+)	1.8	25.7	35.1

Source: World Bank Enterprise Survey 2015

A startup survey conducted with more than 100 CEOs and founders in the Philippines in 2017 found that current startup ecosystem challenges range from access to capital (88 percent), regulatory requirements (54 percent), business/economic conditions (50 percent), talent retention (36 percent), and competition (35 percent). According to the 2015 World Bank Enterprise Survey for the Philippines, 22.6 percent of small firms and 16.5 percent of medium firms found the practices of competitors in the informal sector the main obstacle for their business, followed by access to finance (10.2 percent of small firms, 12.9 percent of medium firms), and corruption (9.7 percent of small firms, 12.9 percent of medium firm).

The heavy reliance on internal funds and high costs of financing remain important constraints. MSMEs cite high interest rates, complex application procedures, and high collateral requirements, as well as lack of need, as main reasons for not applying for a new line of credit. The share of firms saying they do not need a loan has increased and small businesses rely disproportionately on equity, suggesting lack of availability of credit. For startups, constraints on access to finance are especially acute with 88 percent of founders citing it as the top challenge to doing business. Thus, while MSMEs represent a significant share of employment and the growth potential of the economy, these businesses struggle to obtain external finance, despite the government's efforts, such as the Magna Carta for MSMEs which mandated that banks devote 10 percent of their lending to MSMEs (in effect from 2008–28).

Individual Level

Access to transaction accounts in the Philippines, though rising slowly, is significantly behind regional and global averages (Figure G.2). The Global Findex 2017 indicates that only 34 percent of adults had accounts; slightly up from 31 percent and 27 percent in 2014 and 2011, respectively. It is significantly lower compared to some peer economies, including Indonesia, Malaysia, and Thailand, whose account holder percentages in 2017 were 49 percent, 85 percent, and 82 percent,

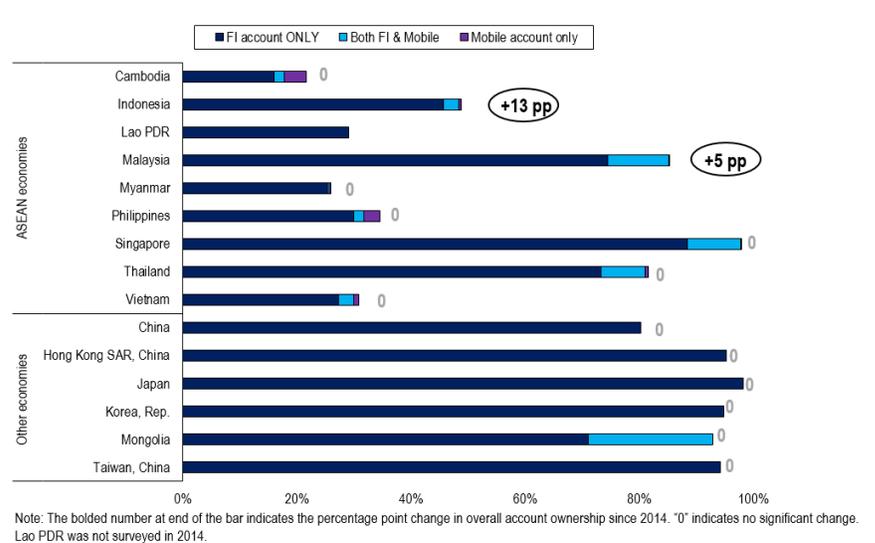
Appendix G Limited and Uneven Access to Financial Services

respectively. Compared with Cambodia (22 percent), Myanmar (26 percent), and Vietnam (31 percent), the adult bank account penetration in the Philippines is slightly higher.

The same database shows that in 2017 the global average of account ownership was 69 percent, the regional (East Asia and Pacific) average was 71 percent, and the lower middle-income group (where the Philippines is included) average was 58 percent.

Figure G.2. Account Ownership among ASEAN

Total Percentage of Adults (15+)



Source: World Bank Global Findex (2017)

Roughly two-thirds of adults in the Philippines remain unbanked. This translates into about 40 million adults without a transaction account. The unbanked cite various barriers to getting an account, including physical distance to financial institutions (41 percent), high costs of financial services (53 percent), and lack of documentation required to open an account (45 percent). These numbers are about twice the developing world averages. Also noteworthy is that 69 percent of the unbanked stated that they do not have sufficient funds to save in an account. Most banks require a minimum balance to open and maintain an account; even if individuals have cash that exceeds the minimum balance, if it is not a high sum of money they may not feel it is worth opening an account at a formal financial institution, given the perceived high costs of financial services and hidden costs of preparing documentation and traveling to access financial institutions.

Wealthier Philippine adults are more than twice as likely than poorer adults to have an account. Among adults in the richest 60 percent of households, 45 percent have an account, against 18 percent of those in the poorest 40 percent of households. Account ownership is nearly two times higher among urban adults than rural adults: 46 percent of urban residents have an account, against only 27 percent of rural dwellers. The Philippines is one of few countries where women are more likely than men to have an account: 39 percent of women have an account, versus 30 percent of men. Among account owners, 73 percent use their account to make or receive digital payments, roughly the same as the developing world average.

Use of banking services is more limited for poorer households living in rural areas. Global Findex 2017 shows that, among adults in the richest 60 percent of households, 45 percent have an account, against 18 percent of those in the poorest 40 percent. Rural households use bank accounts less than urban households: account ownership is nearly two times higher among urban adults (46 percent) than rural adults (27 percent). This occurs because transaction costs are high for clients who live farther from banks. The disparity is also striking for low-income households, which have far lower rates and amounts of savings. Only 4 percent of the poorest 40 percent of households saved at a financial institution while 17 percent of the richest 60 percent saved at a financial institution. The disparity also explains the prevalence of cash loans in rural areas, where other options are scarce.

Physical access to bank offices in areas outside the National Capital Region is limited. Banks have 30 percent of their physical presence in the Metro Manila area, where 13 percent of the population reside, and poverty is low. Meanwhile, Bicol, parts of Mindanao and Visayas, and the CAR, ARMM, and CARAGA regions—which are poorer and more rural—have less banking infrastructure and a lower proportion of people with bank deposits. Geographic remoteness, low population density, the high cost of transport, and political instability contribute to the high transaction costs that make certain regions less attractive to financial service providers.

Appendix H. Social Networks and Borrowing

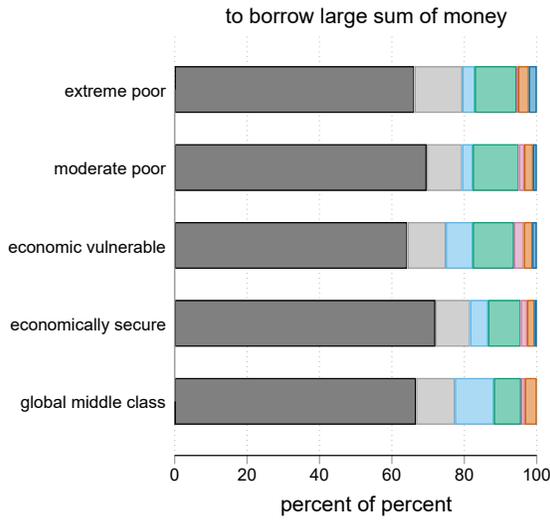
Social networks and informal safety nets are strong. According to ISSP data, across all income groups, most people prefer to use informal resources (family and friends) for their financial needs, and networks for borrowing money appear similar to networks used for other purposes such as help with administrative paperwork or housing (Figure H.1). This means that family and friends may be an important safety net for people, but that people may also have strong obligations to help others around them. Compared with the networks of the global middle class (income > \$15 per capita per day, 2011 PPP) in the other low or middle income countries in ISSP (Mexico, Russia, and Thailand), those in the Philippines are most likely to use these informal networks for such financial purposes as borrowing money (Figure H.2).

The data source for the figures is the International Social Survey Programme. The ISSP is an annual cross-country household survey focusing on various social and economic topics. ISSP is nationally representative and comparable between and within countries across rounds. Each round has a common set of variables representing individual and demographic characteristics along with a set of variables representing the specific topic of a particular wave. The topic for 2017 is Social Networks and Social Resources.

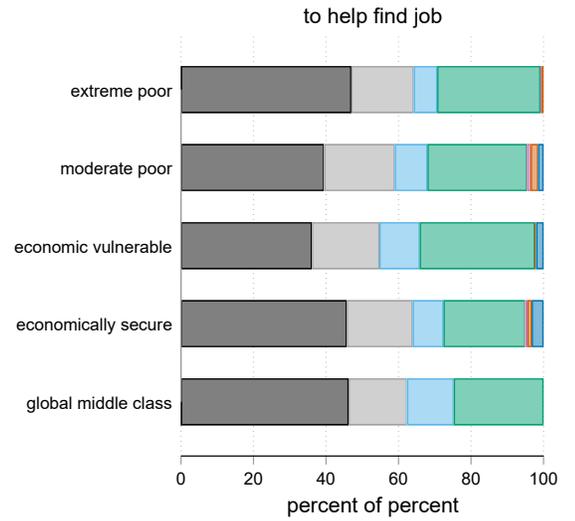
For each year, individuals were categorized into income categories in line with the East Asia Regional Flagship *Riding the Waves* using household monthly income as reported in the survey. This was then converted to U.S. dollars per day by dividing by 30 and using 2011 PPP conversion rates. For the Philippines, this gives a conversion of 17.35 2017 pesos per 2011 PPP. For the other countries considered using the survey year 2017, the conversions are: 7.67 Mexican pesos per 2011 PPP, 24.02 Russian ruble per 2011 PPP, 13.43 Thai baht per 2011 PPP. This is then divided by the number of people in the household, giving the per capita household income in U.S. dollars per day.

One caveat to this analysis is that the income breakdown of the ISSP sample does not match the FIES from the same year. The group of those categorized as extreme poor is much larger. The average monthly household income reported in ISSP is 12,197 pesos, much smaller than the average income reported in FIES 2015, about 22,000 pesos. This may be due to measurement error: while ISSP asks only a single income question, FIES is much more extensive and detailed and includes imputed rental values of owned homes and property, gifts received, and subsistence production. It may also be because the ISSP sample includes only adults over the age of 18 and has a low response rate near 30 percent, much lower than the 90.6 percent reported by FIES. For this reason, results should be interpreted within the ISSP context.

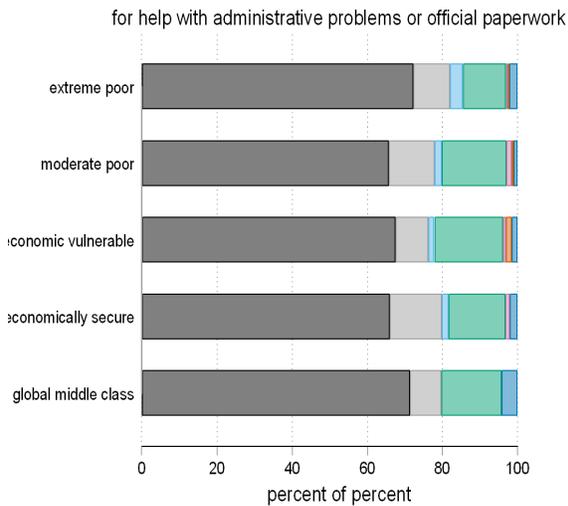
Figure H.1. Social networks. Who would you contact for help?



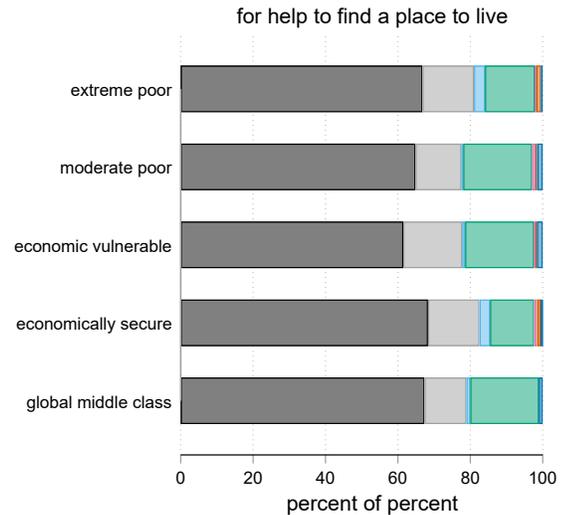
Source: ISSP 2017
N = 1129



Source: ISSP 2017
N = 1118



Source: ISSP 2017
N = 1134



Source: ISSP 2017
N = 1128

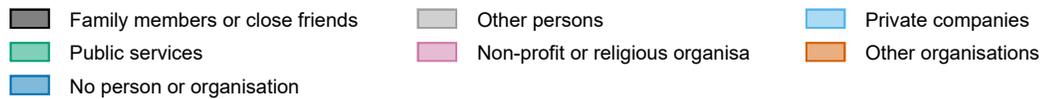
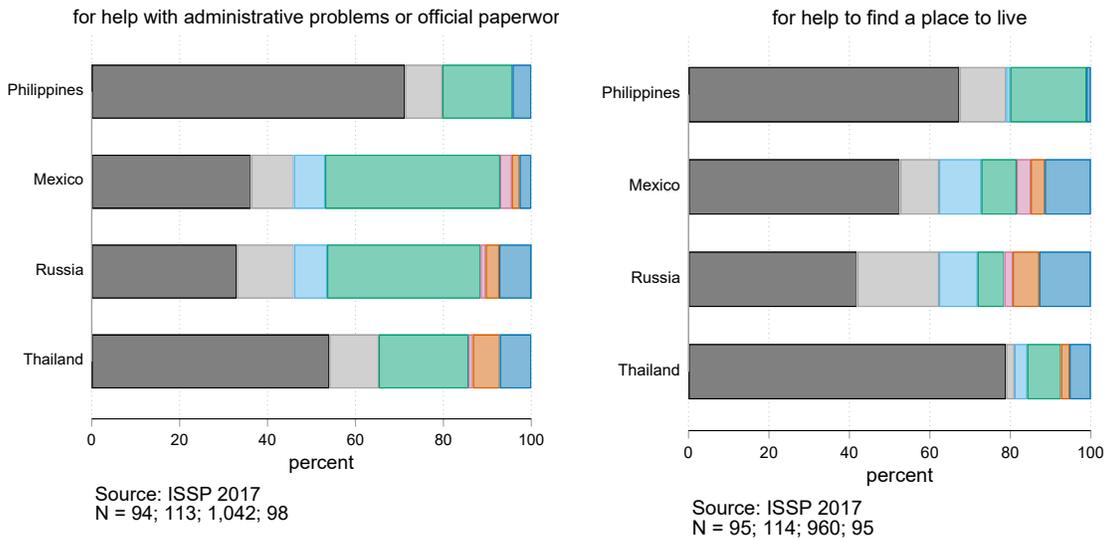
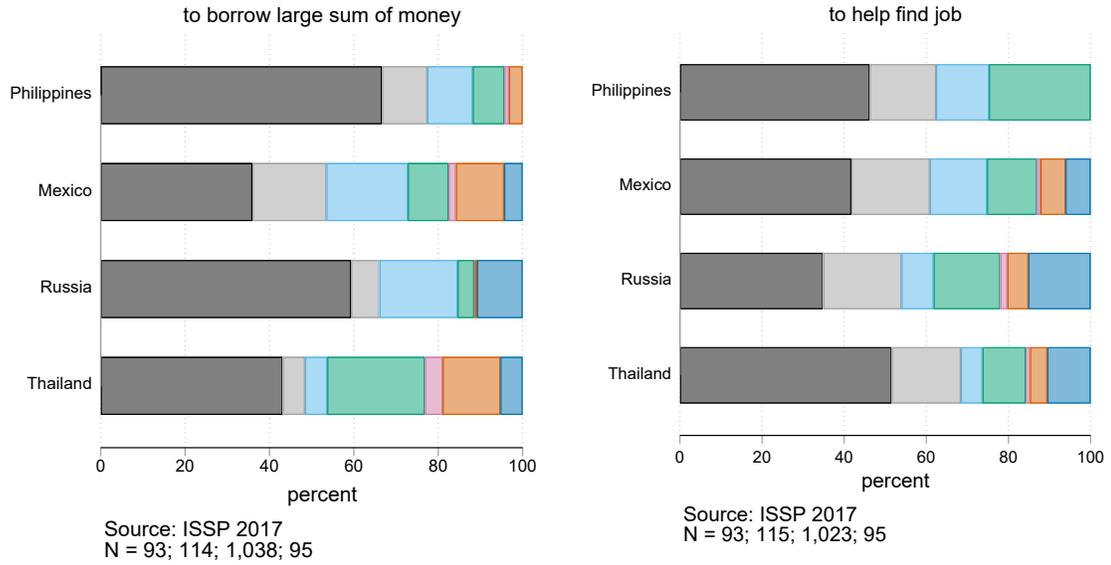


Figure H.2. Social networks: Who would you ask for help?
International comparison, global middle class only



- Family members or close friends
- Other persons
- Private companies
- Public services
- Non-profit or religious organisa
- Other organisations
- No person or organisation

