Philippine External Trade and Regional Production Networks

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The Philippines is growing more integrated with the rest of the world as shown by the increasing ratio of external trade to Gross Domestic Product (GDP). The ratio of exports and imports to GDP increased from 52% in 1980 to 106% in 2000. Exports grew 32 fold - from P57.5 billion in 1980 to P1,859.4 billion in 2000. Imports expanded 24 fold- from P69.4 billion to P1,656.9 billion during the same period.

The spectacular growth of Philippine exports comes with changes in export profile and in the direction of trade. The share of primary exports like food and agricultural materials has been on the decline while the share of manufactured goods has been on the rise. The share of all food items has fallen from 19% in 1990 to 5% in 2000. The share of manufactured goods, on the other hand, has more than doubled from 38% to 90% during the same period. Among the manufactured goods, the share of electronics has doubled in just a decade- from 33% in 1990 to 65% in 2002.

The electronics sector has been the main engine for growth of Philippine exports. Without electronics, the Philippine exports barely grew over the last decade. Among different electronics sub-sectors, electronics exports are concentrated on semiconductors and electronic data processing. The two sub-sectors accounted for two-thirds of total Philippine exports in 2002. Interestingly, the share of semiconductors has been falling over time while the share of electronic data processing has been rising. Semiconductors include transistors, electronic valves and tubes, and capacitors. Electronic data processing includes automatic data processing and digital processing units.

Changes in export profile come with changes in direction of trade. In 2001, a third of Philippine exports went to East Asia, another third went to North American Free Trade Area (NAFTA) countries, and around 15% each to Japan and the European Union. The share of Philippine exports to NAFTA countries, particularly the United States of America (USA), has been falling for the last two decades. This can be partly explained by the trade diversion effect of the NAFTA that favored NAFTA-member countries such as Mexico that benefited immensely from preferential tariffs and investment opportunities. Mexico is believed to have benefited from NAFTA at the expense of some East Asian economies as it has become a production platform for labor-intensive production processes.

The share of Philippine exports to Japan has also been falling over time. The share of Philippine exports to EU, mostly to the Netherlands, Germany, and United Kingdom has been fairly steady at around 15%. However, the share of Philippine exports to East Asia has doubled in just 15 years. The share has increased from 18% in 1985 to 34% in 2001. The leading Philippine exports to East Asia are mostly electronics such as electronic microcircuits, office machinery parts, and digital storage units.

The growth of Philippine electronics exports to East Asia has been due to regional production networks (RPNs). Under RPNs or production sharing, each economy specializes in an aspect of production based on its comparative advantage and these economies are linked through subcontracting arrangements. Advanced economies such as Japan focus on skill-intensive and capital-intensive production of parts and components while developing economies such as the Philippines concentrate on semi-skilled labor-intensive product assembly and testing. RPNs are sensitive to differences and changes in labor cost particularly for low value-added product assembly and testing. RPNs allow firms, mostly multinational corporations, to cut down on production costs due to enhanced efficiency and improved productivity.

The success of RPNs and the participation of East Asian economies such as the Philippines in RPNs have been attributed to falling trade barriers, a sharp rise in foreign investment, and improvements in infrastructure and logistics. To remain a part of RPN, the Philippines and the rest of East Asia must undergo industrial upgrading. This implies that the Philippines should move up to higher value-added production since the entry of low-wage countries such as China challenges the Philippines' position in low value-added assembly.

Industrial upgrading requires that the Philippines invest more in research and development and education. The Philippines also needs to attract further foreign direct investment through more investor-friendly regimes and incentives. In addition, the Philippines government must think of innovative ways to improve its slowly deteriorating infrastructure and inefficient logistics.

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