Philippines-China Economic Relations: What the Philippines Can Learn from China's Development*

Dr. Ellen H. Palanca
Director, Confucius Institute at the Ateneo de Manila University

Both Counsellor Wu Zheng Ping's and Prof. Joseph Lim's presentations on Philippines-China Economic Relations were very enlightening. I would like to expound on a few points to put some information on Philippines-China economic relations in the proper perspective:

1. Counsellor Wu presented many up-to-date statistics. I was particularly intrigued to see the figure on investments made by Filipinos to China. Such data cannot be found here in the Philippines. This is the first time for me to learn of the value of capital inflow to China from the Philippines. Figures on how much China invests in the Philippines can be obtained from the Bureau of Investments, or BSP (Banko Sentro ng Pilipinas – Philippine Central Bank), but not the other way. I want to thank the Counsellor for sharing the statistics and I hope that the Commercial Office of the Embassy will continue to share with us such information for

Reaction to the papers presented by Dr. Wu Zheng Ping and Dr. Joseph Lim.

academic purpose. Names can be kept confidential, but, for our research, we would appreciate a breakdown by sectors and values.

2. From the two-way investment statistics given by Counsellor Wu, we see that, as of August 2010, investment inflow to the Philippines (US$202.07 million) is very small compared to Philippine investment outflow to China (US$2.742 billion). I would like to remark on the outflow. Although the figure is relatively large, from Wu's presentation, we are No. 4 among the five original ASEAN member countries. Singapore, Malaysia, and Thailand are ahead of us, but we are ahead of Indonesia.

3. There are pull and push factors for investment flows. China's rapid economic growth and huge market offer many opportunities for investment. In fact, China is now officially the largest recipient of foreign direct investments in the world, having overtaken the United States. This is the pull factor, from the point of view of Filipino investors.

On the other hand, there are several factors that tend to push away our resources beyond our borders. Labor is much less mobile as a factor of production than capital. However, our labor is moving away incessantly, as we witness the 10,000 overseas Filipino workers daily taking planes out to seek better pastures in other countries. If labor is moving so fast because of lack of employment opportunities here, capital can flow out even more easily if investment conditions here are not favorable. The ease in capital movement has increased since capital liberalization was instituted a couple of decades ago.

In the 1990s, when outflow of capital from the Philippines to China was mostly made by the ethnic Chinese, some politicians were quick to point to the loyalty issue. My answer on that has always been: businessmen are businessmen.

They respond to the market and will invest in projects that they expect to yield the highest return. Just like other multinational companies, profits made are usually plowed back to their mother companies here. For the ethnic Chinese, the language and cultural affinity is an additional pull factor.

San Miguel Corporation was one of the first to invest in China. However, loyalty was not an issue there. In the early 1990s, when kidnapping was very rampant and the Chinese Filipinos lived in fear that something might happen to them or their family members, there was a sharp rise in capital outflow, or capital flight, as some would call it. At the same time, this period of uncertainty and vulnerability coincided with the rapid growth of China's economy, a decided pull factor that gave impetus to the internal push factor.

Political instability, poor socio-economic conditions, and lack of personal security – these are all push factors. These push factors for the Filipinos are, for foreign investors, negative pull factors.

With respect to capital inflow from China, China has been increasing its investments abroad in the last few years since it undertook the "Go Global" campaign for its investments. Investments have been made in the primary sector, to satisfy China's need for natural resources. In the developed countries, China has been acquiring foreign companies for market access, brands, skills and technology. Hopefully our country can develop enough positive pull factors from our side to make the Philippines an attractive place for the Chinese to want to invest in.

4. On the trade aspect of our economic relations with China – it is heartening to see in Counsellor Wu's presentation that our trade with China has really grown. Growth from 2000 to 2007 has been at an exponential rate, although it has declined since 2007 due to the financial crisis.

If we look at trade statistics before 2000, we can see that

we have come a long way. Prior to 2000, the share of China in Philippine exports was barely one percent. In 2007, the share is about 20 percent. Moreover, the trade balance had been in favor of the Philippines. This means that China imports from us more than it exports to us.

It is also necessary for us to see Philippine trade with China in relation to China's trade with the other Southeast Asian countries. Despite the rapid growth in the last decade, the Philippines is still the smallest trading partner among the major ASEAN countries. As presented by Counsellor Wu, the Philippines is No. 5 among the ASEAN countries. We are ahead of Brunei and the four emerging new ASEAN countries, Cambodia, Laos, Myanmar, and Vietnam. With regard to trade with China, the Philippines has always ranked the lowest among the five original member countries since 1980. In other words, despite the growth that we celebrate, there is still a lot for the Philippines to catch up with.

5. Another thing with regard to our trade with China, which the Philippines has to work on, is the diversification of our products. It should be pointed out that our exports to China are highly concentrated on just one industry – the electronic sector. Such is also the profile of our total trade.

One important explanation of this development is the phenomenon of production network adopted regionally since the 1990s. This phenomenon, which characterized the production of many export goods, refers to the segmentation of the production process, i.e. different countries produce different parts of a product. Foreign direct investments, from the region or outside, contribute to intraregional networking and trade. The Philippines produces some components and parts of electronics products which are being assembled in China and exported to the U.S. and other parts of the world. China, because of its cheap labor, is the workshop for such segmented production process where assembly of the

components and parts are being done.

There is risk of such concentration of trade in a single sector. The country's trade is inextricably linked to the performance of the electronics sector, and the market for its products. We saw the effect in the last few years. Our exports to China fell substantially because of the drop in demand from the U.S.

In comparison, our ASEAN neighbors have been able to diversify. Electronics products are also a major component of their exports to China. However, their surplus with China is not only for this component. Malaysia, Thailand, and Indonesia (these are countries with very similar resource endowments as the Philippines) have been able to muster comparative advantage in food and chemical products and semi-manufactures to China.

6. The lack of diversification of Philippine exports can be explained by the country's lack of industrial development. In his presentation, Prof. Joseph Lim compared the Philippine economy with China's economy in this respect, saying that "China has a very strong industrial policy that consciously aims at the upgrading of products and of the technological processes of production... (while) the Philippines has hardly any industrial plan and plan for technical upgrading of its industries due to its 'excessive' free-market ideology and fear of bad governance."

We can see China's industrial development in trade structure over time, especially the structure of its intermediate products trade. China used to depend very much on imports for its intermediate products such as iron and steel as well as semi-manufactures such as leather manufactures, rubber manufactures, cork and wood manufactures, paper, paperboard, mineral and metal manufactures.

However, now China produces and even exports many of these intermediate products. In fact, for iron and steel,

China now has an excess capacity. If you analyze China's trade data, you can see that China's bulging current account surplus from 2004 to 2007 is due to its decrease in import and increase in export in intermediate goods.

7. Industrial development requires much focused planning. If countries with similar resources as we have can produce food products, chemicals, and semi-manufactures for China and other markets, we should also diversify and upgrade our manufacturing and find our niches in China's consumer and industrial markets.

Our competition is no longer with China but with other Southeast Asian countries which have endowments similar to ours. We not only need a good industrial plan. We also need to develop our competitiveness. We need to improve our doing business index, which ranks really low. This means a lot of things for us: good governance, macro-economic stability, reliable legal system, educated labor force, infrastructure, reliable and lower priced power, and others. For all these to happen, much political will is required.

If all these should happen, then we will have an environment conducive for investment that will retain the domestic capital as well as attract foreign capital. This broad issue has to be addressed quickly before we fall behind the smaller developing but fast growing countries such as Vietnam and Cambodia.

Reference

"The Rise of China and its Effects on East Asia and the Philippines," in *China's Trade with East Asian Countries: Impact on Regional Integration*, Ateneo de Manila University Institute of Philippine Culture Publication, forthcoming.