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Review of Bilateral and Regional Trade Agreements
Productivity Commission
GPO BOX 1428
Canberra City ACT 2601
Email: tradeagreements@pc.gov.au

RE: Submission to the Productivity Commission on the Review of Bilateral and Regional Trade Agreements

Dear Commissioners,

Please find attached my submission to your study on bilateral and regional trade agreements.

I am a researcher at the University of Technology, Sydney's Centre for Corporate Governance. My PhD thesis is on corporate governance and reform in the Philippines. I was awarded an Australian Government's Endeavour Research Fellowship[1] to fund my field study. I interviewed high level representatives from the public and private sectors, international financial institutions and multinational corporations in the country for my study. While most of my interviewees have a perspective based in the Philippines, their views are not so dissimilar to others I have spoken from the region.

Therefore, this submission looks less at the policy level issues but more on the attitudes, opportunities, practical barriers and experience of greater regional engagement. My interviewees extensively spoke of greater economic integration through ASEAN and how the economic powerhouse of China is changing the trade relationship of each country within the region. With regards to the former, similar to the EU experience, there is an increasing outward investment occurring from the more developed countries to the less developed countries of the region. With regards to the latter, similar to Australia's situation, a supplier-to-China attitude has emerged with the Philippines becoming part of the supply chain to China especially in the area of resources. Greater regional economic integration brings the positive effects of increased trade and economic liberalisation. However, protectionist measures especially in the area of foreign ownership controls are the main obstacles to wider foreign investment.

[1] http://www.endeavour.deewr.gov.au

The contents of this submission are distilled from parts of my thesis that I believe are relevant to the first and fourth bullet points in the scope of your study:

- examine the evidence that bilateral and regional trade agreements have contributed to a reduction in trade and investment barriers. Consider also to what extent such agreements are suited to tackling such barriers, including in the context of the proliferation of such agreements between other countries;
- analyse the potential for trade agreements to facilitate adjustment to global economic developments and to promote regional integration;

and the second bullet point of the study's key consideration:

- draw on available, credible evidence both nationally and internationally and take into account the changed international trade, economic and strategic environment

My submission is divided into four parts:

Part 1: Promoting Investment – ASEAN and greater economic integration
Part 2: Barriers to Investment - Foreign Ownership Controls
Part 3: China
Part 4: Role of Australia

I hope my submission may provide an insight into the sentiments of the private sector in one ASEAN country and their attitude towards greater economic integration as they echo some similar attitudes by our own private sector. There is a wide anticipation and expectation of the positive effects a free trade area will bring. This submission provides support and encouragement for Australia to pursue regional trade agreements and greater participation in the Asia-Pacific region. Given the general goodwill towards Australia amongst ASEAN countries, Australia can play a pivotal institutional role in the region.

More, not less, integration is clamoured for.

Regards,

Marie dela Rama

Part 1: Promoting Investment – ASEAN and greater economic integration

ASEAN is the best expression of intra-regional trade within the Asia-Pacific region. There is greater cooperation being established across ASEAN member countries. The attitudes of the private sector in the Philippines are mostly positive. There are positive outcomes from greater trade integration with their Asian neighbours:

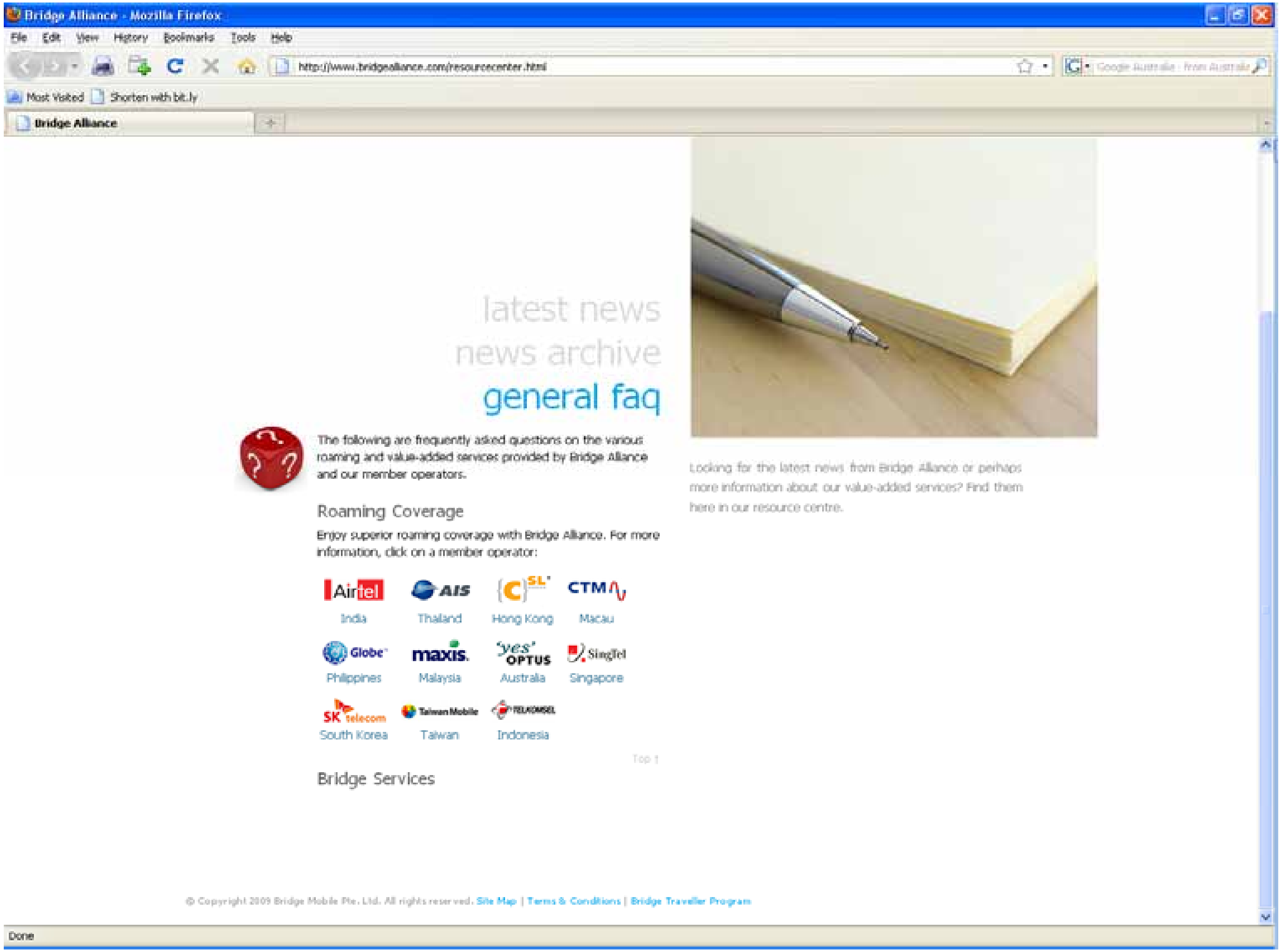
> "We feel it's important to be part of the broader ASEAN community, and the way we intend to do that is by attracting partners from overseas. Secondly, we plan to invest with partners in these countries. We hope that that would blossom into relationships that can be cross-cultural in nature and encourage the flow of goods within the region."[2]CEO of Ayala Group of Companies, Jaime Zobel de Ayala cited in de Borja 2005: 127)

The Bridge Alliance: Telecommunications Cooperation in the ASEAN countries

The effects of greater economic and regional cooperation can be seen in the Bridge Alliance whose members are made up of mobile telecom operators from 11 countries including Optus whose majority owner is SingTel. Established in 2004, it is an Asia-Pacific alliance that allows mobile coverage for nearly 300 million people in the region.

The following contains the screenshot of the website of Bridge Alliance and its 11 operator members comprised of Airtel (India), AIS (Thailand) CSL (Hong Kong), CTM (Macau), Globe (Philippines), Maxis (Malaysia), Optus (Australia, SingTel (Singapore), SK Telecom (South Korea), TaiwanMobile (Taiwan) and Telkomsel (Indonesia).

[2] P.127 in de Borja, Marciano R. (2005) *Basques in the Philippines*, University of Nevada Press



http://www.bridgealliance.com/alliancemembers.html website accessed 12 December 2009

Regional Trade and Corporate Governance

The impact of ASEAN and intra-regional trade mean convergence towards some common corporate governance standards are also gaining import through foreign investment pressures (see also later section Corporate Governance and China). There are moves towards harmonising such standards in addition to IFRS and Basel II requirements:

> "Because we've integrated too rapidly 58% of our trade is intra-regional. We are looking at – and compelled to harmonise attitudes…we are getting basically to recognise governance and understand corporate governance practices." – private sector (1)

However another interviewee spoke about the glacial pace of regional integration:

> "We're part of the ASEAN group. We compete with India. For us to move to international standards there has to be a corridor of regional acceptance to move in that direction. We compete against each to be the first one to take the step. We can suffer. Unfortunately moving towards regional free trade will be gradual, and it can't be done quickly" – private sector (2)

The US economic development model also came for some criticism from another and this was before the 2008 Global Financial Crisis:

> "There was the apex of US influence and power in the economic model of 1950s, 1960s with the great middle class being built. We're talking about reversal now with the low Income disparity amongst ethnic minorities. We have learnt a lot from the Western development model but there are limitations. These very distinct limitations are:
>
> - very capital intensive
> - environmentally invasive
> - socially disruptive
>
> My point is we really need a new paradigm. We must emphasise development-inclusive growth, ad manage social divisions effectively. Yes to opening ownership limits but caution to different levels of development. We must Take into account poverty levels, align investments with that." – private sector (3)

Regional Foreign Investors

Trade within ASEAN is increasing and foreign investors from the region are expected to affect the commercial landscape of the country. [See the section on China and the region in this submission]. One interviewee mentioned that Asian foreign investors were less likely to demand transparency as opposed to their Western counterparts:

> "For foreign ownership, look at the indices where foreign investors are: Europe, US, Australia. And look at other foreign investors: China, Taiwan, Korea – they are somewhat lower down the scale. If they'll (the Asian countries) be major foreign investors, will they be as clean? The Asian

> Chambers of Commerce aren't interested in pursuing transparency as the Western ones." – private sector

The rise of East Asian investors reflects the progressive development of these countries. As they have accumulated enough reserves, there comes a point where they look outwards in order for their capital to grow:

> "If you're looking at corporate governance practices, the weight of capital and the dynamics suggest we have to look to other points of view. In the old days CALPERS, Oregon, Ontario had lots of muscle. Now it pales to insignificant to the reserves of China, Japan and South Korea." – private sector (2)

Indeed, the rise of sovereign wealth funds (SWF) such as Singapore's Temasek, China's Investment Corporation (CIC) and South Korea's National Pension Service (NPS) signals this strength and all three SWFs have already made major investments outside the region.

A New Group of Entrepreneurs: Korean Investment in the Philippines

As a sign of South Korea's economic prosperity and development, there is now substantial South Korean investment in the Philippines. Akin to Japan's investment two decades earlier, the increasing wealth of South Korea has seen the outflow of investment into other countries in the region. After the flight of middle class Filipinos and Overseas Filipino Workers (OFWs), there is a reverse migration occurring: Koreans are entering the not merely as tourists but as a new class of entrepreneurs serving the large expatriate Korean population in the country. Due to the historical legacy of the Japanese occupation of the Philippines, there is less the aggressive resentment of investment towards South Korean investors.[3][4] Why South Koreans should choose the Philippines is based on the affordability of the Philippines as an English-language teaching provider and lower cost of living. The Koreans are an increasing entrepreneurial class in the Philippines and their investment is more likely to be long-term rather than the short-term speculative foreign portfolio investment on the stock exchange.

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[3]Japanese foreign investment in the region is also politically sensitive which may hinder aspirations of leadership in ASEAN: "Japan's aggressive behaviour in Asia and its brutal occupation caused tremendous suffering to the Asian countries…The feelings of suspicion and animosity towards Japan are still palpable today, thus negatively impacting on Japan's relations with Asian countries and hindering its leadership possibilities in the region." (Zhao 2004:114-115) from Zhao, Quansheng (2004) Japan's Leadership Role in East Asia: Cooperation and Competition between Japan and China, Policy and Society, 23(4): 111-128; While countries in the region which suffered most from Japanese wartime atrocities tend to be defensive and nationalistic towards such inflows and reciprocally, Japanese foreign investment has flowed into countries which were less affected by that country's expansionist stance during World War Two.

[4] While most Koreans in the Philippines are small business entrepreneurs servicing the Korean tourists and students in the country, at least there was one deal involving a Korean consortium to invest in Philippine railways:" 3 South Korean firms (Daewoo Corp, Hanjin Engineering and Construction Co. and Rotem Corp) invest in railways with state-owned Philippine National railways (PNR) to rehabilitate 34kms in Luzon from Caloocan to Alabang. Contract worth $49M funded by a $50M loan from the Korean Export and Import Bank." From Estavillo, Marcicel E.: Rail firm, SoKor group agree on negotiated deal, Business World, 21 May, Monday p.S6

Part 2: Barriers to Investment - Foreign Ownership Controls

Foreign ownership controls in specific sectors such as infrastructure are a barrier to greater economic integration. In the case of the Philippines, there exists ownership controls in property, roads, shipping and other sectors deemed politically and economically sensitive.

Direct foreign investors are more attracted to countries that allow majority foreign ownership over joint venture projects. Indeed, some foreign investors are likely to choose countries which have started removing restrictive ownership controls and protectionist barriers. This is a source of competition for foreign investment as external investors prefer to have majority control to ensure the security of their investment and to mitigate risks such as expropriation.

For one company, the issue of a foreigner not being able to own property in the country has made it rethink its strategy in this sector:

> "We're into property development. We are principally driven by property. Some foreigners can own property for example we have a large foreign ownership of 35% from Singapore – The 40:60 principle applies -you can't own land if you're a foreigner. The exemption is for a condominium. A foreigner can own condos. There are other ways to form a corporation as long as you make sure it is Philippine owned. 60% Filipino owned; then buy the property. There's also a 50 year lease renewable. We had a roadshow in the US for our property condominium."– private sector interviewee (4)

This 40:60 principle has allowed the domination of the sector by the local business groups but have placed major obstacles to foreign competitors. The restrictions on foreign ownership of land and development will continue in the foreseeable future, in large part due to pre-existing political arrangements that favour domestic participants[5]:

Deterring Foreign Investment

The ambivalence towards foreign investment in the Philippines is partly historical and partly cultural. With the exception of Thailand, nearly all countries in the region were colonised by European powers. This historical legacy is sometimes used to suit short-term political rhetoric and appeal to fervent nationalists in order to overlook home-grown domestic faults. However, the negative effects of

[5] As Guillen point out, in sectors where foreign investment is restricted, domestic business groups that have proliferated under such protectionist policies will be reluctant to lose this 'asymmetrical' position: "Owners and managers of business groups are fully aware of what it means to lose asymmetric access to resources. This is why they oppose policies that diminish asymmetries in foreign trade and investment. When asymmetries fall, the scope and size of the groups become a liability rather than a strength because competitive pressures from both foreign MNEs and non-diversified local firms intensify. Business groups have no option but to divest from certain industries and concentrate on those with the highest growth and returns. The framework presented here also has implications for MNEs planning to enter an emerging economy. Entering a country with asymmetric flows will be more likely to succeed if it takes place in collaboration with a local business group." (2000: 376) from Guillen, Mauro F. (2000) Business Groups in Emerging Economies: A Resource-Based View, Academy of Management Journal, 43 (3): 362-380

colonialism are still remembered and suspicion is easily and it is unfortunate free trade is sometimes tainted as masquerading a pseudo-neo-colonialism agenda.

As a colonised country for nearly 500 years, exploitation of the country by foreigners does loom indelibly in the psyche of the Filipino. Both Spanish colonialists and American imperialists have left a nationalistic almost xenophobic attitude towards foreigners. Similar to the experience of a former colony and another great democracy, India, restrictions on foreign ownership left the country in a protectionist dome. Import-substitution policies protected local industries leaving them uncompetitive once certain markets collapsed or were opened. Protected sectors remain politicised and highly lobbied for by certain business groups:

> "It's hard to be competitive here, we can't do that, that's the difference. If you're going to attract foreign investment, it's down to the 40:60 principle. The PSE says agrees with this but [certain] families don't want that to happen. [One company] is family owned. [This family is] listed as one of the top families…There are political strings happening…There are vested interests of the families that control the economy and politics."- multinational company

Not surprisingly, despite the interest foreign investors are showing in the country, there is some way to go before it can attract the same amount of foreign investment other places in the region do:

> "According to the US Chamber of Commerce, the bureaucracy is difficult. This comes from foreign businesses – one of the challenges is the process of establishing business in the Philippines to go through. A long the way, foreign investors get confused." – local company

While there are Australian mining companies and at least one Australian bank have a presence in the country, Australian super funds aren't investing in the Philippines:

> "Australia is investing on its own market rather than looking at other countries. Aussie superannuation funds are not here investing." - stockbroker

At a monthly membership meeting of the Australian and New Zealand Chamber of Commerce in Manila, one foreign investor told the Finance Minister about aspects of the Philippine environment that were making business conditions difficult:

> **Foreign Investors:** I am an investor in the UK and UAE. I have recently come here. There is an incredible capacity to make it difficult to do business here. Is there a service of encouraging foreign ownership? It's not like Dubai where there are tax opportunities that create new businesses. Difficulties here are apparent. There are opportunities and hope that one is transparent with start-ups. My hope is that [all investors] are treated evenhandedly as in Dubai, and that all rules become apparent. How would you encourage foreign investment so it creates openness, understanding, transparency and a consistent application of laws?
>
> **Minister Teves** We are struggling with those issues and parameters. Compared with other countries we are not doing too well. There is increased foreign ownership and we continuously work in parameters. These issues you mention affect increased investment. It is important the

element of openness, transparency and consistency, without them we cannot expect too many investment to come in especially with long-term, large investors. Hopefully in time we will see more trade and to reduce red tape with a gradual climate for investing. The macroeconomics is essential such as fundamental investment in infrastructure and to encourage more long-term FDI." Australia-New Zealand Chamber of Commerce (ANZCHAM) July 2007 meeting

Restrictions on foreign ownership and reducing protectionism

Restrictions on foreign ownership are a strong deterrent for some foreign investors. There are foreign ownership restrictions in certain sectors and limits in the percentage of foreign ownership of listed companies. One interviewee mentioned how the majority owner, a foreigner, did not accumulate the same voting rights:

> "We have a majority economic interest in the listed company. If you go back to the annual report, there is a high majority interest in the company. But the voting interest is below 40% because of the 40:60 principle. The majority holder is a foreigner so you can't have more than 40% voting rights." – foreign company

However, there is lobbying from some players within the local private sector to remove the protectionist barriers in infrastructure sectors in order to increase competition, attract investment and new technologies:

> "We don't have as good a road system, aviation is protected. [Protectionism] is not creating jobs. These are macroeconomic issues. We need more openness, more competition. We are still in the Middle Ages. Industries are protected. Competition will bring more technology, relying on performance by foreign investors. If there's competition here, we become more efficient, it raises the labour skills, and creates a virtuous cycle…The limit on foreign investment and ownership is not conducive for foreign investment." – private sector lobby group

In support of trade liberalisation, in the case of the telecoms sector of the country, once barriers were removed, the oppressive weight of protectionism gave way to a flourish of entrepreneurialism:

> "Since the telecoms monopoly break-up, 20M people or more have cell (mobile) phones. 5M people have landline. [The industry has] grown since they've broken up the telecoms monopoly. It's a growth industry[6]…The Philippines has well-trained, well-educated people – we know what has to be done. We have booty capitalism[7] here: a few rich families, entranced our politicians keeping the law tailored to favour them. We have to break up their monopoly over power." – private sector

[6] The telecommunications arms of some business groups may also come under threat from disruptive, new technology: "But for the foreign market. I can count on the number on my fingers how many [companies from a foreign investor's perspective] are worth buying into. On the other hand, I am not an expert. PLDT, Globe have to reinvent themselves. There's the threat of through the internet – the minutes would be a lot cheaper. Smart has a lot of users of cellphones, not too many landlines. People use the phone or text due to the non-availability of infrastructure. VOIP is a threat to them. We don't have inventors, who'd look at this market." – private sector (1)

[7] Hutchcroft, P. (1998) *Booty Capitalism: The politics of banking in the Philippines*, Cornell University Press

While one regulator wondered whether lifting investment restrictions will guarantee more foreign investment:

> "What makes a direct relationship to lift restrictions mean foreign investment will come in? It doesn't mean necessarily foreign investment will come in. There is that situation in the mining sector, which fits the equation, lift rules; they come in." – regulator

The issue of majority ownership does come down to a matter of control. Where the investor does not have control of the investment even though most of the funding comes from the investor, not having that control over that funding may deter investment.

Foreign ownership controls in an ASEAN country remain a strong obstacle to greater economic integration in the region. A simple case study as follows:

> Countries A and B are members of the same free trade region. Firm A from Country A can invest in Country B's Sector X without ownership hindrance. However, Firm B from Country B cannot invest similarly in Country A's Sector X. Country A's Sector X is deemed a politically "sensitive" sector, while Country B's Sector X does not have such a status. As such, Firm B can only invest in Country A's Sector X provided it must be the minority partner with a Country A firm as a majority owner.

Such a scenario has played out several times and already bred resentment as we have seen in the past 12 months in Australia's Foreign Investment Review Board decisions. Restrictive ownership controls compound any notion of a level playing field as they normally favour domestic players.

Thus, unwatched and unchallenged, foreign ownership controls in some industrial sectors of the region will fuel suspicion over the positive effects of free trade. Free trade not only brings, but also demands. Greater free trade demands local ownership controls be reviewed so that all players may have access to the same instructions, rules (and indeed penalties) of the game and that trade is positively seen as reciprocal (two-way) and not merely dominated by a single-investor country.

Therefore, future trade agreements must take into account the domestic policy arrangements of the country in the region on foreign ownership controls specifically by sector.

Part 3: China

Given the importance of China economically in the region, every bilateral and regional trade agreement must take into consideration the strong influence politically and economically of China. While it is notable that that the ASEAN-ANZ FTA has commenced from 1 January 2010, similarly on the same date signals the China-ASEAN FTA.[8] The China-ASEAN (C-ASEAN) FTA has created the world's third largest free trade zone covering 1.9 billion people with a GDP base of USD6 trillion.[9] The FTA has set in motion greater economic integration. Leading up to 2010, the impact of lowered tariffs and increased intra-regional trade were already having an effect.

Intimate knowledge of China

The success of ethnic Chinese business groups of South East Asia is well documented[10]. Knowing the language, cultural norms, cultivating familial and civil relationships and sharing similar ethnic origins gives them an insider's view of the country. As China opens up, its diaspora in every country is reciprocating with "governments increasingly see their ethnic-Chinese populations as assets rather than threats."[11] Where arguably Filipino-Chinese business families have an advantage is to take the opportunities that present themselves with an emerging China:

> "In the Philippine economy, the business climate here is very Chinese. There are a lot of [Chinese] migrants [here]…The Philippines can be fantastic outlet for China. The Philippines is ready made. China's already here." – regulator

China's growth and economic power in the region and in the world is undeniable:

> "We see it as the next superpower. There is no stopping it. It offers all so many opportunities." – private sector (1)

China's emergence impacts each country in her vicinity as the balance of power and trade alters to accommodate her rise and influence. This process of transition is occurring and is symptomatic of the rise of this country's growth as the world's economic centre moves from the USA to China[12]. The impact of China on the Philippines and the region is enormous.

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[8] ASEAN Secretariat (2002) Framework Agreement on Comprehensive Economic Co-Operation Between ASEAN and the People's Republic of China Phnom Penh, 5 November 2002 http://www.aseansec.org/13197.htm accessed 30 December 2009

[9] People's Daily (2009) China-ASEAN FTA sets stage for economic integration http://english.people.com.cn/90001/90778/90861/6854891.html accessed 30 December 2009

[10] See for example Rauch & Trindade (2002) Ethnic Chinese Networks in International Trade, Review of Economics and Statistics, 84 (1): 116-143 accessed 30 December 2009 http://www.mitpressjournals.org/doi/abs/10.1162/003465302317331955

[11] Economist (2008) Speaking In Tongues, February 6th http://www.economist.com/world/asia/displaystory.cfm?story_id=E1_TDGPSNRJ accessed 15 October 2009

[12]Other moves by multinationals such as by the global bank HSBC to move the principal office of the CEO from London to Hong Kong is but one of many activities that chart their readiness to take opportunities of the market

Some business groups have already established commercial entities in mainland China. The rise of China, in general, was mostly seen in a favourable, albeit cautious, light by most interviewees.[13]

This section looks at how business groups see China, China's corporate governance, how China's rise will impact the Philippine economy and geopolitics of the region; and the successes and pitfalls greater interaction with the mighty power in the immediate west of the country brings.

Competition and Banking in China

Several of my interviewees have expanded into China. For one Chinese-Filipino business family, despite the ethnicity, the identity of the company is Filipino. Even with its expansion to China, the family remains Filipino although it has an intimate understanding of Chinese culture:

> "Relationships are emphasised in the China market, there are Chinese walls [but] we are a pure Filipino company." – private sector

For the Philippines' largest mall operator, the founder was born in China and there are strong emotional links to his country of birth. This link has translated into building malls in China though they are located in provinces where there is less competition. Oft-repeated amongst my interviewees who have expanded into China is the potential market size as the middle class grows in the country:

> "China will be a power. It will continue to grow. We will have malls there but not in Shanghai or in Beijing. These two cities are already crowded. If there's opportunity [it will be in the provinces]. The Philippines has a population of 87 million. That is the population of one province in China.. We are not looking at other countries outside of China. China is close to the Philippines…Whatever you need will be made in China. This will happen in the next few years." – SM interviewee

Banking is crucial to international trade. Some harmonisation in corporate governance practices in this sector is occurring especially in the wake of further Basel reforms on capital adequacy (especially in the wake of the GFC) and at some point in the future further convergence could also be one result of greater interaction in the banking system.

> "Manulife operates in China through Manulife-Sinochem Life Insurance Co. Ltd, a joint venture company between Manulife (International) Limited (51 per cent) and China Foreign Economic and Trade Trust & Investment Company, a member of the Sinochem group (49 per cent). China's fast growing is stimulating the growth of most of the countries in the Asia, including the Philippines. Manulife has an optimistic view on investment in the Asian region." - Manulife

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and the region; See Cheng, Jonathan and Poon, Aries (2009) HSBC re-emphasises its 'H', Wall Street Journal, September 26 http://online.wsj.com/article/SB125387285012240573.html accessed 10 October 2009

[13] This concurred with most press coverage during my fieldwork with government supportive of more links with china. However, my fieldwork ended just prior to the NBN contract scandal. See Dizon, Nikko (2007) GMA wants RP to be part of China's development plan, Philippine Daily Inquirer, 8 June, 22 (180): A1, A12; Balaba, RM (2007) View China as opportunity, not a threat, Business World, 18-19 May, 2 (424): A8

As Part of the Chinese Supply Chain: Resources and Chinese investment

Interviewees from the private sector spoke of how the country's future role as a supplier of raw minerals is occurring, similar to Australia. Notwithstanding the controversy mining sometimes brings, China -has a resource-hungry economy, and meeting this demand is a prospect for all countries in the region:[14]

> "As long as China requires stainless steel we have endless supplies of nickel. This country is so fertile you can spit on the ground and in one year's time, there will be something growing from the ground." - regulator
>
> "Mining is an economic potential. [China is the] biggest buyer of resources. You will have one dominant player in one sector. China will dominate operations." – consultant
>
> "[The] effect [of China] is like a ripple in the pond. In the Philippines it will increase in the mining sector, [and increase the] mineral output." – private sector (3)
>
> "China is investing in Africa. China wants to tap into the resources here. [The country is an] energy consuming machine, not driven by ROI… As competition for natural resources increase, [things will] becomes more difficult."[15] – private sector (4)

However, the subservient, and sometime pessimistic, outlook of the country to the economic giant was persistent. Echoing Australian wariness on Chinese investment, the cautious attitude towards China was stated in terms of the unequal trade balance that was occurring and increasing reliance and dependency on China:

> "The Philippines would be a supplier to China in some form or another. The Philippines can't compete. We have to find our niche. There are currently a lot of questions regarding these investments signed with China to set up new agricultural business. We'll be suppliers and compete in certain industries. At the end of the day, it is the drive of the work ethic of China that will make us suppliers to that country." – private sector (2)
>
> "[We are part of] the supply chain, [and we need to find] our niche in the supply chain. China plays a big role in the supply chain. A growing China will result in greater in Philippine economic development. The danger is if [China] turns inwards. Now, they're growing big by exporting to the US but they have a big internal market and as the market grows prosperous, [they] may now

[14] See Economist (2009) Testing their metal: China and the market for iron ore, October 22nd http://www.economist.com/businessfinance/displaystory.cfm?story_id=14710643 accessed 24th October 2009

[15] Indeed the competition for natural resources and for China to secure its future energy needs was highlighted with the debacle over Chinalco's attempts to buy the coal reserves of Anglo-Australian mining company Rio Tinto. The detention of a Rio Tinto executive was widely seen as a retaliatory move after the deal fell through. See Rio Tinto (2009) Chinalco http://www.riotinto.com/shareholders/Chinalco.asp; Economist (2009) A souring relationship, August 10th http://www.economist.com/businessfinance/displaystory.cfm?story_id=14205057 and Economist (2009) Behind Chinese walls, July 17th http://www.economist.com/businessfinance/displaystory.cfm?story_id=14025254; all accessed 15th October 2009

produce instead for their own market. They are producing for the export market, as the international market, [eventually] they'd start selling to themselves [although that's] still a long way off. In the meantime, we're going with them." – private sector (3)

Manufacturing

Manufacturing in the Philippines has been especially hit hard by the rise of China and will continue to do so in the wake of the C-ASEAN agreement. The decline of the manufacturing sector in ASEAN countries due to China's rise is a trend that will continue:

> "China has an enormous impact on the Philippines. Previously the country had a cheap manufacturing base. Many of the manufacturing bases have now moved to China itself." – listed company (1)

> "China's economic impact is so strong, we can't compete with China for example in the manufacturing sector." – listed company (2)

> "We feel that a growing China is good for the global economy as a whole. As for the Philippines, unfortunately, we have seen a lot of manufacturing businesses exit the Philippines to move to China where they can produce at lower costs. At the same time, China is becoming a very large market for the Philippines for certain products and services. Agricultural and mineral exports are a good example." – holding company (2)

For the most part labour costs in the Philippines are far too high, and the unreliable infrastructure in the country makes the country uncompetitive relative to China:

> "Basically [China's growth]is affecting local industries as labour is cheap in China. Even here, there is a lot of Chinese items available locally. It's all about globalisation. All are affected indirectly; the Chinese economy is effecting Hong Kong where a lot of OFWs are." – public sector (4)

> "[If you look at] manufacturing labour costs, China, Vietnam, India have proved to have lower costs dramatically. Labour is a significant cost [here] and electricity [prices] is high." – consultant

However, the upskilling of Chinese labour could increase that cost:

> "[China is] very competitive in the pricing. I'm not too scared for now. The Chinese are getting more expensive because their highly skilled workers are much in demand." – private sector (3)

Corporate Governance in China

While Chinese corporate governance practices are different from the expected measures of transparency and disclosure Australian listed companies are used to, when it comes to corporate governance reform, China's state-owned enterprises will do what its government will tell them to do. China's government is not deaf to criticisms and are quickly responsive when the necessity rises. Chinese corporate governance practices may lead the region and a distinctive form of 'Asian' corporate governance may arise taking into account the relationship-based culture of business decision making that would be markedly different from Western corporate governance practices:

> "I know for a fact that there is a concerted effort by the Chinese government to improve the corporate governance level of China and this may have an effect. I would like to say if and when corporate governance arrives in China, we are in Asia and governance is a concept from the West...there will be an impact if they (the Chinese) improve their governance practices and that will be an issue for the Philippines. We use the improvement of China as leverage to tell companies here to improve corporate governance. The attention of the companies is that they look at what China has done and the Chinese have a plan. In the Philippines there is no central part…The myth of China is that the economy booms on the coast but not the interior - but for all its worth, looking at whatever we could observe, we want to capitalise it." – private sector lobby group (3)

Boards of Chinese SOEs are also required to have 50% independent directors. However, the notion of 'independence' is arguable in substance:

> "*Guanxi,* relationships still dominate in China. What part of that is corporate governance? Corporate governance is relatively new; there are government related moves in regulatory authorities. In China, the country requires 50% of the board be composed of independent directors, in the Philippines it is 20%. In Hong Kong and Korea it is 40%. But of course is it 50% in reality? The Philippines is more open than China."– private sector lobby group (3)

> "The logic for corporate governance is to be investor friendly. In China, with independent directors – how independent are they? China, Vietnam. They are planned economies on being founded as they are covered. [China does] not respond to Western corporate governance practices. It's to do with *realpolitik*." – private sector (2)

Enforceability of rules and regulations in China was echoed by several others. The fact that Chinese law allows for capital punishment of white collar criminals is a strong deterrent to engage in wider malfeasance. This penalty is a strong incentive for greater compliance by companies:

> "If you look at China as a growing economy, you can enter the market and predict what will happen. Rules are clean, well-defended such as the number of board seats. Violations are punished in a draconian way. If you're corrupt, you're shot. Here, when you've done so (corruptly), you get away scot-free " – private sector (5)

> "There are corporate directors' regional meetings attended by China. China has still a fledging culture of corporate governance. China has own home-grown initiatives where 50% of boards must have independent directors. You'd better prepare and comply as there is a strong power of government. It's harder not to comply. China is a command economy." – business advocate (1)

> "On China's connective transaction there must be a controlled committee regarding how much directors can borrow from the company. Modern Chinese corporate governance has adapted to global standards theoretically." – private sector (2)

China itself is undergoing change and evolving into a system that needs to fit its cultural needs and at the same time to mostly external Western pressures:

> "China is socialist with capitalism thrown in. If [China] wants to institute corporate governance, they can do it more quickly. I'm not sure if they're completely convinced [about corporate governance]. Corporate governance is a capitalist complex, not sure if they can put that into the system. We get to interact with them through the East Asian Institute of Directors. China joins us." – business advocate (2)

> "The quandary is applying Western practices in an Oriental context the same way Western companies are adjusting to the practices in China." – private sector (6)

Transparency

Practising good corporate governance takes greater import when China does business internationally. The lack of disclosure, transparency and the ownership structure of state-owned enterprises in China is a concern. Recipient countries of Chinese SOE investments take a wary approach to the informal manner some investments are occurring especially when they are substantial.

Chinese SOEs who do not practice good corporate governance and are not doing business in a transparent manner in the Philippines was a point highlighted during my field trip when there were covert deals made between the government with Chinese firms in the telecoms industry and the agricultural sector[16]. Opacity in the tender processes undermined public trust and confidence. Several interviewees mentioned such cases may have a long-term debilitating effect on the Philippine business environment if these covert deals continue:

> "The rise of China and its effect on the Philippine economy through infrastructure, railroads and telecom contracts – it would be good for us if they practice good corporate governance. If they don't, we'll pay for it…We'd prefer to trade and to practise good corporate governance (with partners) who practice good corporate governance. That is key to global competitiveness. In an IMD Global Report, there were 7 criteria on corporate governance. It'd benefit us if China will reform itself and if they practice corporate governance. " – private sector (2)

> "Westerners are usually upfront on the surface. There are big questions on contracts with the Chinese. There has been no open bidding and it's more agricultural based. The government is prepared to give up a lot of land for China to come here and set up entities for export: fisheries, land. They are projects that are supply driven that they set up with the government. The

[16] See Reuters (2007) China firm eyes Philippine ethanol plants, Business World, p.S6 21 May; BTN (2007) Chinese firms start surveying lands, Business World, 15-16 June, 20 (227) 3

government is giving up government land, orchestrating, purchasing and expropriating more land for these projects." – private sector (6)

> "Long term I am very concerned about China. China will establish a hegemony in Asia if it's not doing so already. Japan is the second largest economy in the world which China will soon overtake. China has to learn to be more socially responsible. China is far too much money oriented at the expense of doing anything else. There are three questionable contracts [here], large amount of bribe money paid to local government officials. If America does that, the locals go to jail. I'm worried that we'll see more of that. [This is] not what the country really needs. If China grows, will we be part of a major part of the economy? Will we be part of this dominant culture?" – private sector (7)

China and the region

As the giant that dwarfs other countries in the region, China's economic superpower status emitted opinions of enthusiasm, ambivalence and trepidation. There was no doubt China's status had an impact on the country and the greater ASEAN region. However, there were some differing opinions on how positive was the impact of China's rise.

Positive views on China were mostly based on the economic angle such as its role in stimulating the region to recover from the East Asian crisis, contribution to increased world trade, and by making a substantial input to the role and future of greater regional trade and cooperation through ASEAN:

> "In 2004, things were getting better, dollar debt in corporate value shares, more restricted. Banks found buyers from non-performing loans. Currency picked up in 2004, then commodities in 2005. For Indonesia, the commodities took them out of the crisis. China was also growing strongly. China helped, began to take (the rest of Asia) out of the slump." – stockbroker (1)

> "China will help the Philippines. China is contributing to the world with low inflation everywhere. Trade benefits all participants." – private sector (1)

> "China, and to a lesser extent, India are the 800 pound gorillas. Down the pipeline, India's coming on board." – private sector (2)

Like Japan a quarter of a century earlier, some interviewees expressed the view China could begin to rise up to this investor role and invest more regionally:

> "China has become the dynamo of the region. China exports to the West. This is the interval growth of China and it is going to be a dynamo like US or Japan was in the region. [The challenge would be] sustainability over the long term." – private sector (3)

> "The best way to look at it is not as a threat but as an opportunity. Eventually, [China] would have to invest in other countries such as Japan previously. China could be a catalyst in the region as Japan did decades ago. It's inevitable and the US has to adjust to an economically powerful China." – private sector (4)

While strong arguments were made for China's growth be placed in the context of her wider participation and greater cooperation with ASEAN. If China is to help the region, then ASEAN would be the best forum and a regional currency would facilitate intra-regional trade. As we saw with the EU, the poorer countries of Europe received substantial infrastructure development funds once integration happened in form. Exposure to the European single market accelerated economic development in less developed countries in that continent.

A single currency for ASEAN?

The prospect of moving towards a single currency, akin to the euro, is an idea that is gaining momentum and could be widely embraced in the near future. In a private dialogue with members of the Chinese bankers' association[17], there is some support for a single currency unit. A single currency unit for the ASEAN region will be a catalyst for greater regional and economic integration. While the practical introduction of a single Asian currency unit is still a concept and not an operational idea (especially with the fixed currency of the Chinese yuan), the possibility of its introduction is not remote.

> "We need a regional currency in Asia which is strongly resisted by the USA [as regionally it is the] yen zone. Now it's a yuan zone. However, the process has began and it is irreversible, there will come a point where there must be agreement on economic standards to value" – private sector (6)

> "From a regional perspective, on a macro-level: the political economy perspective is that the ASEAN group is coming up well with a Free Trade Area along the lines of the European Union. China is a mass market; member-countries will face a large potential market." – regulator (1)

> "We're working with our ASEAN neighbours – to be one trading group and dialogue with China, to be one group with Japan. When these things happen, we can become a trading bloc (ASEAN agreement with China, then ASEAN agreement with Japan). So we can compete as a trading bloc with US and Europe." – private sector advocate

> "We see it as a good sense of diversification as we have heavy reliance on two trading partners: US and Japan. There is now a renaissance in East Asia. The World Bank looked at this study as a new phenomenon: Middle-income countries trading with each other (ASEAN) and China. This is a new phase, not just big and small countries trading with one another " – private sector (5)

> "There is a whole notion of Asian response which ambivalent in many respects. We have to put that in the context of how we are seeing the centre of gravity of the world shifting from the West to the new Asia: ASEAN + 3 (the three is China, Japan, South Korea). The region that now accounts for half of the world's population, in excess of global net reserves. There are proposals where growth from the region would exceed the OECD countries by 100%. The region substantially finances the US deficit." – investment banker

[17] November 2009, Sydney

But then again, some ambivalence towards a growing China

Ambivalence on China's impact on ASEAN was largely based on issues of equality and democracy. Interviewees expressed hope that China would exercise its economic power in a responsible manner:

> "China is a young power. They'll cooperate more closely with the other powers and the Philippines will benefit from the competition. One hopes it does not transfer and get captured by a few that there is something left for most of us." – private sector (7)
>
> "China has produced a rapid transition. But there are still the inequalities between the coastal vs. interior. China has accumulated huge surpluses and is a major investment behemoth which will influence behaviour." – private sector (8)
>
> "Japan has became the major investor [in the region] and provided development assistance. China is not at that level yet. There are challenges for China in areas of government requirements, corporate governance, public lending. China is sitting on reserves and will heavily influence its neighbours." – private sector (4)
>
> "For China, [when they] are angry with Taiwan, that's going to cause a political struggle for support for and against in the region" – regulator (2)
>
> "It's good thing for [China] to grow. Hopefully, [they would] have a lot of wisdom to develop that growth. They are under pressure from the G8 to open up completely and democratically." – private sector (2)
>
> "Worldwide there's an anxiety of China being an economic superpower. For the next decade, we hope China would consider the Asian countries as little brothers and not impose its own will on Asian countries. We'd like to see China take the lead the way Japan has. Big nations like China, US, Europe, look at the interest of developing countries in the world. Anything you see in the US is made in China. Everybody would be concerned with the extent of influence generated as a superpower." – holding company (2)

Trilateral Summit of China, Japan and South Korea

As a sign of things to come, in 2008 the first trilateral summit between the three biggest economies in the region – China, Japan and South Korea – was held in response to the global financial crisis and in attempts for greater regional competition. The summit was a strongly symbolic event and did not include a significant Western power. Political differences and historical grievances were set aside to discuss issues of the economic bent as an increasing sign of the growing maturity of the region economically and move towards greater regional cooperation.

> "The current financial crisis continues to spread," [Chinese PM] Wen said. "We are important players in Asia and the world, and we must strive to respond to this once-in-a-century crisis."

> "It is the first time historically for the three countries to hold an independent summit," [Japanese PM] Aso said. "It is epoch-making progress for the leaders of the three countries to hold meetings regularly and strengthen ties."[18]

Similarly to the way the EU has developed and struggled with regional cooperation in the latter half of the 20th century, the 2008 summit is indicative of the seeds of greater regional cooperation that is now taking place in East Asia. The most developed economies of the region are starting to take the lead and providing guidance with the emerging China taking a pivotal role. If the EU experience is any indication, the emergence of ASEAN+3 is widely anticipated as greater regional integration helps less developed economies such as the Philippines. Regionalism, rather than the China syndrome seems to be the sentiment of the new emergent world economic order in Asia.

[18] Fackler, Martin (2008) China, Japan and South Korea focus on economy at summit, International Herald Tribune, 13 December http://www.iht.com/articles/2008/12/13/asia/asiaecon.php accessed 15 October 2009

Part 4: The Role of Australia

In the region, Australia is held in positive regard as a politically stable country with strong institutions – legal, economic, regulatory and political. The goodwill created by Australian soft diplomacy through its aid development arm, AusAid, is recognised and widely acknowledged. For example, in developing corporate governance institutions, Australia's approach has helped establish company director associations in Thailand and the Philippines helping professionalise the profession of company director in those countries. Similarly, the ASX has also provided advice and support aiding capital market reforms in the Philippines. In areas of customs and tax administration, Australia and New Zealand's are seen as exemplars.

With increased trade, there will be demands for underlying institutional infrastructure support to support trade. As we have seen with global financialisation, if there is no underlying regulatory institutional support that can be quickly coordinated regionally, crises such as the 1997 East Asian crisis may occur regularly rather than occasionally.

Measures must be taken to ensure the ultimate role of trade is to contribute to the betterment of economies and societies in the ASEAN region. While most countries in East Asia have seen their per capita income increase in the last quarter of the century and indeed the Chinese experience is testament to the benefits of free trade in lifting hundreds of millions out of poverty, the region still hosts to a great deal of income equality compounded by corruption. Increased trade and participation must also mean increased transparency and ensure trade liberalisation benefits all, not just a few.

As a country which recognises judicial independence and rule of the law, Australia can also provide a neutral place where intra-regional disputes and arbitration can be settled. In this sense, the development of greater regional integration provides Australia a unique place not only in increasing intra-regional trade and investment but capitalising on the country's institutional experience and knowledge.

Australia should continue supporting trade and engagement with the region. The prospects for greater interaction and trade by Australia with the region are bright.