Connecting the Spokes:
Trade, Investment, and Economic Relations

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The theme of this conference, Connecting the Spokes, implies a hub. In general terms, both the Philippines and Australia tend to view the US, perhaps also China, as hubs around whose interests and values we in this region revolve – or in multilateral terms, of course ASEAN, although that leaves us in Australia at one step removed. But if we're talking bilaterally, the hub around which our relationship's spokes revolve comprises trade, investment and economic relations.

In Australian dollar terms, merchandise trade between the countries fell 15% to $2.7 billion in 2018. That makes the Philippines merely Australia's 28th largest merchandise trading partner. Trade in services – chiefly tourism and students – has the Philippines in 21st place. Australia, meanwhile, is the Philippines' 22nd target for exports and the 13th source of imports. Mutual investment is also thin. Australia has invested about $9.6 billion in the Philippines, but only about a tenth of that are directly in operations and assets, while the rest are in shares.

Australia's Ambassador to the Philippines, Steven Robinson, said at the Dialogue that "our trade ties are remarkably small. That seems completely out of kilter with the tenor of our relationship…. It should be about tenth." Maybe that's not such a surprise. Australia is 14th on the International Monetary Fund's list of world economies by gross domestic product, while the Philippines 39th. We have in the past been competitors more than partners in trading both resource and agricultural commodities. Structurally, we are not as committed economically as we are in the strategic space. While Australia has bilateral free trade arrangements with Singapore, Malaysia, Thailand, and Indonesia, and while Malaysia, Singapore, Vietnam, and Brunei are, like Australia, part of the especially comprehensive Trans-Pacific Partnership 11 arrangement that is going ahead without the United States, Australia depends on a deal led by the Association of Southeast Asian Nations (ASEAN) for its best terms under which to trade with the Philippines.

But as usual, the raw data do not tell us the full story. The situation on the ground seems a lot more positive – and promising. Despite a fall in trade revenues in 2018, almost entirely due to a correction in commodity prices in that period, the figures have resumed their upward trend. Indeed, in the first nine years after the Australia/New Zealand free trade arrangement with ASEAN, which came into force in 2010, trade between Australia and the Philippines rose about 70%, driven in the case of Australian exports by surging demand for agricultural goods (wheat and beef), energy sources (chiefly coal and now gas), and precious metals.

The high cost of liquefied natural gas – of which Australia has recently overtaken Qatar as the world's biggest exporter – will rapidly change the trade profile. The Philippines is set to run out of its main gas supply by 2023-24, and is thus inevitably looking to import, with up to three reception plants being considered.

The longstanding appetite in the Philippines for Australian grains and horticulture is growing rather than diminishing, fuelled by the 6% growth of the Philippine economy. There are now 33 flights a week from Australia, making it easy to deliver fresh produce – while continuing problems in upgrading infrastructure within the Philippines itself, with its 2,000 inhabited islands, means it can be less hassle, and even possibly ultimately cheaper taking into account spoilage, for a Manila buyer to import such goods by plane from Australia, than to bring them by road or sea from, say, Baguio. This issue also provides Australian business with a further opportunity – getting involved in helping improve logistics and the domestic supply chain in general.

The services sector profile is also changing rapidly, with the Philippines becoming the fastest growing educational market – up 49% in 2018, albeit from a low base. There are around 13,000 Filipinos who are currently studying in Australia. We have the advantage of proximity against more traditional targets for Filipino students like the US, and some surveys show that Australia is viewed as a particularly welcoming place to study. The numbers are soaring in part because the Philippines has just extended universal education from year ten to year twelve, from which 1.2 million students will be emerging annually. Australian educational institutions have also set up 30 partnerships in the Philippines with domestic counterparts, including vocational educators. Traditionally, the fields of study have focused on business, health care and aged care, but now there is more growth in science and technology driven fields and in innovation, reflecting a shift in the Philippines economy.

An estimate of 305,000 Filipinos have moved the other way, making Australia their home – and becoming valued, and highly popular, members of the multicultural Australian community. Tourism into Australia from the Philippines is also growing rapidly by 20% a year, and there is greater potential for growth in tourists the other way, with the help of more sophisticated marketing efforts, surely some of the Bali and Fiji holidaymakers will find as much to enjoy in the Philippines.

Also reflecting changes in Australia's economy, businesses from sectors such as fintech, cyber security, blockchain, and technical services generally are seeing more traction in the Philippines market.

Remittances remain very important – providing about 10% of the Philippine economy – but domestic consumption is, of course, considerably more important, while the business processing industry already accounts for more than 10%.

About 300 Australian firms are operating in the Philippines, employing more than 44,000 people. Many are engaged in business processing in a general sense, shifting as automation gains pace to more complex activities, and away from just operating call centres towards a range of back-office functions. Macquarie, ANZ, QBE and Telstra are all in this kind of space. Ambassador Robinson highlighted digital finance, data analysis, and science and technology generally, among the promising areas of engagement. Naturally, there's a lot of talent for such firms to draw on because the Philippines has a young population, median age 24, highly digitized and English speaking.

Most Australian investment has been in Manila and Cebu, but there is growing involvement in the Clark free port and special economic zone, which is booming on the land formerly occupied by the huge US air force base. Thirty Australian firms are already based there, handily alongside the zone's own international airport. But businesses operating there must be exporters rather than selling to the domestic market. The city will gain handy promotion throughout the region when it hosts the Asian Games at the end of the year.

Overseas investment by Philippine corporations has been dominated, inevitably, by the businesses of the great family-led conglomerates. They have tended in the past to focus on securing supply chains for the domestic markets they also dominate, although that is changing. Those firms are starting to invest in infrastructure and other sectors overseas as part of a broader diversification. A good example is International Container Terminal Services, now a major player in Australian ports, owned effectively by Enrique K. Razon, viewed by Forbes as the third richest man in the Philippines, whose grandfather established what became Manila's main port. Last year, Philippine companies put their toe into the renewables market in Australia, investing $US30 million as they check out that sector's potential.

Ambassador Robinson, again, said: "More Philippines firms are looking at investment in Australia, and we would encourage that wholeheartedly. Now is the time for us to seize those opportunities."

What could foster a more beneficial economic relationship?

There are limited prospects of rapid change in trade terms under the present structural settings. Despite the inevitable continuing quarantine quarrels over agricultural products we both grow – bananas have comprised a particularly rancorous one – most tariffs between the countries have already been slashed to zero. But if the Philippines were to consider joining the TPP group (now the Comprehensive and Progressive Agreement for Trans-Pacific Partnership or CPTPP), that would be a transformative move because many companies within that grouping are now starting to use that as their default base for calculating comparative advantage in terms of markets and investment.

Mutual direct investment is the key area that would most transform our relationship. In Australia's case a lot of work needs to be done to encourage corporate leaders to consider investing in Asia generally, let alone in the Philippines particularly. We have too few people in our main boards and top executive roles who have lived or worked or studied in Asia. And even as the US trade war began to gain traction, sectors of Australian business tended to view China as a kind of proxy for "Asia."

In building a momentum for greater business involvement with the Philippines, obviously right now an early assessment would point to anxiety about the new comprehensive tax regime which, while it may well end up providing a more rational structure, may cause investment decisions to be postponed. But plans for legislation to make it easier for the private sector to fund and participate in the government's ambitious infrastructure program will be closely followed. The 40% cap on foreign investment, which applies universally except in Clark, acts as a deterrent; other Asian regimes allow wholly foreign owned entrants. Joint ventures do often prove more durable, but newcomers to investing in Asia and to some Asian countries, tend to view such requirements as an obstacle.

Australia's growth rate has slowed but it is now in its 27th straight year of growth, and the Philippines has access to capital, management skills and expertise in a range of sectors that are important for production and employment in Australia. Hence, the overall outlook remains highly positive.

Finally, China is by far the biggest trading partner of both of us. Within Australia, concern has been expressed by some of those most heavily exposed to China economically, that any criticism of China expressed politically, including over security or influence concerns, imperils the country's revenues. But recent polling by Australia's best-resourced foreign affairs think-tank, the Lowy Institute, indicates that the broader public have changed their minds about such issues, with 74% stating that Australia is too economically dependent on China, and 77% wishing Australia to "do more to resist China's military activities in our region, even if this affects our economic relationship." Australia's national government, unlike the Philippines', has not signed China's Belt and Road Initiative memorandum of understanding – although the government of the state of Victoria has done so.

For some of Australia's business community, China has become their hub, profitably so. But there are always risks in placing too many eggs in one basket, and building better business relations between Australia and the Philippines is a step that can be taken to limit such risk, as part of a broader diversification of Australia's economic partnerships – as well as being a step worth taking in its own right.

*** NOTE ** This commentary is based on the discussions in the recent Philippine-Australia Dialogue, jointly organized by the Asia Pacific Pathways to Progress and the Griffith Asia Institute, and with the support of the Australian Embassy in Manila.*