Breaking Borders: A Case Study on the Impact of the Foreign Investments Act of 1991 on the Philippine Economy

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Abstract: Many developing countries look into foreign investors to catch up with developed countries. For this reason, measures have been taken by the Philippine government in order to attract foreign investors to the country. They believe that the entry of investors will bring about a spillover effect in the form of a transfer of technological know-how, formation of human resources and economic growth. However, even though there is much to say about the many benefits of foreign investments, some people still find that these also come with negative effects. Similarly, MSMEs are considered as the lifeblood of the Philippine economy, and should more or less be prioritized by the government.

Given the ambiguity of results, this paper seeks to determine whether or not the Foreign Investments Act of 1991 is balancing the need of attracting foreign investors with its duty of protecting the citizens' interests. The relevant factors such as the economic and political standing of the Philippines are also to be considered to leverage the positive effects of FDI in the country. The data gathered came from two (2) interviewees– one is an investment specialist at the Board of Investments (BOI) and the other one is the Chairman of ValueStrat Consulting, Inc., which is a technical and management consultancy firm. The researchers likewise compared the FIA with laws of other ASEAN countries in order to determine its effectivity as a law.

Keywords: globalization; MSMEs; industrialization; foreign investments

1. STATEMENT OF THE PROBLEM

A. Research Background

Gone are the days when self-reliance and independence are a trend, when countries are comfortable living in their own bubbles thinking that they can stand on their own. Due to the emergence of globalization, there is a need for governments to constantly upgrade their administrative capacities to cope with the challenges of rapid globalization in the twenty-first century, which are characterized by hyper-competition, hyper-complexity, and hyper-uncertainty (Bowornwathana, 2009). It is defined by Merriam-Webster dictionary as the development of an increasingly integrated global economy market especially by free trade, free flow of capital, and the tapping of cheaper foreign labor markets. According to Gane (2001), "It is political, technological and cultural, as well as economic."

In a study conducted by Hazel Parcon, it showed that the decision to push for trade liberalization in the Philippines is mainly brought about by its failed import substitution and protectionism implemented in the past. The government thinks that this would lead to the improvement of the allocation of resources and bring domestic prices closer to world price. But with the different experiences of countries that have undergone trade liberalization, it is worth looking into whether trade liberalization indeed enhances productivity and economic growth.

2. METHODOLOGY

In order to arrive at a conclusion, the researchers will make use of two methods of research, namely: comparative analysis and qualitative interviews.

A comparative research will be done to have an idea as to whether or not the Philippines is at par with its neighboring states and also to serve as an instrument for learning and knowledge. By looking into various international laws, the researchers will able to determine where the Philippine legislature based the law from and whether there is something lacking in it. This way, it will be easier to propose amendments to the Foreign Investment Act of 1991 to make it more suitable for the Philippine economy. Also, a comparative analysis of the current standing of some ASEAN countries, in relation to their respective investment policies, will likewise be studied in order to determine whether or not further liberalization really leads to a better economy.

After comparing the FIA with other laws, the researchers will interview management and investment experts to get their insights regarding the current standing of the MSMEs in the country and whether the protection being accorded to them by the law is sufficient to help them develop their businesses. The results from these three methods will then be collated in order to arrive at a conclusion and come up with possible recommendation for the legislature.

3. RESULT AND DISCUSSION

The $200,000 Threshold

The 1987 Constitution enumerates the goals of the national economy, to wit:

1. A more equitable distribution of opportunities, income, and wealth;
2. A sustained increase in the amount of goods and services produced by the nation for the benefit of the nation; and
3. An expanding productivity as the raising quality especially for the underprivileged.

Under List B of the 10th FINL, foreign ownership is limited for reasons of security, defense, risk to health and morals and the protection of SMEs alone. As such, domestic enterprises with paid-in equity of less than $200,000 are reserved to Philippine nationals. Anything more than this would be allowed 100% foreign ownership. This is $300,000 less than what was provided under the 1st Negative List created during 1994, and no changes have been made to the $200,000 threshold since then. The conversion rate of Dollar to Peso from the year 1994 to 2015, as well as the corresponding amounts, are shown in Table 6 below.

Table 1: Conversion Rate of 1 USD to Philippine Peso from the 1st – 10th FINL

Negative List	Conversion Rate	Multiplied to Threshold
1st FINL (1994)	26.4172	13,208,600
2nd FINL (1996)	26.2157	5,243,140
3rd FINL (1998)	40.8931	8,178,620
4th FINL (2000)	44.1938	8,838,760
5th FINL (2002)	51.6036	10,320,720
6th FINL (2004)	56.0399	11,207,980
7th FINL (2006)	51.3143	10,262,860
8th FINL (2010)	45.1097	9,021,940
9th FINL (2012)	42.2288	8,445760
10th FINL (2015)	46. 8522	9,370,440

Source:

http://www.bsp.gov.ph/dbank_reports/ExchangeRates_1.asp

As the inflation rate goes higher (which in the Philippines happens year-on-year), the prices of goods also increase along with it. That's why when $200,000 is converted to Philippine Peso during the time of the issuance of the 10th FINL (the most recent one), it would only amount to approximately P9,000,000. This would therefore protect only a portion of small enterprises and would no longer reach the medium enterprise category. In an interview with Ronaldo Buluran, a supervising investments specialist that works for the BOI, he expressed that the $200,000 threshold is not enough to protect MSMEs. He also added, "If the intention really is to protect all small and medium enterprises aside from micro enterprises, the threshold must be adjusted and increased to US$2,000,000." This is because $2,000,000 when converted to Philippine Peso would amount to P10,063,000. In this case, all MSMEs will be protected under the law.

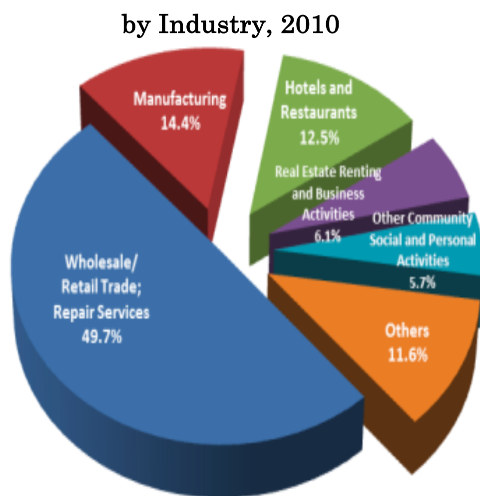
Comparison with other ASEAN Member States

Amendments to the FINL are to be done every two years. However, from the first until the 10th FINL, not much notable changes have taken place. In fact, the only recent changes to it have been the liberation of the retail industry, from being restricted to foreign nationals to being open to large enterprises or those which have more than $2,500,000 paid-in equity, and the reduction of the professions prohibited from foreigners.

In this case, Constitutional restrictions on foreign capital would be more difficult to change as compared to legislation. Also, "since restrictions are scattered through several laws, some of which are quite old and have rarely been reviewed, it would be difficult to determine their efficacy." It will also be difficult to determine whether or not they still serve the national interest or stand in the way of creating jobs due to the lack of a reform policy in the government. "Year after year, government departments passively apply the same legal restrictions and add new ones when Congress creates them."

In the negative list, manufacturing is only restricted in terms of the production of nuclear and biological weapons, firecrackers and other pyrotechnic devices, and other defense related products. Other than these things, manufacturing is already open to foreign investors.

Figure 3: Percentage Distribution of MSMEs by Industry, 2010



As shown in Figure 3 above, the industries which MSMEs belong to and are not included in the Negative List are the following:

- Wholesale;
- Repair Services;
- Hotel and Restaurant;
- Real estate and rental businesses; and
- Manufacturing of products aside from weapons and defense-related materials.

Amendments to List A may be made any time to reflect changes established in specific laws. This is problematic in a sense that changes to the FINL would require a lot of time and effort on the part of lawmakers since before any changes to it can be made, either the Constitution or laws need to first be amended. For example, most MSMEs in the country are focused on the retail and repair services industry. But in the FINL, only the retail industry is present since it falls under Republic Act 8762. Prior to this law, the retail industry was reserved to Philippine nationals alone. And since no law specifically pertains to the industries listed above, they cannot be included in said List.

Similar to the Philippines, Indonesia also makes use of a Negative List to highlight certain industries which are open to and restricted to foreigners. They categorize businesses as either open, closed, or those which are open but with conditions. But unlike the Philippines, foreign restrictions in Indonesia are not based on specific laws or its Constitution. Also, their list is more thorough and covers all types of industries in said country. They do not merely put the category retail business, but rather specify the types of retail businesses which are limited to MSMEs alone (e.g. footwear retail business). Indonesia's Negative List was created to further investment activities both from home and overseas, and to accelerate development while improving protection accorded to Micro, Small and Medium-scale enterprises."

In Thailand, they have what is called The Foreign Business Act B.E. 2542 (Business Act). Unlike Indonesia and the Philippines, they do not make use of a Negative List but something similar to it. Business activities that fall under the business act are divided into three categories: a) Schedule 1 or those which are closed to foreign investments because of special reasons; Schedule 2 or those businesses which are related to national safety and security, affecting cultural arts, traditional customs and folk handicrafts and businesses which affect the environment or natural resources; and Schedule 3 or those businesses which Thai nationals are not yet ready to compete with foreigners.

Some of those which are listed under Schedule 3 of the Business Act but are missing in the FINL are: (1) wholesale businesses trading all types of products, with a total minimum capital of less than Baht 100,000,000 per establishment and (2) sale of food and beverages. These are the kinds of industries which MSMEs in the Philippines are also focused on. Other than the industries previously mentioned, the FINL and the Schedules listed under the Business Act would already be similar. Regardless of this fact, the Philippines is still lagging behind in terms of attracting FDI. During the year 2015, FDI in the Philippines only

amounted to 58,580 (in million USD), while Indonesia and Thailand had 279,000 and 218,400 (both in million USD) respectively.

In Indonesia, MSMEs are mostly engaged in the agriculture, trade, hotels and restaurants, and rent and services businesses. This is why these sectors are mostly restricted to Indonesians alone. For example, retail business of car, motorcycle, and commercial vehicle requires 100% domestic capital. In Thailand, MSMEs cover businesses in the manufacturing, wholesale, retail and service industries. Similarly, these are also the very industries which are restricted under the Business Act.

5. Conclusion

In conclusion, although previous studies would often say that foreign investments are good for developing countries since they provide with technological know-how and increased employment, some economists claim that these benefits do not always materialize. And that to this day, the real effects of foreign investments in host countries still remain ambiguous. The government therefore needs to be careful in providing incentives to investors as well as in drafting legislation. This is because there are certain instances when these MNEs may be supplanting the existing industries instead of supplementing them. And if this happens, then the law would be doing the opposite of what it wants to achieve.

Based on the discussion above, there is reason to believe that amending the Foreign Investments Act of 1991 will be beneficial to the country. In amending the said law, it would be better to consider foreign investment laws of countries such as Indonesia and Thailand, who are leading in terms of economic growth. This will not really be difficult since both countries utilize similar investment policies. Instead of making the Negative List reliant towards existing and future laws, it would be better to make the list more general and easier to amend. Also, areas of investments which are deemed to be in need of investments or industries (and should be specifically limited to MSMEs) must likewise be properly determined. This is to make the law more effective in terms of attracting investors while boosting MSME development in the process. Just because MSMEs are unable to produce expected results, doesn't mean that the government should just rely heavily on foreign investments alone.

Results would also show that Indonesia and Thailand tend to provide more protection for their MSMEs as compared to the Philippines. It can be said that these countries recognize the potential of these industries and are giving them the necessary support in order to develop their businesses. This is why MSMEs in both countries tend to contribute more to the GDP of the country. While the Philippine government tends to rely towards foreign investments for needed capital, some would argue that it would be better to first develop one's own industries before expanding globally.

This is why although there is a possibility of benefiting from foreign investments, the Philippine government still needs to be wary of its possible negative effects. It must be able to ensure that the measures taken to further liberalize is coupled with support measures provided to MSMEs. Considering the fact that trade liberalization does not automatically amount to a competitive domestic market, trade policies should be construed against investors and beneficial to the Filipino people. After all, the FIA was created to expand livelihood and employment opportunities for Filipinos. If this end is not being achieved, then trade liberalization would actually defeat the law's purpose.

It can also be concluded that the Foreign Investments Act of 1991 does not provide enough protection for MSMEs. This is because there is only one provision which specifically caters to its protection and this protection only reaches a portion of the MSMEs. Considering the possible negative effects of foreign investments in the country, it is important to provide more protection to the country's MSMEs so as not to add up to their already increasing obstacles to growth and development. Regardless of whatever motive the government has in this case, the primary goal of the FIA is still to significantly expand livelihood and employment opportunities to its people. Although it is indeed important to likewise attract needed investments to the country, the extent of which needs to be carefully studied. And more than

anything, the best interest of the Filipino people needs to be prioritized.

Lastly, compared to other ASEAN countries, the Philippines is falling behind in terms of attracting investors. And more often than not, this is being attributed to the lack of liberalization undergone by the country. But Indonesia and Thailand have Negative Lists which are far more exhaustive than that of the Philippines, yet they still perform better in terms of getting FDI. This may mean that the reason for the country's slow progress in attracting foreign investors does not really come from its lack of liberalization. This is because liberalization is not the only solution to the country's problem in the same way that too much protection does not always lead to a better domestic market– there are a whole lot of other factors to be considered.

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20
17
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