Philippines: [In This Economy] Will economic charter change work? An objective look at the studies

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Once again we find ourselves at the crossroads of the Cha-Cha (charter change) train.

Last year, if you recall, there was a similar effort by lawmakers in the House of Representatives to amend the 1987 Constitution, through a Constitutional Convention (Con-Con). They envisioned the election of delegates by October 2023 and a draft constitution by June 2024. Alas, this grand plan did not come to fruition.

Now, the plans are getting more aggressive. Speaker Martin Romualdez is shepherding lawmakers to push for constitutional amendment by People's Initiative. Signature campaigns are ongoing across the country, marred by allegations of bribery and disinformation.

Curiously, the petition focuses on just one amendment: the joint (rather than separate) voting of both houses of Congress on constitutional amendments or revisions. It sounds small and simple, but this amendment can pave the way for more drastic and frequent constitutional changes at the behest of future congressional supermajorities.

Sure, the new move for Cha-Cha is procedural in nature. But it's still predicated on overhauling the 1987 Constitution's allegedly outdated economic provisions, and attracting more foreign direct investments or FDIs.

Said Speaker Romualdez late last year: "I believe 2024 will allow us again to revisit the issue of the Constitution because I think it's timely that we really visit, we'd like to focus very much on the economic provisions. But even to get there we have to look at the procedural aspects of the amendment of the Constitution so we have to tackle that and of course to make sure that the economic provisions are backed up."

Senators, whose votes and voices are threatened by the joint voting proposal, are initiating their own review of the Constitution's economic provisions, supposedly with the backing of the President himself.

Senate President Juan Miguel Zubiri said recently, "The President agreed with us that the [2023] proposal was too divisive, and asked the Senate to instead take the lead in reviewing the economic provisions of the Constitution. In this way, we can preserve our bicameral nature of legislation."

There's a lot of huffing and puffing about Cha-Cha and the Constitution's economic provisions. But I think it's time to put more structure in the debates by looking at the studies on this matter.

A case for lowering FDI restrictions

In April 2014, almost a decade ago, I co-wrote a section of a World Bank report titled, "Preserving stability and promoting growth." We summarized previous studies in the literature. In a nutshell, we said, "Where countries have relaxed foreign ownership restrictions, FDI has increased, yielding significant economic benefits for the receiving country."

Take the case of Vietnam. In 1987 they passed a Foreign Investment Law which allowed foreigners to own 100% of certain businesses. Supported by further amendments, it led to huge waves of foreign investments in succeeding years.

Thailand, meanwhile, passed in 1999 a Foreign Business Act, which expanded the list of sectors where foreigners can participate. While it still had some restrictions, the passage of the law provided clarity in investment rules and was followed by a steady rise of FDIs, at least until the global financial crisis. In 2004, Cambodia's amendment to its Law on Investment also led to an influx of FDIs.

As for the Philippines, we had our own experience of successful liberalization in the financial sector. When the Foreign Bank Liberalization Act was passed in 1994, that allowed foreign ownership in banks from 0% to 60%. Billions of dollars of investments by foreign banks came as a result.

A 2003 study, looking at the effect of this policy, concluded that "foreign competition induce[d] domestic banks to be more efficient" and lowered interest rates on loans. Of course, the entry of foreign banks also opened up thousands of job opportunities and careers for Filipinos.

In summary, laws relaxing foreign investments would seem to have a positive impact on FDIs (at least for select Southeast Asian countries). But the study we wrote was just descriptive, and there needs to be stronger (causal) evidence on the link between laws and FDIs.

Caveats

In December 2021, a newer study by Bangko Sentral ng Pilipinas (BSP) economists found further evidence showing the importance of FDI restrictions.

They looked at the determinants of FDIs in ASEAN-5 countries – the Philippines, Indonesia, Malaysia, Thailand, and Vietnam – from 2009 to 2019.

They found that "reducing FDI restrictions can potentially increase foreign investments." However, they offered important caveats.

First, the effect of relaxing FDI restrictions pales in comparison with other, more important factors, including the ease of doing business. Hence, they said that "while reducing FDI restrictions and the corporate tax rate could provide a boost to a country's FDI performance, improving the way business is done in a country would most likely have a more positive impact in attracting and retaining FDI."

Second, while looser FDI restrictions tended to promote FDIs from Asian economies, they stifled FDIs from non-Asian economies. No satisfactory reason was offered for this weird result, and they left this for "future research."

Third, some types of FDI restrictions may matter more than others. For instance, "Asian investors do not seem to be deterred by FDI regulations on employment of foreigners and approval mechanisms. Meanwhile, non-Asian investors are deterred by regulations on employment of foreigners, but not by regulations on approval mechanisms."

What the BSP study found, all in all, is that contrary to the claims of some groups, loosening FDI restrictions is not the end-all and be-all of attracting investments.

They concluded: "there is no factor that can single-handedly attract FDI… Reduction in taxes and FDI restrictions will not be sufficient if a strong investment climate does not exist. FDI promotion can be successful only if it is accompanied by relevant policies, including but not limited to those that improve the efficiency of business regulations, raise the quality of public governance and infrastructure, and improve the availability of appropriate human capital."

Note that even without constitutional amendments, the Philippine government over the past two decades has already loosened restrictions in many sectors.

In 2018, former president Rodrigo Duterte signed the Ease of Doing Business Act. In 2021, he signed the amendments to the Retail Trade Liberalization Act, which allowed lower capital requirements for businesses wishing to do retail trade in the Philippines.

Then in 2022, Duterte signed a law reducing the list of sectors where foreign investments can be made, as well as amendments to the Public Service Act that defined the six remaining public utilities that cannot have full foreign ownership.

The truth is, the Philippine economy now is almost as liberalized as can be under the present 1987 Constitution. Yet FDIs even *declined* in 2023 compared to 2022. How come?

One might say that we're still not liberalized enough, and that amending the Constitution's economic provisions will finally open the floodgates to investments.

But if you ask the Marcos administration, it would seem the floodgates have already opened. State media keep claiming that from President Marcos' foreign trips alone, he was already able to attract nearly P4 trillion worth of foreign investments. If the President is so successful, why even change the Constitution? Is the Constitution a true hindrance to investments?

The most likely reason is that foreign investors are looking at way more things than just the foreign participation rules. These include the Philippines' weak rule of law, the poor quality of institutions, the penchant for bureaucracy and red tape, the endless permits, high power costs, the lack of adequate infrastructure – to name just a few things.

Moving forward, we can nuance our discussions of Cha-Cha by distinguishing between the *formal* or legal restrictions to investments (which are as loose as ever) and the *informal* restrictions (which may be partially rooted in our culture). I think we need to focus on fixing the second more than the first.

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P.S.

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