THE CHARTER CHANGE ISSUE

Looking at the evidence

The Foundation for Economic Freedom
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1. Introduction

Reforming the 1987 Philippine Constitution has long been a standing issue, starting from former President Fidel Ramos up to former President Gloria Macapagal-Arroyo's term. Proposed revisions under the different efforts of the past administrations have revolved around institutional reform through a shift in the type of government from Presidential to Parliamentary-Federal as well as economic liberalization. Only President Joseph Estrada's Constitutional Correction and Development (CONCORD) zeroed in on the economic provisions of the Constitution, highlighting the need to free up key sectors of the economy to foreign ownership.

Today, the charter change (or "cha-cha", as it is famously called) has resurrected, ushered in by talks among and pronouncements of certain members of Congress. To quell suspicions that the cha-cha will serve as a vehicle to advance political interests (and to some extent change the term limits of power-hungry members of the parliament), Senate President Juan Ponce Enrile and Majority Leader Neptali Gonzales gave the assurance of limiting discussions on the Constitution's economic provisions.[1]

The provisions in question

Essentially, reforms are seen to focus on provisions that limit foreign ownership. As a general rule, foreign equity of a Philippine domestic enterprise can only go as high as 40 percent, save for cases allowed by Republic Act No. 7042, otherwise known as the Foreign Investment Act, as amended, like retail trade and export businesses (albeit with certain conditions). But for certain sectors expressly indicated in the Constitution, such as the ownership of natural resources, public utility, and media – the rule is inflexible. These restrictions are embodied in Article XII (National Economy and Patrimony) and Article XVI (General Provisions).

Related provisions in Article XII of the 1987 Philippine Constitution are, to wit:

> *"Section 2. All lands of the public domain, waters, minerals, coal, petroleum, and other mineral oils, all forces of potential energy, fisheries, forests or timber, wildlife, flora and fauna, and other natural resources are owned by the State. With the exception of agricultural lands, all other natural resources shall not be alienated. The exploration, development, and utilization of natural resources shall be under the full control and supervision of the State. The State may directly undertake such activities, or it may enter into co-production, joint venture, or production-sharing agreements with Filipino citizens, or corporations or associations at least sixty per centum of whose capital is owned by such citizens. Such agreements may be for a period not exceeding twenty-five years, renewable for not more than twenty-five years, and under such terms and conditions as may be provided by law. In cases of water rights for irrigation, water supply fisheries, or industrial uses other than the development of water power, beneficial use may be the measure and limit of the grant.*

[1] Reported by the Philippine Daily Inquirer on 20 July 2012 in the article titled, "Congress pushes Charter change. Belmonte, Enrile to Aquino: Let's do it". Accessed at: http://newsinfo.inquirer.net/231689/congress-pushes-charter-change

The State shall protect the nation's marine wealth in its archipelagic waters, territorial sea, and exclusive economic zone, and reserve its use and enjoyment exclusively to Filipino citizens."

"Section 10. The Congress shall, upon recommendation of the economic and planning agency, when the national interest dictates, reserve to citizens of the Philippines or to corporations or associations at least sixty per centum of whose capital is owned by such citizens, or such higher percentage as Congress may prescribe, certain areas of investments. The Congress shall enact measures that will encourage the formation and operation of enterprises whose capital is wholly owned by Filipinos.
In the grant of rights, privileges, and concessions covering the national economy and patrimony, the State shall give preference to qualified Filipinos.

The State shall regulate and exercise authority over foreign investments within its national jurisdiction and in accordance with its national goals and priorities."

"Section 11. No franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines, at least sixty per centum of whose capital is owned by such citizens; nor shall such franchise, certificate, or authorization be exclusive in character or for a longer period than fifty years. Neither shall any such franchise or right be granted except under the condition that it shall be subject to amendment, alteration, or repeal by the Congress when the common good so requires. The State shall encourage equity participation in public utilities by the general public. The participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital, and all the executive and managing officers of such corporation or association must be citizens of the Philippines."

"Section 14. The sustained development of a reservoir of national talents… XXX

The practice of all professions in the Philippines shall be limited to Filipino citizens, save in cases prescribed by law."

As for Article XVI of the same, the following section is also being considered:

"Section 11. (1) The ownership and management of mass media shall be limited to citizens of the Philippines, or to corporations, cooperatives or associations, wholly-owned and managed by such citizens.

The Congress shall regulate or prohibit monopolies in commercial mass media when the public interest so requires. No combinations in restraint of trade or unfair competition therein shall be allowed.

(2) The advertising industry is impressed with public interest, and shall be regulated by law for the protection of consumers and the promotion of the general welfare.

Only Filipino citizens or corporations or associations at least seventy per centum of the capital of which is owned by such citizens shall be allowed to engage in the advertising industry.

The participation of foreign investors in the governing body of entities in such industry shall be limited to their proportionate share in the capital thereof, and all the executive and managing officers of such entities must be citizens of the Philippines."

The Raison d'être

It has been made clear by Senator Enrile that the move to consider constitutional reform is nothing short of economic and not political. Even then, when the CONCORD had been organized by then President Joseph Estrada, the rationale of liberalizing the economic provisions of the Constitution was to help the domestic economy be more conducive to investments, and in the process, increase competition that will ultimately redound to an increase in the welfare of its people[2]. Roused by fears of being left out in the globalization game and the gains it afforded to much more open economies, proponents then and now emphasized the importance and urgency of adopting a liberal policy.

The urgency has not changed, despite having more than a decade of supposed gains after the Asian financial crisis in the late 1990s. Now, coming from the latest shock that reverberated across the globe, which affected not just developing economies as before but even the giants of the global economy, prospects are a little bit tricky. On the one hand, investor confidence has definitely plummeted as risks become widespread; international linkages due to increasing globalization have made a lot of countries exposed to the global financial crisis, ultimately resulting in a global economic crisis. And those economies whose ties are not with the developed economies' shook-up financial sector, the global economic crisis took care of. On the other hand, wealth remains in the hands of some investors – albeit risk-averse ones – that could be parked in economies that are less risky, are more resilient, and of course, that offer higher returns. Competition for this wealth kicks up notches higher given less supply of foreign investments; developing economies like the Philippines face a good deal of opportunities from foreign capital to capacitate their respective production sectors. In short, as the global economy hit rock-bottom (and there is nowhere to go but up), it is an opportune time to implement reforms that could propel the economy to greater heights. Failing to jump the bandwagon could very well cement the country's famed status – the sick man of Asia or simply, the 'laggard'.

This bandwagon could also take the form of the Trans-Pacific Partnership (TPP) deal that has been the buzzword in the international community. A multilateral agreement that seeks to "enhance trade and investment among the TPP partner countries, promote innovation, economic growth and development, and support the creation and retention of jobs"[3], this should be able to alleviate the threat of growing protectionist sentiment – one that rose from the traumas of the recent economic onslaught – that puts global recovery at risk. As of end-2011, 9 countries have committed under this deal, namely Australia, Brunei Darussalam, Chile, Malaysia, New Zealand, Peru, Singapore, Vietnam, and the United States. Whether the Philippines can participate, that remains a question – a question that can be answered by a liberal policy attractive to foreign countries.

[2] Archived news. Accessed at http://www.newsflash.org/1999/08/hl/hl011537.htm

[3] Website of the US Trans-Pacific Partnership. Accessed at http://www.ustr.gov/about-us/press-office/fact-sheets/2011/november/united-states-trans-pacific-partnership

2. Literature review

Why place so much importance on foreign capital?

Foreign capital, or aptly referred to as foreign direct investments (FDIs) in economic parlance, has been regarded by many as one of the key ingredient in supporting growth, particularly of a developing economy's. By their very nature, FDIs are long-term, coming in the form of asset acquisition that results in increased production capacity – whether it is physical equipment purchase, technology transfer or simply the infusion of financing that could help support operations. Being a developing economy with little starting capacity, this kind of assistance is most welcome. The literature cites theoretical studies done by Wang and Blomström (1992)[4] and Markusen and Venables (1999)[5] as take-off points pointing to the overall positive effect of FDIs on the host country's development efforts.

This is not new, given how neoclassical economics through the Solow-Swan growth theory posits the significance of capital accumulation in shifting the economy to a higher long-term growth path. Suppose a low saving rate (which is actually a characteristic attributed to the Philippines), there is little hope in achieving a higher "steady-state". With FDIs, however, domestic savings can be supplemented, thus yielding the same effect. Furthermore, the infusion of FDIs that pass through information and know-how likewise lends support to the endogenous growth theory as the transfer of knowledge eventually facilitates innovation and furthers technological progress, spurring the economy to a higher long-term growth path.

However, the literature further takes note of gaps in empirical evidence that seek to estimate the extent of the efficiency gains of FDIs as well as their spillovers. Dimelis and Louri (2004)[6] in their literature review took note of conflicting results from empirical work arising from differences in research design, methodology, and the type of data – whether cross-section or panel data. Some of the empirical studies on developing economies cited in literature, which are measured at the firm-level, are done by Aitken

[4] See Wang, Y., and M. Blomström (1992). Foreign Investment and Technology Trans- fer: A Simple Model. European Economic Review 36 (1): 137-155.

[5] See Markusen, J., and A. Venables (1999). Foreign Direct Investment as a Catalyst for Industrial Development. European Economic Review 43 (2): 335-356

[6] See Sophia Dimelis and Helen Louri (2004). Foreign Direct Investment and Technology Spillovers: Which Firms Really Benefit?. Review of World Economics / Weltwirtschaftliches Archiv 140 (2): 230-253

and Harrison (1999)[7], Blomström and Sjöholm (1999)[8], Chhibber and Majumdar (1999)[9], Sjöholm (1999a[10], 1999b[11]), Kokko et al. (2001)[12], and Dimelis and Louri (2002)[13].

Results notwithstanding, material evidence on the benefits from FDIs is very well observed. In its recent study, the World Bank (2010) acclaims the *"global network of 80,000 multinational corporations and 800,000 foreign affiliates has helped create millions of jobs, transferred technology, upgraded skills, fostered competition, and contributed to the fiscal standing of many economies."*

That is why it had been the policy of developing countries to welcome FDIs into their economy. In realizing this policy, countries had undergone structural reforms such as further opening up their economy to make way for foreign investments. As seen in the World Investment Report done by the United Nations Conference on Trade and Development (UNCTAD) in 2010, more and more reforms have been undertaken in the past two decades (see Table X).

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[7] See Aitken, B. J., and A. E. Harrison (1999). Do Domestic Firms Benefit from Direct Foreign Investment? Evidence from Venezuela. American Economic Review 89 (3): 605-618.

[8] See Blomström, M., and F. Sjöholm (1999). Technology Transfer and Spillovers: Does Local Participation with Multinationals Matter? European Economic Review 43 (4/6): 915-923.

[9] See Chhibber, P., and S. Majumdar (1999). Foreign Ownership and Profitability: Property Rights, Control, and the Performance of Firms in Indian Industry. Journal of Law and Economics 42 (1): 209-238.

[10] See Sjöholm, F. (1999a). Productivity Growth in Indonesia: The Role of Regional Characteristics and Direct Foreign Investment. Economic Development and Cultural Change 47 (3): 559-584.

[11] See Sjöholm, F. (1999b). Technology Gap, Competition and Spillovers from Direct Foreign Investment: Evidence from Establishment Data. Journal of Development Studies 36 (1): 53-73.

[12] See Kokko, A., M. Zejan, and R. Tansini (2001). Trade Regimes and Spillover Effects of FDI: Evidence from Uruguay. Review of World Economics/Weltwirtschaftliches Archiv 137 (1): 124-149.

[13] Dimelis, S., and H. Louri (2002). Foreign Ownership and Production Efficiency: A Quantile Regression Analysis. Oxford Economic Papers 54 (3): 449-469.

Table 2.1. National Regulatory Changes*

Item	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Number of countries that introduced changes	43	56	49	63	66	76	60	65	70	71	72	82	103	92	91	58	54	50
Number of regulatory changes	77	100	110	112	114	150	145	139	150	207	246	242	270	203	177	98	106	102
Liberalization/promotion	77	99	108	106	98	134	136	130	147	193	234	218	234	162	142	74	83	71
Regulations/restrictions	-	1	2	6	16	16	9	9	3	14	12	24	36	41	35	24	23	31

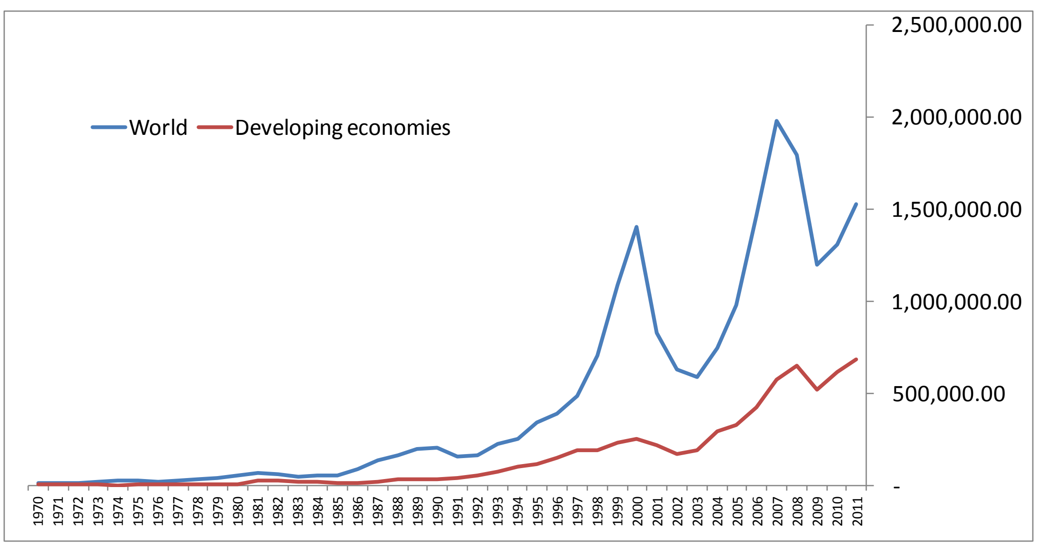
Source: UNCTAD database on national laws and regulations.
[a] Compared with reporting on these numbers in previous WIRs, the wording in the table has changed from "more favourable" to "liberalization/promotion" and from "less favourable" to "regulations/restrictions".

** This is directly culled from the 2010 World Investment Report of the UNCTAD; page77, Chapter III*

The growing vigor of liberalization policies are very much reflected in the escalating inflow of foreign capital since the 1970s (see Figure X below).

The share of developing economies no doubt represents a bulk in the total inflows, in 2011 alone, they accounted for about 45 percent. The promise of these economies and their relatively less-costly environment (largely due to cheaper labor costs) provide incentives for investors seeking higher returns. What would set these developing economies, apart, however, are the very questions concerning investment climate, specifically the macroeconomic fundamentals, infrastructure, and institutional context (i.e., rules, regulations and cost of doing business).

Figure 2.1. Net FDI inflows: billions of U.S. dollars at current prices and exchange rates



Source: UNCTAD, Foreign Direct Investment Online, http://stats.unctad.org/fdi.

Zooming in on Rules and Regulations

The constitution frames the body of fundamental laws and political constitutions that are critical in setting the way economic agents behave. By extension, one could say that a nation's economic performance is affected by the way the basic law of the land is written.

A study done by Sicat and Sicat (2004a)[14] develops a model in which economic performance depends on constitutional characteristics (x factors) and economic variables (z factors). Specific observations of constitutional characteristics represent ratings of each aspect of the constitution that is being identified as compared to the US constitution as benchmark. The economic factors are derived from the literature. The constitutional characteristics are: 1) brevity; 2) directness of language; 3) coverage of the constitutional framework; 4) inclusion of economic and social rights; and 5) the incidence of major constitutional revisions. The economic factors were limited to one measure of competitiveness, as measured by an index reported by the World Economic Forum's annual competitiveness reports - that is in itself composed of various economic factors.

The results suggest that constitutional construction is generally an important factor in economic development, but economic competitiveness is a more powerful force in determining economic performance. In particular, the complexity or relative simplicity of the constitution helps determine whether it is a positive or negative factor behind economic performance. For instance, a constitution over-burdened by too much detail has a constricting effect on economic actions in the form of policy or actual implementation. Simpler constitutions that do not overly restrict actions undertaken by economic agents help improve economic performance.

Still on the same subject, Sicat and Sicat (2004b)[15] in another study further discuss the implications of the Constitution on economic progress. They maintain that Constitutions should be simply written, and are based on general principles rather than specific rules, allowing greater freedom of movement of the factors of production in pursuing in economic activity. Should something go wrong, governments can introduce ordinary laws to control the framework of economic policy and allow greater economic activity while also redirecting the course of economic progress to change undesirable outcome. In driving this point, the study points out that:

> *"In countries that proceeded from simpler constitutional premises, factors of production were allowed greater movement because they omitted the issue of dealing with their regulation and control. The benefits of greater trade, of movements of capital and labor where needed made it relatively less painful to attain greater economic progress. In some countries that lacked domestic capital, the participation of foreign capital made capital accumulation easier to achieve. This permitted the absorption of labor and entrepreneurial skills in various sectors of the economy that helped boost the nation's productive capacity above its natural limits."*

[14] Sicat, G. and L. Sicat. (2004), "The Constitution and Economic Progress: When More is Less and Less is More."

[15] Sicat, G. and L. Sicat. (2004), "An International Comparison of Constitutional Style: Implications for Economic Progress."

Citing the Philippines as an example, they assert the Constitution's restrictive provisions as impediment to efficient movement of factors of production, and in the process hamper investment promotion in the country. The authors further note the difficulty of removing this impediment because it is “maintained by an alliance of the ruling classes and many nationalistic elements that favor restrictions”.

3. Stylized facts

On the subject of constitutional reform that has been the topic of interest recently, perhaps one might be able to appreciate the context of why such reforms are wanting.

Figure 3.1 below shows how much the country appears to be almost imperceptible in the investment radar, lagging behind neighbors such as Singapore, Indonesia, and even Vietnam. Table 3.1, meanwhile, shows the performance of ASEAN economies in terms of FDI inflows, investment and GDP growth in 2000 to 2010.

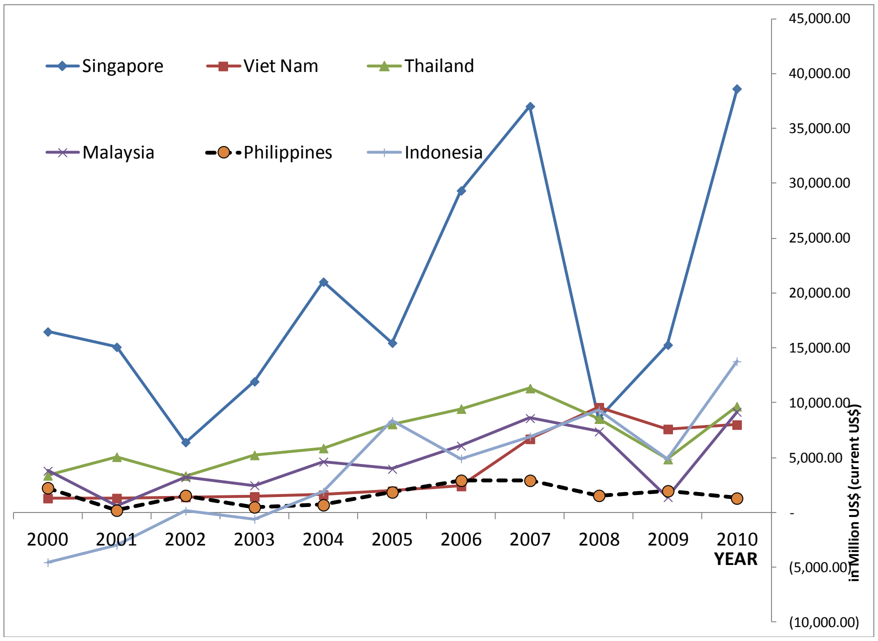
Singapore, being the highest recipient in this group, likewise has the highest average proportion of FDIs to GDP at 14.07 percent in the years 2000 to 2010. Even when the financial crisis struck in 2008 and 2009, inflows to this country rebounded sharply in 2010, even surpassing its 2007 peak record. Not surprisingly, the share of capital formation to GDP is one of the highest in the ASEAN region, second to Vietnam.

Vietnam, which is at the receiving end of large official development assistance and FDIs, likewise has a relatively high proportion of FDIs to GDP. Incidentally, it is also the second fastest-growing country in the ASEAN bloc in the years 2000 to 2010 with an average annual growth rate of 7.26 percent.

The Philippines, on the other hand, pales in comparison in terms of share of FDIs to GDP. FDIs for the 10-year period accounted for only about an average of 1.34 percent. Still, it managed to invest about an average of 20.3 percent relative to its GDP during this period.

Now the TPP deal previously mentioned could be one avenue in which the Philippines can improve its standing in the investment radar. Comparing its openness with its neighbors and the TPP partners, however, the country appears to offer little incentives for foreign capital holders; the Philippines, is in fact, quite restrictive (see Table 3.2).

Figure 3.1. Foreign direct investment inflows (in current million US$) in selected ASEAN countries, 2000-2010



Source: The Worldbank database. Accessed at http://data.worldbank.org

Table 3.1. Foreign direct investments, investment-to-GDP ratio and average annual growth rate of ASEAN economies plus China, S. Korea and India during the years 2000-2010

COUNTRY	FDI (in current MILLION US$)	FDI as % of GDP	Investment as % of GDP	GDP growth (CAGR)
	AVE. 2000-2010	AVE. 2000-2010	AVE. 2000-2010	2000-2010
ASEAN				
Singapore	19,571.44	14.07	24.99	5.62
Viet Nam	3,935.55	6.01	33.07	7.26
Cambodia	411.54	5.60	18.34	8.00
Thailand	6,797.79	3.52	25.22	4.33
Lao PDR	132.94	3.28	23.55	7.12
Malaysia	4,655.02	3.15	21.84	4.61
Brunei Darussalam	209.14	2.28	14.47	1.36
Philippines	1,604.73	1.34	20.33	4.76
Indonesia	3,823.80	1.23	24.05	5.23
Myanmar	472.00	n/a	11.19	n/a
Other Asian Economies				
China	100,886.05	3.64	39.73	10.48
Korea, Rep.	4,096.73	0.46	29.00	4.16
India	16,487.51	1.70	28.54	7.44

Source: The Worldbank database. Accessed at http://data.worldbank.org

Table 3.2. Allowed foreign equity, ASEAN economies plus other non-ASEAN TPP partners

The Philippines, TPP, and Other ASEAN Economies	Mining, oil & gas	Agriculture forestry	Light manufacturing	Telecom	Electricity	Banking	Insurance	Transport	Media	Construction, tourism, & retail	Health care & waste management
Philippines	40	40	75	40	65.7	60	100	40	0	100	100
TPP Economies											
Canada	100	100	81.1	46.7	100	65	100	79.6	73.4	100	50
Chile	100	100	100	100	100	100	100	100	100	100	100
Malaysia	70	85	100	39.5	30	49	49	100	65	90	65
Mexico	50	49	100	74.5	0	100	49	54.4	24.5	100	100
Peru	100	100	100	100	100	100	100	89.8	100	100	100
Singapore	100	100	100	100	100	100	100	47.4	100	100	100
United States	100	100	100	100	100	100	100	85	62.5	100	100
Vietnam	50	100	75	50	71.4	65	100	69.4	0	100	75.5
Australia*	-	-	-	-	-	-	-	-	-	-	-
Brunei*	-	-	-	-	-	-	-	-	-	-	-
New Zealand*	-	-	-	-	-	-	-	-	-	-	-
Other ASEAN Economies											
Cambodia	100	100	100	100	85.7	100	100	69.8	100	100	100
Indonesia	97.5	72	68.8	57	95	99	80	49	5	85	82.5
Thailand	49	49	87.3	49	49	49	49	49	27.5	66	49
Laos*	-	-	-	-	-	-	-	-	-	-	-
Myanmar*	-	-	-	-	-	-	-	-	-	-	-

Note: 100=full foreign ownership allowed

*The study, which covers 87 countries, does not cover Australia, Brunei, Laos, Myanmar, and New Zealand.

Source: World Bank: Investing Across Borders 2010 , http://iab.worldbank.org/

Furthermore, zooming in on ownership of natural resources (represented by agriculture and forestry), the Philippines provides the smallest allowed foreign equity share and one of the lowest in terms of share of Agriculture gross value added to GDP (see Table 3.3). Incidentally, those open economies such as Lao, Cambodia, Myanmar and Vietnam all have high shares.

While opening up agricultural lands to foreign investment and competition is a highly contentious issue, it is worthy to note how infusion of foreign capital can help raise their productivity. Looking at the profile of the country's merchandise exports, save for electronics and semi-conductors (that offer little value-added), we still pretty much rely on agricultural commodities. Strengthening the agriculture sector to pursue our comparative advantage may also bode well for the rural poor (which comprise a big bulk of the group living below the poverty line) that reside in these areas, as well as fulfilling our goal of self-sufficiency.

Table 3.3. Allowed foreign ownership and average contribution of the agriculture sector to GDP (2000-2010) of selected ASEAN economies

COUNTRY	ALLOWED foreign equity (%) Agriculture & Forestry	Contribution of Agriculture to GDP AVE. 2000-2010
Cambodia	100	34.01
Indonesia	72	14.62
Lao PDR	100	38.37
Malaysia	85	9.25
Myanmar	100	53.56
Philippines	40	12.95
Thailand	49	10.49
Viet Nam	100	21.87

Sources: The Worldbank database. Accessed at http://data.worldbank.org for the figures on the contribution of agriculture to GDP; World Bank report: Investing across Boarders published in 2010 for the foreign equity policies of Cambodia, Indonesia, Thailand, Philippines, Malaysia, Singapore and Vietnam; and ASEAN summary of foreign equity policies for Myanmar and Laos, accessed at: http://www.aseansec.org/8825.htm

4. Clarifying Concerns and Policy Implications

Summary of arguments for constitutional reforms

Efficiency gains

The primary motivation for the move to amend restrictive economic provisions is that such provisions hinder the free flow of factors of production, most notably foreign capital and technology, and constrains and alters the behavior of economic agents. Furthermore, economic restrictions also represent costs either in the form of additional costs of compliance (and circumvention) or foregone opportunities. In other words, there is a case for efficiency gains to be had from removing these economic restrictions. All our subsequent arguments are related to the overarching goal of welfare-maximizing economic efficiency, in some way or another although issues such as good governance may be worthy causes by themselves independent of their economic implications.

The openness of the economy is seen as one of the primary determinants of economic development. The Philippines cannot be a truly open economy when its fundamental law is protectionist and inward-looking. This is not to say that one must completely open up the economy to foreign investors. Certain strategic industries that are deemed vital to national interest can still be supported by the state in line with its development objectives but enshrining these economic provisions in the constitution, as is currently the case, is not the best way to go about this. An argument for greater flexibility by removing these restrictions can be made while still allowing the state to pursue key development goals.

To set in stone, so to speak, specific economic provisions in the law of the land results in a rigid and inflexible institutional framework which governs the operations and interactions of the state and the private sector. As we shall elaborate further down, this also presents opportunities for rent-seeking and corruption and adds a layer of complexity to the rules investors have to deal with. We maintain that constitutional reforms entail not so much an overhaul of the existing constitution but rather removing the nationality restrictions among others in the sense of turning these into ordinary laws that result in greater flexibility and responsiveness to changing economic circumstances.

While it is true that other economic factors may exert a greater influence on the economic performance, this does not necessarily mean that we stand to gain nothing from constitutional reforms. Moreover, constitutional reforms need not be mutually exclusive of other reforms. In fact, constitutional reforms can be construed as an important first step towards broader and deeper economic and institutional reforms with the end in view being that of placing the economy on a rapid and sustainable economic growth path.

Lastly, these constitutional reforms serve as a signal to the international community that the Philippines is indeed open for business. This may not, by itself, be the prime reason for enticing investors into the country. Constitutional reform is not a cure-all for the country's underdevelopment but nevertheless it can make a difference – all the more so if taken as a component of a larger reform package that reorients the Philippine economy towards a more open and globally-competitive economic regime.

Weak state captured by oligarchs

The Philippines has often been described by social scientists as a "weak state" subject to capture by oligarchs and vested interest groups. Inasmuch as the constitution is a product of each country's unique socio-political and economic context, our present constitution to some extent also reflects this state capture. It is the victors of the historical process who write the constitution and for the longest time the Philippines has been ruled by an oligarchy that is out to further their own interests.

While others attribute the economic provisions of the present constitution to nationalist sentiments, the other perspective is that these are the product of entrenched interest groups who have historically either comprised the ruling class or exert considerable influence over them. The so-called "preferential treatment for the Filipino" may be well-intentioned, but it begs the question of which Filipino do we refer to when we speak of preferential treatment? Do these restrictions actually benefit Filipinos in general or are do they actually benefit selected groups and individuals at the expense of the rest of society?

Such a situation where vested interests have hijacked control over the domestic economy complicates economic management. Increased openness of the economy to trade, capital, and technology has been the primary strategy employed by our Asian neighbors in building robust and rapidly growing economies. And yet these Asian countries do not find this economic openness to be in contrast with their strong nationalistic sentiments. This belies the nationalistic arguments employed by some quarters in defense of economic restrictions in the charter that are a holdover from the 1935 charter and have remained unchanged since then.

We argue that the capture of the state and of a broad range of specific industries by oligarchs emphasizes the need for constitutional reforms, particularly restrictions on foreign entry and ownership. Doing so is an effective way of freeing large swathes of the economy from the oligarchy that has benefited from the status quo for more than seven decades. Liberalizing erstwhile closed industries will only serve to level the playing field and lead to better competition to the benefit of consumers and of society as a whole.

Corruptive effect

Constitutional restrictions also result in adverse selection problems, a situation in which the principal (host country) is more likely to select a “bad” agent (foreign investors) under asymmetric information. Restrictive rules either screen out or make the costs of complying with (or circumventing) the restrictions prohibitive for most investors, including the “good” ones. Meanwhile, the “bad” investors who break the rules anyway are more likely to be the ones left in the market and, thereby, the chance of selecting a “bad” investor now increases. This ultimately leads to opportunities for corruption as “bad” investors either try get exemptions from a weak Philippine state or work around the existing regulations with the cooperation of state instrumentalities.

The Fraport-PIATCO NAIA Terminal 3 fiasco can in effect be attributed to Fraport needing to get a dummy to circumvent the ownership restriction. The issue has been tainted by corruption and exposes the weaknesses of Philippine institutions, further exacerbated by the an additional layer of complexity to the rules of the game brought about by the economic provisions in the constitution. This frayed our economic ties with Germany and the Philippines’ image took a beating in front of the global investment community. To this day, the terminal technically remains unfinished, needing further structural works, and is not fully operational.

Removing the constitutional restrictions and liberalizing foreign ownership is expected to result in a more level playing field, enhanced competition and, therefore, more socially optimal outcomes. The caveat, however, is that the state still needs to exercise regulatory or oversight functions in order to safeguard public interest. Nonetheless, the argument stands and selective liberalization can be implemented with society standing to gain the most from such a strategy employed for specific industries.

The case of the telecommunications industry is also instructive, resulting not only in greater connectivity among Filipinos but also in the adoption of technological advancements that enabled the growth of the business process outsourcing industry. While one might argue that this was achieved despite the constitutional restrictions on foreign ownership, the recent questions on the ownership structure of the country’s largest telecommunications company, Philippine Long Distance and Telephone (PLDT) Corp., bring to fore the problems caused precisely by these economic restrictions.

In sum, the country can free up economic restrictions and liberalize where possible and appropriate, mindful of the strategic importance of certain industries to economic and non-economic goals. This also means building up institutional capabilities specifically required under the liberalized regimes in these industries.

Response to arguments against constitutional reforms

One of the more compelling arguments against constitutional reforms is the demand for evidence-based decision-making. It has been argued[16] that the assertions regarding the need to amend the economic provisions of the constitution that restrict foreign investment, thereby, resulting in lost economic and employment opportunities are not supported by empirical evidence and have no basis in fact. Direct evidence regarding the deleterious effects of the restrictive economic provisions is practically impossible to produce but this is only because the precise economic effects of a country's constitutional provisions are difficult to directly quantify.

As is often the case in macroeconomics, the best that can be done is to estimate parameters indirectly as we in earlier sections. Nevertheless, it bears noting that the evidence-based arguments against amending the constitution are also subject to this limitation. The supposed empirical evidence presented answers the question of how constitutional provisions affect the macroeconomy only indirectly such as through estimating the economic effects of foreign investment. Note that this method is already one step removed from the direct question of whether certain constitutional provisions affect the economy. We will discuss these arguments against constitutional reforms below and proceed to present our counter-arguments point by point.

> **Claim**: The Philippine economy is able to expand at high growth rates under the present constitution. Therefore, removing the restrictive economic provisions becomes unnecessary. "If it ain't broke, don't fix it."
>
> **Response**: While the economy grew a strong 6.4 percent in the first quarter of the year, there are two things worth noting. One, growth has been primarily driven by consumption rather than investment. The fact of the matter is that the Philippines has attracted the least amount of foreign direct investment (FDI) during the past 25 years among its comparable Asian neighbors at a mere $32 billion. Two, given the history of the economy, it is questionable whether the Philippines can sustain the first quarter performance and move into a long-term, high-growth path. Again, the facts bear out that we have not been able to sustain high economic growth during the past 25 years with the GDP growth rate at slightly over 7 percent only in 2007 – the highest since 1987 and the only time the economy reached such growth rate. The main point of constitution reforms is to address these issues by making the country more attractive to FDIs that would help propel sustained economic expansion.

[16] Solita Monsod. "It's not necessary to Cha-cha." Philippine Daily Inquirer. July 13 2012.

Claim: At the micro-level, a sizeable minority (25-45 percent) of FDI projects had deleterious effects on national income, i.e. not all FDI will contribute to sustainable development.

Response: But, of course, that is the natural course of things. Businesses ventures fail. Moreover, in the case of the Philippines, the failure rate can be expected to be higher precisely because of the difficulties and costs imposed by the constitutional restrictions on investors and because of adverse selection of investors.

Claim: At the macroeconomic level, there is correlation but not causation between FDI and the level and distribution of national income.

Response: First of all, a causal relationship between FDIs and national income cannot be established because of the general limitations imposed on macroeconomic research. It is often the case that true causation cannot be established in macroeconomic studies and the alternative option usually comes in the form of correlations. Notwithstanding the question of whether FDIs cause economic growth or the other way around, the economy still stands to gain from foreign capital into industries that the domestic economy has yet to develop and from technological and managerial know-how that are otherwise not locally available. As to the more direct question of whether constitutional reforms will help attract FDIs, Lall (1997)[17] concludes that host country policies, of which ease of entry and ownership issues are included, is one of three major factors affecting FDI inflows.

Claim: FDI has historically played only a minor role in the growth of most high-performing Asian economies.

Response: There is considerable empirical evidence of the positive effect of FDI inflows on host economies as detailed in various studies. Granger causality tests, which do not represent true causation but is the second-best option in macroeconomics, reveal positive unidirectional effects of FDI to GDP in the case of Asian economies like China, Taiwan, Hong Kong, Singapore, Malaysia, Philippines and Thailand, and Latin American economies like Mexico, Brazil, and Argentina. Moreover, there is evidence that FDI indirectly affects the growth process inasmuch as it serves as an indicator of economic openness, which Won et al. (2008)[18] have shown to be the most important economic factor behind the rapid growth of the newly industrialized Asian

[17] See Lall, S. (1997), "Attracting Foreign Investment: New Trends, Sources and Policies." Economic Paper 31, Commonwealth Secretariat.

[18] See Won, Y., F. Hsiao, and D. Yang (2008). "FDI Inflows, Exports, and Economic Growth in First and Second Generation ANIEs: Panel Data Causality Analyses." KIEP Working Paper, 08-02: 11-86.

economies. In other words, as argued by Hsiao and Hsiao (2006)[19], countries that successfully attract FDI can finance more investments and grow faster than those that deter FDI.

Claim: The factors affecting FDI include physical infrastructure, skill levels, regulatory framework, clear and consistent rules, and fiscal determination. With or without constitutional reforms, attracting FDIs will continue to be a challenge unless the above factors are addressed.

Response: While all the factors cited are indeed important determinants of FDI inflows into the country, this does not necessarily mean that there are no benefits to be derived from amending restrictive economic provisions in our constitution. Constitutional reforms are not a panacea for improving the Philippines economic competitiveness, but they have a role to play under a broader package of reform efforts that will also aim to address the aforementioned factors. The restrictive nature of the economic provisions is indicative of an inward-looking economic attitude that is directly contrasts the economic openness represented by FDIs. Moreover, these restrictions add to the complexity of the rules under which foreign investors operate. With regard to the broader institutional framework, moves to make the charter more open to foreign investors will send a signal that can help improve perceptions of the country's investment climate as the constitution represents the basic law of the land that sets the tone for all other institutions.

Claim: Nationality restrictions are not a real issue for foreign investors as there numerous ways working around them. On land ownership, foreign firms can lease land for up to 75 years and foreigners can own condominium units provided they do not own more than 40 percent of the condominium. Restrictions on foreign control are not a constraint either because foreign investors can still be in control or beneficial ownership of corporations either by liberal interpretation or by redefinition through legislation, or the use of creative financial and other instruments.

Response: The fact that investors still have to work around the rules, no matter how minimal the effort may appear to be, reinforces the need to remove the restrictions. These efforts in dealing with the imposed restrictions are not costless and signal to investors that they are unwelcome. In the case of the Manila Hotel, the Supreme Court interpreted the constitutional provision under the national economy and patrimony giving Filipinos preference as a basis for a qualified Filipino to "match" the highest bid offered by a foreign firm. This suggests that the intent of the constitution is for Filipinos to retain control of enterprises, which would then imply

[19] See Hsiao, F. and M. C. Hsiao (2006). "FDI, exports and GDP in East and Southeast Asia – Panel data versus time-series causality analyses." Journal of Asian Economics. 17:1082-1106.

that working around the control restrictions through creative methods is contrary to the law of the land as exemplified by the current ownership fiasco with the Philippine Long Distance Telephone (PLDT) Corporation. Such “creativity” can also be applied in the wrong ways, as seen in the Fraport-PIATCO experience, and these workarounds are also not costless. In cases where the law is interpreted liberally in favor of foreigners, note that such interpretations can change and provide incentives for investors to cozy up to authorities in the hopes of gaining favorable rulings. Ditto for legislative redefinition which is a political and thereby slow and tedious process – and even then can still be questioned before the courts. In sum, these restrictions add to the complexity and uncertainty of the rules of the game while also presenting opportunities for corruption as firms try to curry favors from the state to work around the constraints.

Claim: There is a possibility that legislators will not restrict the constitutional amendments to economic provisions only and may instead use the opportunity to further their own interests such as through term extensions

Response: The appropriate answer to this is the exercise of utmost vigilance during the entirety of the process and not abandoning the process altogether. We need not “throw out the baby with the bathwater,” so to speak. If one is convinced of the importance of constitutional reforms, then the possibility of political exploitation is really a secondary issue. We must proceed to address the problem of restrictive economic provisions while all the while doing our best to safeguard the process.

Possible safeguards

The best safeguard against possible political exploitation of the process of constitutional amendments remains to be the people’s vigilance and the weight of public opinion. Should our representatives stray from the promised economic amendments, then ultimately it is in the people’s hands to ensure that it does not happen and to forcefully oppose political exploitation if it does occur. It is the public that will have the final say on whether to approve amendments to the constitution. By bringing to bear the light of public scrutiny on our legislators during the process, we can send a message to our representatives whose interests exactly are they tasked to represent.