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Let's Change our anti-FDI History: A Rejoinder to the UPSE Discussion Paper on Charter Change

A UP School of Economics (UP Econ) Discussion Paper, entitled "How to Change a Constitution by Hand-Waving (Or, the unbearable lightness of evidence in support of lifting foreign ownership restrictions)", authored by several economists, namely Toby Monsod, Aleli Kraft, Cielo Magno, Jan Carlo Punongbayan, Orville Solon, Elizabeth Tan, Agustin Arcenas, Florian Alburo, and Emmanuel de Dios, concluded that the evidence for amending the restrictive economic provisions of the Constitution is light.¹

We, the Foundation for Economic Freedom, put forward our rejoinder to the Paper, which we believe to be ahistorical and devoid of context.

It fails to take into consideration the long history of anti-foreign direct investment (FDI) policies in our 1935, 1973, and 1987 Constitutions, which have all espoused the protectionist economic model. Given the state of our economy vis-à-vis our neighbors who have taken a more liberal route, the model has clearly failed. Likewise, the factors affecting FDIs are complex, including the country's history of xenophobic economic policies and protectionist elite politics.

Our rejoinder will address specific assertions posited by the said Paper.

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¹ Toby Monsod, Aleli D. Kraft, Cielo Magno, Jan Carlo Punongbayan, Orville Jose C. Solon, Elizabeth Tan, Agustin Arcenas, Florian Alburo, and Emmanuel S. De. Dios. (2024). *How to Change a Constitution by Hand-Waving (Or, the unbearable lightness of evidence in support of lifting foreign ownership restrictions)*. UPSE Discussion Paper No 2024-1.



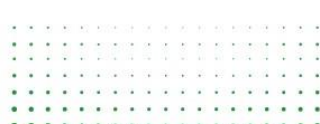
Assertion 1: Equity restrictions have no significant impact on FDI inflows.

The UP Econ Paper critiques the econometric studies put forth by the proponents of charter change during the hearings on RBH7 in Congress which provide statistical evidence on the positive outcomes on FDI associated with lower restrictions on foreign equity. The authors caution against uncritical enthusiasm in interpreting the statistical results of the econometric studies to justify liberalizing economic provisions in the charter.

The proponents of charter change may have overburdened the statistical results of the econometric studies by presenting a calculation of the possible magnitude of the increase in FDI from reducing equity restrictions, based on the estimated coefficients in the regression equations. The authors, however, make the same mistake by putting much emphasis on the differences in the coefficients of variables, such as corruption and infrastructure development, and attributing to these various factors their relative power in stimulating FDIs. From here, the authors make a short hop to the position that reducing equity restrictions will have a weak effect on FDIs compared to other factors, and then a big jump to the conclusion that changes in economic provisions in the charter are not warranted.

The paper makes a reasonable observation that the factors affecting FDIs are complex, context-dependent, and are subject to other factors such as corruption, infrastructure and regulatory regimes. Corruption and infrastructure gaps could very well be more significant turn offs for foreign investors, and there's no denying the need to undertake arduous reforms in these areas, not just for FDIs, but also for stronger overall economic performance. This, however, does not rule out the need for reducing restrictions on foreign equity. The studies mentioned in the paper showed that the coefficient of FDI regulatory restrictiveness is significantly different from zero and this warrants the need to address this variable as part of economic liberalization.

The complex factors affecting FDIs inflows and the limitations in the statistical methodology behoove caution in interpreting which factor is more important, based on the estimated coefficients. The issue is that the independent variables





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in the regressions are not real economic variables, but are constructed indices for corruption, infrastructure development and ease of doing business. The widths of the norm for each variable are not standardized. For indices with wide norms, the estimated coefficients will be lower, while for indices with narrow norms the coefficients will be larger. Care must be taken in making observations such as “reducing the index of corruption will have a bigger impact on FDIs than reducing restrictions on foreign equity”, based on the relative coefficients.

Let us go beyond theory and look at a proof of concept that negates this assertion.

The case of liberalizing renewable energy (RE) demonstrates that opening the door will result in increased investments. Since the kinetic renewable energy sector was liberalized (solar, wind and tidal), several billion dollars in investments have come in or have been committed. After RE liberalization, Bloomberg also identified the Philippines as the 4th best destination for RE investments and the new "darling" of the RE global industry. There are potential investments in the manufacturing of machinery needed for RE such as wind turbines and solar panels, which can make the Philippines a manufacturing hub for RE machinery and tools for the region. Ten (10) seaports must be built to transport and build tools and machinery like turbines for wind energy, solar panels and batteries. This will translate to direct employment as well as livelihood opportunities from ancillary services to the RE sector.²

Assertion 2: Removing foreign equity restrictions is not necessary, let us just concentrate on fixing other issues such as rule of law, corruption and ease of doing business.

The UP Econ Paper posits that removing foreign equity restrictions is the least significant variable in increasing foreign investment. Hence, it’s nice, but there is no need for it.

² Statement of Undersecretary Sharon Garin during hearings of the Committee of the Whole of the House of Representatives on February 2, 2024.



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We believe that removing the restrictions is a necessary condition since we have to open the door first for investors to be able to come in. For foreign businesses to benefit from better institutions and processes, they must enter the country first. How does one even experience all of the other enabling factors if one is barred from the get-go? There is a need to signal that the Philippines is open to FDI and demonstrate a “credible commitment” to this economic framework. Removing these anti-FDI provisions in the Constitution will signal our openness to foreign investment.

Besides, the incremental effort required to reduce an index of corruption by some quantum in the real world will entail massive political will, institution-building, and changes in social values that will take many more years than changing the economic provisions in the Constitution which can be effected through a constitutional process. This will set in motion dynamic economic forces in terms of more competition, technology transfer, contestable markets, and access to global markets, among others.

There is a need for a critical mass of reforms to create a more conducive environment for foreign direct investment. The lifting of the foreign equity restrictions is not being proposed as a magic bullet that will cure all ills and should not be seen as neglecting to fight corruption, investing in infrastructure, or improving the rule of law. These initiatives are not mutually exclusive and can be addressed simultaneously. There’s no reason why we can’t walk and chew gum at the same time.

Moreover, restrictiveness cannot be separated from corruption; it may be a cause for corruption as National Scientist for Economics Dr. Raul Fabella showed in the PIATCO case.³ The construction of Terminal 3 of the Ninoy Aquino International Airport (NAIA) attracted foreign interest, among them Fraport. But the ownership restriction on foreign ownership meant that the foreign interest could not wholly

³ Fabella, R. (2024, February 18). *The lifting of the constitutional 60-40 foreign ownership rule: Credible commitment, the PIATCO Scandal, and mistrust*. BusinessWorld Online. <https://www.bworldonline.com/opinion/2024/02/19/576341/the-lifting-of-the-constitutional-60-40-foreign-ownership-rule-credible-commitment-the-piatco-scandal-and-mistrust/>



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own and run the facility. Fraport needed a local partner to pose as majority owner (some say a dummy). It found one, but the partner was embroiled in corruption cases leading to lawsuits that caused the completed Terminal 3 to be mothballed for a decade since delivery in 2002. In 2016, the Philippine Supreme Court, confirming an arbitral ruling, ordered the Philippine government to indemnify PIATCO P25 billion. Had the ownership restriction not been there, Terminal 3 would have been running and earning since 2002 and the P25 billion indemnity would have been avoided. For the next decade, PIATCO was the red flag that popped out on the screens of global foreign investors. It said: "Beware the Philippines!"

Assertion 3: Flexibility in policy-making is tantamount to making "discretion" the rule.

The UP Econ Paper asserts that the choice between flexibility vs rigidity in policy-making is actually more sinister, and is actually a choice between discretion and rules. It poses a strawman fallacy that flexibility will give our legislature (that our people elect into office) too much discretion in crafting economic policy. It also asserts that our legislators cannot be trusted with this discretion and must be bound by the "rule" of constitutional restrictions.

The real issue is not even about the rules themselves, but whether said rules should be in the Constitution, instead of being in the legislation. Constitutions of all other countries only contain general principles. Of the 28 Constitutions reviewed by the Senate Committee during its hearings, we are the only country with foreign ownership restrictions in our Constitution. To attract foreign investments, our legal framework should be at par with our competitors in the region.

Allowing for flexibility in our economic policy to be more responsive to changing local and global conditions does not throw out the rule book. It merely situates rule-making in the proper venue. Adding "unless otherwise provided by law", merely allows Congress to craft laws that must still align with constitutional principles.



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The World Bank has stated that the Philippines is the most concentrated economy in Asia, i.e. monopolies and duopolies dominate the economy. Giving flexibility to Congress to change the rules will improve contestability in a market dominated by existing monopolies and duopolies. This means that actual competition or even the threat of competition from foreign players will lead local players to improve the quality of and access to, their goods and services if they know that new entrants from abroad can be facilitated by Congress.

This has been proven by the increase in capital spending by the entry of Dito Telecommunications and the availability of satellite-based telecommunication services in the telecommunication sector prompted by the amendments to the Public Service Act and the entry of Starlink into the Philippine market.

Lastly, we find it rather inconsistent that the paper asserts that the Philippine government cannot be trusted with the discretion to create sound economic policy due to the “idiosyncrasies” of the Philippine political economy when discussing charter change, but expects the same government to address issues of corruption, ease of doing business and infrastructure, which they claim should be the exclusive approach towards attracting foreign direct investment.

Assertion 4: Adding “unless otherwise provided by law” will lead to short-run uncertainty.

The UP Econ Paper posits that foreign investors will be discouraged by the uncertainty of waiting for the economic legislation that will be passed into law.

We believe that foreign investors have long been discouraged by long-term uncertainty. The uncertainty in our economic policy framework stems from the contradiction between the restrictive provisions in our Constitution and the attempts to mitigate them through legislation. The uncertainty lies in the fact that enacted legislation, that went through rigorous debate and deliberation by both houses of Congress, can be rendered moot through a Supreme Court challenge on the grounds of constitutionality. This is the situation that is faced by the Amendments to the Public Service Act today. Existing and potential investors in the telecommunication and transportation sector must await the resolution of



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these challenges to be certain of the actual policy of the Philippines. If the Supreme Court decides to rule that this law is unconstitutional, this will greatly damage the image of the Philippines with foreign investors. Adding the phrase “unless otherwise provided by law” will render this Constitutional challenge moot.

We firmly believe that RBH 7 and its counterpart RBH6 in the Senate will provide certainty to the country’s economic policy direction by giving our legislators the flexibility to create legislation that is responsive to global and domestic economic realities, for the benefit of the Filipino people.

In summary, it is easy to find fault with proposed solutions to problems, while being completely comfortable with doing the exact same thing that created the problems in the first place. After 100 years of solitude from FDI, we believe it’s about time we try solving the problem.