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Rejoinder

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Rejoinder

We are pleased to note that the discussion paper we wrote ("How to change a constitution by handwaving"*) has attracted some interest from the public and observers of economic policy. Our main motivation in writing it was, after all, to stimulate more judicious thought and discussion of the issue of lifting the remaining constitutional restrictions on foreign ownership. In that, we claim modest success.

Among the more thoughtful responses the paper has received is that from the Foundation for Economic Freedom (FEF). [1]It is gratifying, first of all, that FEF agrees with our paper's general observation that "the factors affecting FDI are complex, context-dependent, and are subject to factors such as corruption, infrastructure, and regulatory regimes". Indeed, their response concedes the main point of our paper, which is that compared with lifting foreign-equity restrictions: "Corruption and infrastructure gaps may well be more significant turnoffs for foreign investors."

Notwithstanding this, the FEF response incongruously then insists that "removing the restrictions is a necessary condition". Part of this may be a quibble over terms,[2] so let us make our own point in plain language: we have never denied that removing ownership restrictions could result in additional inflows of foreign direct investment (FDI). What we do question—based on studies that proponents themselves have put forward—is whether such restrictions represent the *main hindrance* to attracting desirable FDI. Moreover, we also question whether removing equity restrictions is a *precondition* or *prerequisite* before more substantive initiatives such as addressing corruption, the ease of doing business, and infrastructure deficits can be addressed. We think the answer to both questions is plainly "no". It is in this sense that we said removing such restrictions is "nice but not necessary". One would have hoped the FEF would answer similarly, but apparently not.

To insist on their conclusion, the FEF challenges our interpretation of the quantitative evidence as well as presents illustrative anecdotes or events meant to repair what they perceive as our paper's being "ahistorical and devoid of historical context". Here, we set the record straight on both FEF's appreciation of the econometric evidence and on the anecdotes they recount.

1. First, allow us to dispose of a few technical points. According to FEF:

> 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 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

* More fully, "How to change a constitution by handwaving (or the unbearable lightness of evidence in support of lifting foreign ownership restrictions", Discussion Paper 2024-01, University of the Philippines School of Economics. The paper is available through https://econ.upd.edu.ph/dp/index.php/dp/article/view/1552.

[1] https://fef.org.ph/wp-content/uploads/2024/04/FEF-Rejoinder-to-the-UPSE-Study-on-ChaCha.pdf

[2] Those interested in a more wonkish explanation may wish to refer to footnotes 7, 31, and 32 of our discussion paper, where we distinguish between what the terms "necessary" and "sufficient" may mean in the context of regression analyses.

> 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." [pp. 2-3, emphasis added]

COMMENT: In fact, in the studies cited by the proponents themselves, the variable representing equity restrictions is *not* consistently different from zero. In what we regard as the central and more reliable study by Parcon-Santos, Amador, and Romarate [2021] of the Bangko Sentral, the index of equity restrictiveness is *insignificant* in four of ten regression specifications once other variables such as indices of rule of law, ease of doing business, telecoms infrastructure, and road infrastructure are included. (See Table 2, p. 13 of the discussion paper.) This is hardly what one would call a "necessary" condition.

FEF's second technical point concerns our interpretation of the regression coefficients. Unfortunately, this criticism is also misplaced. The estimated coefficients from the model employed in the three papers are simple *elasticities*.[3] Elasticities are pure numbers (unitless) and are therefore comparable regardless of the "width of the norm for each [index]". Thus, if a one-percent improvement in the Equity Index is associated with a 0.77 percentage increase in FDI stock, and a one-percent improvement in the Corruption Perception Index is associated with a 6.5 percentage increase in FDI stock, then FDI stock is about 8 times more sensitive or responsive to changes in the latter variable than the former variable.[4]

2. To "go beyond theory"[5] and to instruct us about history and context, FEF instead cites the renewable (RE) sector as a good example of how removing equity restrictions can encourage foreign direct investments:

> 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." [p. 3]

COMMENT: Indeed "opening the door" can result in increased investment. But the case of liberalizing RE is precisely an example of how binding restrictions may well be located not in specific provisions of the Constitution but in the maze of fragmented, poorly crafted or poorly applied rules, and poor coordination that beset the business environment of various sectors.

As a point of fact, the sector of kinetic renewable energy was "liberalized" not by amending the 1987 Constitution but by correcting and refining a loosely-worded administrative rule promulgated by the Department of Energy (DOE) in 2009. Specifically, in writing Section 19 of the IRR to the RE Law (RA 9513), the DOE seems to have conflated "kinetic energy"—water, wind, solar, marine current, and the like—and "forces of potential energy", a natural resource. The IRR thus subjected RE development to the forty-percent foreign equity limitation under Section 2, Article XII of the Constitution. The current DOE leadership proactively corrected this misinterpretation and

[3] See p. 11 of our paper: ""Owing to the specification of their models, almost all of the estimated coefficients generated by the PPML in the cited papers are simple "elasticities" which measure the responsiveness of the variable to be explained to changes in the explanatory variables included in the regression…"
[4] Technically, this means that FDI stock is in fact *inelastic* with respect to the Equity index and *elastic* with respect to the Corruption Perception Index.
[5] We can only note the oddness of regarding empirical studies as "theory".

promulgated amendments to the IRR in November 2022, removing the foreign ownership limitations imposed by a previous DOE. [6, 7]

The improved ranking of the Philippines among emerging markets in BloombergNEF's *Climatescope 2023*—from #10 (in 2022) to #4 (in 2023) worldwide, and from #4 (in 2022) to #3 (in 2023) in the Asia-Pacific region—seems to have been propelled by better regulatory coherence and coordination in the sector as well.[8] The report reads: "Fourth place goes to the Philippines, which appears in the top-five list for the first time thanks to its auctions, feed-in tariffs, net-metering schemes, tax incentives and strong targets for renewable energy" [BloombergNEF 2023:5].

The current DOE continues to address long-standing coordination problems. Executive Order No. 21, s. of 2023, signed 19 April 2023, establishes the policy and administrative framework for offshore wind development and explicitly directs 26 permitting agencies to get their act together (e.g. strictly observe time frames, rationalize fees, and the like) in support of the DOE. The correction to the IRR is also expected to contribute to the growth in offshore wind investment.[9] Future studies may be able to better establish the relative contribution of these critical interventions.

Far from showing the "necessity" of lifting constitutional equity restrictions, therefore, the example of renewable energy cited by the FEF demonstrates how much foreign investment can result from merely clarifying the definition coverage of simple statutes and improving the regulatory environment in a sector.[10]

3. Presumably to provide further "context", the FEF also draws a link between lifting equity restrictions and improving the level of competition in the economy:

> 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 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." [p. 6]

COMMENT: "Historical" facts first: Dito Telecommunications entered the bidding for the telecommunications market in 2018, well before the amended Public Services Act (RA 11659) was passed (in 2022). It did so as a 60-40 venture between Mr. Dennis Uy and China Telecom, that is, under the *existing* constitutional restrictions on foreign ownership. Hence this particular anecdote "proves" nothing about the restrictiveness of existing constitutional provisions nor anything about congressional flexibility, since Dito's entry required no congressional action or amendment to the constitution.

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[6] Citing Angeles, J. L. [2020] "Revisiting foreign investment limits on renewable energy contracts in light of the text and context of the 1987 constitution", *Philippine Law Journal*, 93(4), 962-978, DOE argued that kinetic energy is not a 'force of potential energy' nor a natural resource as contemplated in the Constitution, See DOJ Opinion No. 21 series of 2022 (September) [https://doj.gov.ph/opinion.html?y=2022].

[7] The amended IRR was released through DOE Department Circular No. 2022-11-0034, signed November 15, 2022. Application procedures for RE Service/Operating Contracts followed in the first semester of 2023.

[8] Available at https://www.global-climatescope.org/

[9] "The Philippines' release of an offshore wind roadmap and no foreign ownership restrictions have encouraged growth in offshore wind investment." [Bloomberg NEF 2023: 71].

[10] Looking further ahead, if it were so inclined, Congress could even now allow 100-percent foreign ownership of nuclear power facilities simply by amending provisions of RA 5207.

As for the entry of Starlink, i.e., the availability of satellite-based telecommunication services, the relative newness of the technology (Starlink first launched satellites in 2019) partly explains the recent timing of investor interest. For us in any case, what it demonstrates is the already-existing openness of the environment for foreign investment, especially under the amended Public Service Act. Indeed, as a further "history" lesson, Starlink was approved by the National Telecommunications Commission as a value-added service (VAS) in May 2022, even *prior* to the release of the IRR for RA 11659. [11] How this particular anecdote demonstrates the necessity for constitutional amendment, therefore, remains unclear.

Any future concern for competition in the telecommunications sector should focus not in fiddling with the constitution but in regulatory reforms. The World Bank [2018: 10] that the FEF itself cites notes that: "NTC's lack of regulatory power to foster competitive market conditions has resulted in suboptimal market outcomes."[12] Also: "Competition will still be restricted if incumbents/public entities can influence regulated rates due to lack of [in]dependence of [the] regulator and local-loop unbundling is not regulated." [ibid: 61]

More generally, in the matter of competition, the myriad rules and regulatory restrictions embedded in key sectors is the main subject of the cited World Bank [2018] report. The report attributes concentration in various markets to state control (41 percent), barriers to entrepreneurship (36 percent), and barriers to trade and investment (23 percent). Constitutional and other explicit barriers to trade and investment are lumped under the last category and account for one-fourth of its score (i.e., about 5.75 percent).[13] Hence again, lifting constitutional restrictions as a condition for enhancing competition appears to be overshadowed by weightier factors.

Finally, having been admonished to be mindful of "context", we cannot now neglect the work of National Scientist Raul Fabella, who has argued for a more nuanced view of the significance of firm size and market dominance in the specific conditions of the Philippines.[14] Essentially, Professor Fabella argues that unlike simple monopoly of the textbooks, many large Philippine conglomerates ("conglopolies", in his words) strive to attain size and market share in several sectors as an adaptation to imperfect capital markets and a weak system of third-party legal enforcement, as well as a defense against possible government harassment and predation. In a weak institutional environment, Fabella argues, large and diversified conglomerates are not only inevitable but also functional, i.e., "beautiful". To point to mere large scale and share as being inherently inimical to public welfare without identifying the deeper institutional failures that render those traits adaptive is to mistake the effect for the cause. None of this is to deny that competition problems do exist: indeed Fabella advocates intense competition among such large conglomerates. What his ideas point to, however, is the need for a deeper understanding of the true causes of observed firm size and weak competition before one proposes blanket solutions and panaceas. Context, indeed, is important.

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[11] The IRR of R.A. 11659 were released in March 2023. Although VAS are not subject to foreign equity restrictions, Starlink, a wholly-owned subsidiary of SpaceX, required R.A.11659 prior to entry because of "satellite and spectrum issues" [personal correspondence].

[12] World Bank [2018] *Fostering Competition in the Philippines: The Challenge of Restrictive Regulation*. Washington, D.C.

[13] WB [2018:5]. About 30 policy options are listed to address these barriers and "eliminate FDI restrictions in key sectors" is one of six that are economy-wide [ibid: 12-15]. Among the sector-specific options, the report has much to say about transport regulators (e.g. Philippine Ports Authority, Civil Aeronautics Board, LTFRFB) and state-owned enterprises (e.g. Philippine National Railways), as well as price controls and other restrictions (e.g. advertising, marketing) in regulated professional services.

[14] See, R. Fabella [2016] "Conglopolistic competition in small emerging economies: when large and diversified is beautiful", University of the Philippines School of Economics Discussion Paper 2016-05. Available from: https://econ.upd.edu.ph/dp/index.php/dp/article/view/1492.

4. It is interesting therefore that the FEF does cite Professor Fabella in another connection:

> 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." [p. 4, emphasis added][15]
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> 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**." [p. 5, emphasis added]

COMMENT: These two assertions are strong hypotheses that can and ought to be subjected to testing. The first seems to be a hazardous claim.[16] The second is something we think was already reasonably settled by our analysis of the three empirical papers in our discussion paper, which compared the potential effects of statutory equity restrictions on FDI. This is the closest to an empirical test that we have; it behooves FEF to provide evidence to the contrary.

5. Finally, the FEF paper reiterates why constitutional change should be put on the agenda at this time ahead of other reforms:

> 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? … 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." [p. 4]

COMMENT: The impression conveyed here is that Constitution has "shut" the doors on foreign investments ("barred from the get go"). To put things in proper context, however, one must recall that only the ownership and management of *mass media* (excluding recording and the internet business) and the use of *marine resources* (and small-scale use of resources in smaller bodies of water) are reserved exclusively to Filipino citizens under the Constitution. [17] In most other sectors, the door is and has for some time been open from a partial 30 percent (e.g. advertising) and 40 percent (e.g. public utilities), up to 100 percent (e.g., manufacturing, wholesale, resale, financial services, etc.).

[15] The anecdote continues: "… 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 …. 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."

[16] We leave it to others to dissect the PIATCO case minutely. The only thing we are sure of is how hazardous it would be to claim that no corruption would have occurred if only the project had been 100-percent foreign-owned. And even more perilous to assert that the PIATCO experience could be generalized to all joint ventures between foreigners and Filipinos.

[17] E.O. 175 s. of 2022, the 12th Regular Foreign Investment Negative list. EO 175 enumerates 11 activities for which "no foreign equity" is allowed. Of the 11, only four are restricted by the Constitution, without any qualification: mass media (Section 11, Art. XVI); marine resources (Section 2, Art. XII); activities relating to nuclear material; and those relating to biological, chemical, and radiological weapons (Section 8, Art II). In the latter two items, even domestic investments are prohibited. The other seven are restricted owing to ordinary laws; the practice of professions is restricted except if subject to reciprocity as provided in pertinent laws.

Even the definition of "public utilities" covered by equity restrictions in Section 11, Article XII of the Constitution has since been narrowed via RA 11659 to cover only electricity distribution and transmission, oil pipelines, water pipelines and sewerage, seaports, and public utility vehicles. These are the sectors at stake in the current economic cha-cha debate.

In this connection, it is puzzling that to illustrate the insufficiency of mere changes in statutes, the FEF should bring up the issue of ten seaports that "must be built to transport and build tools and machinery like turbines for wind energy, solar panels and batteries". Despite the liberal regime in renewable energy, the argument goes, constitutional change is still required to remove equity restriction on those urgently needed seaports if the supply chain in the RE industry is to be adequately supported. What makes this example curious is that the equity restriction on seaports is not a constitutional matter. It was Congress that categorized seaports as a "public utility" when it promulgated RA 11659. In any event, if following FEF's entreaties, Congress were to change its mind and now want to allow greater foreign equity in seaports, all it would have to do is amend RA 11659.

More generally, however, we think it speaks to our point about the real barriers to foreign investment that FDI has been tepid *even in areas where no equity restrictions exist*. This is especially true for manufacturing, to which conventional wisdom still assigns the key role in industrialization and development.[18] To us, this only reiterates the main point that equity restrictions are not the binding constraint on foreign direct investment in the Philippines.

In the final part of the text quoted above, the FEF response argues that amending Section 11, Art. XII of the Constitution will be more expeditious and require far less effort and time than, say, improving corruption perceptions (among other governance reforms, presumably). FEF also suggests that amending the Constitution is the necessary, if not singular credible signal that the Philippines is committed to FDI.[19]

Based on the empirical evidence reviewed in our original paper—and even including the cases of the renewable energy sector and Starlink brought up by the FEF—it is our view that the key to gaining investor confidence is rather mundane: palpable improvements in sector coordination, fair regulation, and lower perceived corruption, as well as amendments to long-standing administrative rules and ordinary statutes that impede market entry and distort the playing field. Nor should we overly mystify the problem of corruption and exaggerate the social effort needed to make headway against it. The goal after all is not a governance utopia, and historical experience has already demonstrated how the required improvements in corruption perception are well within reach.[20]

The efforts involved in such quotidian reforms must be compared to the deep social divisions and mistrust that have perennially accompanied all attempts at charter change from Ramos to Duterte—attempts that are resisted by popular opinion even now and whose advantages may be ephemeral beyond sending singular "signals".

Both history and context make the choice between them obvious.

[18] This conventional wisdom however has itself been the subject of rethinking in the light of emerging technologies. See for example R. Baldwin and R. Forslid [2023] "Globotics and development: when manufacturing is jobless and services are tradable", *World Trade Review* 22: 302-311.
[19] "There is a need to signal that the Philippines is open to FDI and demonstrate a "credible commitment" to this economic framework." [FEF p.4]
[20] See p. 17 and footnote 39 of our discussion paper.