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People economics
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Our destructive foreign investment fetish

There's been a flurry of foreign investment laws in the twilight months of the Duterte administration. The Retail Trade Liberalization (RTL), Foreign Investment Act (FIA), and Public Service Act (PSA) amendments were signed into law within weeks of each other. These all passed on the strength of a powerful argument – that the country is in desperate need of foreign investment, and more foreign investment is always a good thing.

The argument is compelling – but wrong. If anything, the foreign investment fetish is keeping Filipinos poor and the economy underdeveloped. Is foreign direct investment (FDI) the magic bullet for development that it is so often made out to be? Not really, if we look at the Philippine experience with unjaundiced eyes.

FDI flows

The lament that the Philippines is an FDI laggard in the region is enough to make many want to give everything to foreign investors just so they'd come to us instead of to Vietnam, Thailand, Indonesia, Malaysia or anywhere else in Southeast Asia. Never mind that every government in the region doing the same thing really just means a race to the bottom to make foreign investors happy while giving up any development gains for domestic economies.

But this distracts from how the country is actually already seeing much more FDI now than ever – yet despite this, is still very much underdeveloped.

The country has been opening up to FDI since the Marcos dictatorship, for instance with the first export processing zones (EPZs) it opened in the early 1970s, and then through decades of World Bank and International Monetary Fund programs, under World Trade Organization (WTO) agreements, and many domestic laws including the recent trio that the Duterte administration passed.

Foreign investment has increased in absolute terms and as share of gross domestic product (GDP) since the 1970s. Inward FDI flows were at an annual average of some US$80 million in the 1970s (1970-1979) and then reached an average US$6.2 billion over the last decade (2012-2021). Its equivalent share in GDP quadrupled from a little less than 0.5% to 1.9% over that same period.

The inward stock of FDI has increased eighty-fold from US$1.3 billion in 1980 to US$103.2 billion in 2020, and its share to GDP increased eight-fold from 3.6% to 29.9% over that period. These are not piddling amounts of foreign investment.

Yet, looking at the share of manufacturing and agriculture in the economy, the economy is down to its weakest in 70 years.

The bulk of FDI goes to manufacturing. Yet this shrank to 18.6% of GDP in 2020 – its smallest share since 1950 – with only a marginal increase to 19.2% in 2021. Agriculture falling to 9.2% of GDP in 2019 is the smallest in history, though increasing incrementally to 9.6% in 2021.

Manufacturing and agriculture in structural decline explains the lack of jobs in the country. The last five to six years which saw record FDI coming in actually also saw the weakest annual average job generation of seven post-Marcos administrations. Annual average net employment creation fell to 313,000 in 2016-2019 – even before the pandemic and the government's destructive lockdowns – compared to annual averages of 355,000-902,000 in previous five-year periods.

When opening up to FDI started in the 1970s, we were a poorly diversified economy with high unemployment, mostly low-productivity, low-paid or low-earning jobs, and mainly low value-added primary and labor-intensive goods exports.

After over four decades of FDI coming in, we're still a poorly diversified economy with high unemployment, still mostly low-productivity, low-paid or low-earning jobs, and still mainly low value-added primary and labor-intensive goods exports.

The economy's fundamental character has not changed although there is now also an over-reliance on overseas work and an expansion of FDI enclave special economic zones (SEZs) disconnected from the domestic economy (including cheap labor-intensive business process outsourcing services). Any increase in foreign investment from relaxing foreign ownership restrictions will actually not make any difference.

Less is more

Believers will argue that the problem is that the Philippines just hasn't opened enough to FDI. Setting aside the desperation of this line of reasoning – because surely the increase in FDI should have improved the economy even by just a little if it was as magical as believed – it turns out that FDI isn't really as essential as it's made out to be.

The simple truth is that economies have actually developed with much less foreign investment than the Philippines has today. Just here in Asia, the last real industrializers South Korea, Taiwan and China actually had less foreign investment in their periods of economic take-off than we do today.

South Korea and Taiwan took off in the 1970s and early 1980s. Annual FDI inflows averaged just 0.5% of GDP in South Korea and just 0.4% in Taiwan then (in 1970-1984). China's acceleration to double-digit growth in the 1990s started in 1980-1989 when annual FDI inflows averaged just 0.5% of GDP. The Philippine has three times more in relative terms today at over 1.5% of GDP in 2005-2019.

By the early 1980s (1980-1984), FDI inward stock in South Korea was 1.7% of GDP and in Taiwan 5% of GDP. In China, FDI inward stock was just 0.7% in the early 1980s and 3% in the late 1980s. Again, the Philippines has much more today at 23.1% of GDP in 2015-2019, or 5-14 times more.

FDI fanatics ignore how the Asian industrializers' economic take-off happened while they were heavily regulating foreign investment. More to the point, the Asian industrializers' economic take-off happened because they were heavily protecting and supporting national capital rather than desperately seeking foreign capital.

Counterflow

Our lawmakers and economic managers like to argue for FDI liberalization by saying that the country will be left behind without this. This is however being oblivious to global trends which, on the contrary, are going in the opposite direction.

While the Philippines is relentlessly opening up to foreign investment, global FDI policy changes are increasingly towards restrictiveness. The United Nations Conference on Trade and Development

(UNCTAD) World Investment Report 2021 pointed out how the number of restrictive investment policies is rising worldwide and already the highest on record.

And it's mainly the developed economies which are becoming more restrictive. If developed economies see the need to more strongly regulate investment – with their more developed domestic firms – this makes it even more odd that underdeveloped Philippines is insisting to go in the other direction. What does not kill us will make us weaker.

FDI liberalization is both lazy and bad economics. It is lazy economics because it is being used as a substitute for the necessary but painstaking strategic agricultural development and industrialization that has served developed countries so well. It is bad economics because no country has ever developed from backwardness on the back of indiscriminate FDI liberalization.

It's long overdue for the Philippines to learn from decades of failed globalization as well from the successful use of regulations and restrictions on foreign investment.

FDI flaws

What is to be done? FDI must be put in its proper context as a mere means to development and not an end in itself, which is what our economic policymakers dogmatically make it out to be.

It's understandable that foreign investors crow about openness because they're after opportunities to profit. Our government, however, should be seeing the bigger picture and thinking about the country's long-term development. Two things have to be borne in mind.

First, more is not always better – the real question is whether foreign investment is contributing to developing Filipino industry.

The Philippines is not underdeveloped because of strict FDI regulations -- it's underdeveloped because the government doesn't want to protect, support and invest in domestic agriculture and Filipino industrialization.

The country must begin from having a strategic program for national industrialization, agricultural modernization and publicly-provided social services. Without this, opening up to foreign investment just to report higher investment figures will mean one-sided gains for foreign investors and only token short-term gains for the national economy.

There's a lesson from Intel's US$1.5 billion in investment (peak 1,500 employees), Hanjin's US$2.3 billion (peak 34,000 employees), and even the US$4.5 billion Malampaya project with Shell/Chevron. After 35 years of Intel (1974-2009), 12 years of Hanjin (2006-2018), and 21 years running of Malampaya (since 2001), the Philippines still does not have a Filipino electronics, shipbuilding or natural gas industry.

The lesson is to stop obsessing with the wrong metrics of success. The real measure of FDI's contribution to development is not the headline-friendly quantity of investment, firm employees, or even exports.

It's how much technology is transferred, the opportunities created for local content suppliers, reinvestments in the wider economy, and other long-term contributions to domestic economic development. Has FDI increased domestic productivity, created value chains and diversified local production? Have they reduced our imports while increasing our exports? We should be looking for these broad-based long-term macro benefits and not just fixate on short-term firm-specific investment and employment quantities.

These critical benefits won't materialize without judicious regulation and, much less, with 100% foreign ownership. The experience of literally every developed country with FDI in their respective periods of economic take-off affirms this.

In contrast, the absence of any meaningful industrialization by underdeveloped countries liberalizing since the 1980s affirms the folly of doing otherwise. The Philippine deindustrialization experience of the last 40 years is shared by underdeveloped countries around the world.

Second, letting foreign investors entrench and take over more of the Philippine economy actually jeopardizes domestic economic development.

We will be even more unable to develop domestic enterprises and more dependent on foreign capital. Once foreign firms take root, it will be even more difficult for Filipino firms to emerge and compete. This means that the economic benefits of higher productivity, using domestic natural resources and labor, and selling to the local market will accrue mainly to foreign firms – that, moreover, will likely have low value-added and limited links to the domestic economy.

The 100% foreign ownership is particularly dangerous if the Philippines does not have the ability or even interest to benefit from, control and regulate foreign investment in the country. Foreign capital will always prioritize their narrow self-interest over national development. Any foreign dominance over major sectors means foreign firms having disproportionate influence over domestic economic policymaking.

Alarmingly in the case of critical infrastructure, public utilities like telecommunications and transport will be vulnerable to malign foreign activity. Which is why passing the amended PSA is one-step-forward-two-steps-back for the country.

The national security costs are unquantifiable. Telecommunications and transport are critical infrastructure that are prime levers for strong-arming the economy and prime targets for espionage, sabotage, and other self-serving interventions. Much more developed countries like the United States and China with much more developed domestic utility firms continue to protect these sectors.

This underscores how important national control is even in the face of persistent globalization hype. We shouldn't completely open up areas of the economy to foreign capital that we ourselves do not yet more fully grasp, control and provide.

Open carefully

Opening up to foreign investment should depend on a combination of, first, how developed domestic enterprises are and, second, the capacity of the state to regulate investment to ensure long-term gains for the national economy.

We're unfortunately weak on both counts in industrial firms and, especially, in the public utilities being liberalized. As they were, the 1987 Constitution's restrictions were effective and economical means to protect critical sectors and removing them puts the country at a disadvantage.

The 1987 Constitution's restrictions are the best safeguard against foreign control. Non-equity ownership regulatory controls or leaving the definition of "public utility" to be protected to Congress only works if regulatory authorities and Congress have the requisite technical capacity, which they don't, and are independent from vested foreign economic interests, which they aren't.

In the case of the PSA, the 1987 Constitution's restrictions should be seen as giving the opportunity to develop robust Filipino capacity in telecoms, shipping, airports and airlines, and railways. Relaxing them in favor of foreign investors is a decision to forego developing this entirely with adverse long-term economic and national security implications.

The investment liberalization laws of President Rodrigo R. Duterte mark his administration's signal contribution to the country's decades-long trajectory of neoliberal economic decline. Will the new administration have any new ideas?

Unfortunately, our politicians and policymakers are chronically captive to obsolete “free market” globalization thinking. The dogmatic close-mindedness is the biggest barrier to real industrialization, agricultural modernization, and national development.

History certainly does not give any reason to be optimistic. The country’s administrations have swung from outright dictatorships to so-called democratic restoration to today’s demagogic populist authoritarianism. Yet what has been consistent amide wide swings in political dispensations is the linear trajectory of neoliberal policies and economic decline.

Hence another lesson – change won’t come from changes in administrations without deeper changes in the balance of political power in favor of the many. ###

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