Facilitating FDI by improving the Philippine investment negative list

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Every two years, the business community, especially the foreign investors, looks forward to the release of the Philippine foreign investment negative list (FINL). Aside from serving as a compilation of business activities reserved for Philippine nationals, the list also guides foreign investors on the business areas open to them. Their aspiration is for the list to be shorter as this means that the country is opening up to foreign participation and becoming more welcoming to their investments.

In its current form, the FINL only contains information on the percent share of allowed shareholding. Foreign investors, however, are interested in the whole investment regime, including its overall restrictiveness and its potential impact on their investment. They need to know all the regulatory measures that affect them and their investment from establishment, operation, and disposition. From a transparency perspective, such information should be made available and accessible to the public in a form that is easy to understand.

This Policy Note revisits the policy objective of the Foreign Investment Act (FIA) and the implementation of FINL as a transparency tool in the Philippines. It highlights the need to improve the information content of the FINL to capture the full picture of the country’s investment regime and help facilitate the inflow of foreign direct investment (FDI).

Current foreign investment negative list
The FINL functions as a guide to foreign investors. As a negative list, it contains all activities where foreign investment is either prohibited or limited. When the activities are not in the list, it means these are open to 100-percent foreign ownership. This makes the FINL a transparency tool that keeps things simple and clear to those intending to invest in the Philippines.

The regular FINL consists of two parts. The first section, List A, enumerates the activities where foreign equity participation is restricted as prescribed under the 1987 Philippine Constitution and other existing laws. Meanwhile, the second section, List B, specifies the activities where foreign participation is limited up to 40 percent for reasons of public health, public morals, national security, national defense, and the protection of small and medium enterprises.

The first regular FINL was issued in 1994, three years after FIA was enacted in 1991. Given the policy goals
of FIA to attract and promote foreign investment in the country, the law mandates the National Economic and Development Authority (NEDA) to formulate and recommend the FINL to the president every two years. As the last FINL was issued in 2015, NEDA has already prepared and submitted the 11th FINL to the Office of the President, where it is awaiting approval.

The extent of change in the FINL, however, depends upon the policy reforms done before the formulation stage. Given that the FINL is based on the Constitution and existing laws, including the FIA itself, any change to the list would only be possible had there been an enactment of new laws or amendments in existing laws that alter the limitations on foreign participation.

Likewise, the effectiveness of the FINL as a transparency tool on foreign investment is restrained by policy design limitations in the FIA itself. As it is, the focus of the FINL is on the restrictions that apply to foreign capital in terms of shareholding only. It does not take into account regulatory measures that have cross-cutting implications on all sectors and activities, such as limitations on the citizenship of board of directors and economic needs test on employment of foreign nationals. Banks and other financial institutions under the General Banking Act and other laws under the ambit of the Bangko Sentral ng Pilipinas are also excluded from its scope.

Increasing transparency in investment
As stated earlier, foreign investors are interested in the whole gamut of restrictions that may apply to them. That is why in free trade negotiations, for example, discussions cover all types of regulatory measures that limit participation and discriminate against foreign investors or service suppliers, whether they be individuals or companies. This highlights the importance not only of a freer but also a more transparent environment.

Take the case of the General Agreement on Trade in Services (GATS), the multilateral agreement pertaining to trade or supply of services, which came into force in 1996. Its main concern is on regulatory measures that restrict market access and discriminate against service suppliers and investors from other countries. Based on its Article on Market Access, restriction on foreign shareholding is but one aspect of market access limitations. The other types of limitations include (1) limitations on number of service suppliers, (2) limitations on the value of transactions or assets, (3) limitations on the total number of service operations, (4) limitations on the total number of natural persons (i.e., individuals) that may be employed, and (5) measures requiring specific type of legal entity or joint venture. The economic needs test as applied to any of these is also considered a limitation.

The trade negotiation perspective propounds a framework that can help us understand how regulatory measures affect foreign participation. This approach widens the usual notion of what is considered restrictive, which often is associated with ownership or equity restrictions. It articulates the presence of other regulatory measures that (1) have as much impact as equity limitations on foreign participation and (2) can affect them at the pre- and post-establishment phases of operation. Taken together, these measures bear upon the decision-making process of foreign investors.

Discussions in trade negotiations, specifically on services and investment, can serve as barometer on the values attached to the different types of regulatory measures. As observed, these values have shifted toward the demand for a greater level of transparency on regulatory measures that can materially affect foreign investors and service suppliers. This shift is apparent in the new wave of free trade agreements, known as 21st century agreements, which recognize that regulatory measures have significant effect on foreign participation far wider and greater than what the GATS covers.

Hence, in new generation trade agreements, its member-countries are tasked to identify and specify regulatory
measures that have a bearing on service supply and investment, such as those that
• discriminate between own national and foreign nationals;
• discriminate treatment among foreign nationals;
• attach conditions or additional requirements to investments of foreign investors;
• require citizenship and/or residency on those involved in governance and management of a foreign company;
• impose quantitative restrictions and limitations on the type of entity; and
• prescribe conditions for cross-border supply such as local presence.

As such, trade agreements include annexes on reservation lists of member-countries that reveal the variety of regulatory measures imposed on foreign participation going far beyond equity limitation (Table 1).

The demand for improved transparency in free trade negotiations shows that enhancing the country’s transparency regime on policies affecting investment is critical for attracting and promoting foreign investment as this helps potential investors make informed decisions.

Relationship between investment and transparency

In a report, the Organisation for Economic Co-operation and Development (OECD) (2003) emphasized the correlation between investment and transparency. According to OECD (2003), transparency is associated with increased investment flows and higher quality of investments as investors, especially foreign investors, demand greater stability and predictability in the policy and regulatory environment. Specifically, it serves as an instrument to curb potential abuse of authority by making both actors in the government and business accountable for their actions (OECD 2003; Molienuevo and Saez 2014). The OECD added that a transparent policy environment can significantly reduce the cost of doing business and minimize investors risk perception.

As such, countries that aim for both an increase in the level of investment and higher quality of investment should foster a fair, open, and accountable policy environment (OECD 2003).

The FIA sets the right direction in institutionalizing the issuance of the FINL on a regular basis. It likewise improves the transparency regime by going beyond merely making the laws and regulations publicly available and accessible. Through the FINL, for instance, relevant information on equity participation or limitation has been sifted from the file of laws that have not been codified yet, not to mention that some of these date back to the Commonwealth period.

However, although the FINL already provides some level of transparency, it still falls short of rendering a full picture of the country’s investment regime. In fact, it does not capture other regulatory measures that restrict engagement in an investment activity, such as the limitations on the number of suppliers or divestment requirements. In addition, it leaves out other relevant information to foreign investors, such as exceptions to the general rule (e.g., where foreign participation may be allowed in specific cases or circumstances). As such, potential foreign investors still have to do further work to search for these information, which entails additional costs on their part and adds to the risks of doing business in the Philippines.

Conclusion

As discussed, while the information included in the FINL is already useful, it is but one dimension of the many limiting regulations that impact investment decision. Other equally critical information are not readily available to investors to enable them to make well-informed decisions.

In an ever-increasing level of global competition, improving the transparency environment should be a priority of the government. Other countries have already done so by listing the nonconforming measures annexed
Table 1. Means by which countries impose discriminatory treatment against foreign nationals

<table>
<thead>
<tr>
<th>Restrictions on Foreign Nationals (in sectors, subsectors, industry, or activity)</th>
<th>Engagement in Private or Public Sector Activity</th>
<th>Land Ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Ownership</td>
<td>• Exchange control</td>
<td>• Land lease</td>
</tr>
<tr>
<td>• Type of legal entity</td>
<td>• Economic need</td>
<td>• Land rights</td>
</tr>
<tr>
<td>• Type of person (natural or juridical)</td>
<td>• Contribution to economy/subject to determination (net benefit, public interest)</td>
<td>• Nationalization</td>
</tr>
<tr>
<td>• Forms of entry</td>
<td>• Distribution channel (through commercial arrangement with domestic provider)</td>
<td>• Divestment of ownership/equity</td>
</tr>
<tr>
<td>• Number of operators/suppliers</td>
<td>• Priority to citizens and nationals</td>
<td>• Exchange control</td>
</tr>
<tr>
<td>• Number of licenses</td>
<td>• Preemptive right (i.e., in case of transfer of right)</td>
<td>• Approval (merger, expansion, relocation)</td>
</tr>
<tr>
<td>• Quantity supplied</td>
<td>• Residency</td>
<td>• Rules on access to database</td>
</tr>
<tr>
<td>• Approval/screening</td>
<td>• Legal representative</td>
<td></td>
</tr>
<tr>
<td>• Authorization/certification</td>
<td>• Number of (i.e., students)</td>
<td></td>
</tr>
<tr>
<td>• Concession</td>
<td>• Local incorporation</td>
<td></td>
</tr>
<tr>
<td>• Registration</td>
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Source: Author’s compilation

In this light, the Philippines should already consider enhancing its transparency for investment. It may start, for instance, by improving the information content of FINL. At the moment, however, it may be constrained to immediately effect this because changing the provision in the FIA on what the FINL should contain necessitates an act of Congress. Notwithstanding, the executive department can call upon its departments and agencies to come up with a transparency list to supplement and address the deficiencies of the FINL. The Philippines can refer to the general template on the negative list as used in trade agreements for guidance and basis.

References