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# Sustaining foreign direct investments (FDIs) in the Philippines

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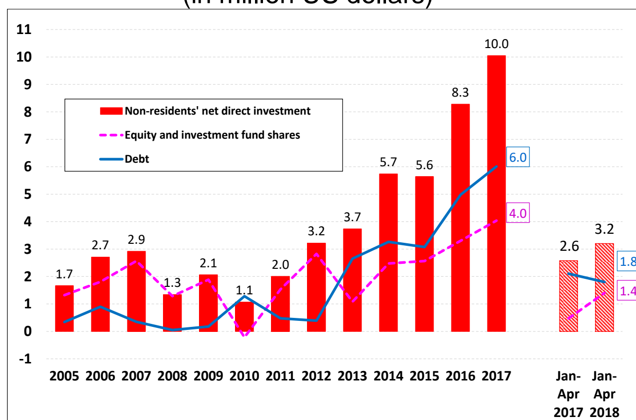
Heightened interest on FDIs and how the Philippines can sustain such flows were sounded off by both investors and policymakers. In 2017, FDI net inflows recorded an all-time high level of US$10.0 billion, while for the period January-April 2018, it recorded US$3.2 billion (Figure 1 and Table 1). This developed on the back of significant inflows of foreign equity and investment fund shares (i.e., equity and reinvested earnings) as well as debt instruments (i.e., intercompany borrowings/ lending). The strong FDI performance was also achieved in the midst of government programs and reforms that are geared toward attracting foreign investments into the country. Remarkably, FDIs flowed into the country amid a nascent global economic recovery, geopolitical noise, diverging monetary policies and increasing protectionism in advanced economies.

**Figure 1. Non-Residents' Direct Investment, by Instruments: 2005–April 2018**
(in million US dollars)




Source: BSP

In terms of FDI source countries, for the first four months of 2018, net equity capital placements originated mainly from Singapore, Hong Kong, China, Japan, and the United States.

These developments may be seen as an indication of investors' continued positive outlook on the Philippine economy on the back of sound macroeconomic fundamentals and robust growth prospects.

With its recent strong showing, FDI flows into the Philippines are expected to continue from the robust levels achieved in 2016 and 2017. The expectation is in line with the sustained positive developments in the domestic economy where gross domestic product grew by 6.7 percent in 2017 and 6.8 percent in Q1 2018, the projected improvement in global economic conditions in 2018 relative to 2017, as well as the implementation of priority infrastructure projects that were approved and awarded in the previous years.

**Table 1. Net Foreign Direct Investment, by industry: 2010–April 2018** (in million US dollars)

| INDUSTRY/SECTOR | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017[P] | Jan-Apr 2018 | Share to total (in %) |
|---|---|---|---|---|---|---|---|---|---|---|
| MANUFACTURING | (1,275.2) | 119.4 | 1,770.3 | 216.4 | 209.2 | 772.7 | 334.3 | 1,149.9 | 505.8 | 44.6 |
| FINANCIAL AND INSURANCE ACTIVITIES | 59.6 | 222.2 | (200.0) | (377.0) | 889.8 | 522.5 | 1,126.1 | 138.5 | 245.9 | 21.7 |
| ARTS, ENTERTAIMENT AND RECREATION | 104.1 | 3.6 | 4.4 | 167.3 | 0.4 | 4.1 | 575.0 | 27.8 | 185.5 | 16.4 |
| REAL ESTATE ACTIVITIES | 181.5 | 135.2 | 164.2 | 70.5 | 153.8 | 137.9 | 121.9 | 247.8 | 121.4 | 10.7 |
| ELECTRICITY, GAS, STEAM AND AIRCONDITIONING SUPPLY | (14.8) | (22.4) | (14.2) | (27.4) | (58.4) | 9.8 | (83.1) | 1,383.7 | 26.8 | 2.4 |
| CONSTRUCTION | (1.6) | 28.1 | 8.7 | 1.7 | 6.1 | 102.6 | 8.8 | 161.2 | 16.7 | 1.5 |
| WHOLESALE AND RETAIL TRADE; REPAIR OF MOTOR VEHICLES AND MOTORCYCLES | 32.4 | 30.6 | 202.2 | 23.6 | 98.8 | 115.7 | 208.2 | (3.1) | 16.2 | 1.4 |
| ACCOMMODATION AND FOOD SERVICE ACTIVITIES | 105.7 | 3.1 | 2.6 | 6.5 | 18.1 | 5.6 | 168.2 | (34.5) | 6.3 | 0.6 |
| TRANSPORTATION AND STORAGE | 103.9 | 1.0 | 3.8 | 21.3 | 90.2 | (3.3) | 7.8 | 48.5 | 4.5 | 0.4 |
| OTHERS | 308.3 | 37.2 | 63.6 | 560.7 | 191.4 | 148.6 | 124.9 | 143.5 | 4.6 | 0.4 |
| **EQUITY OTHER THAN R.E., NET** | **(396.0)** | **558.0** | **2,005.7** | **663.7** | **1,599.4** | **1,816.2** | **2,592.1** | **3,263.2** | **1,133.8** | **100.0** |
| **REINVESTMENT OF EARNINGS** | **182.4** | **972.6** | **818.7** | **420.2** | **876.8** | **746.8** | **710.2** | **776.2** | **268.4** | |
| **DEBT INSTRUMENTS** | **1,284.0** | **476.5** | **391.0** | **2,653.5** | **3,263.4** | **3,076.1** | **4,977.3** | **6,010.0** | **1,800.0** | |
| **TOTAL** | **1,070.4** | **2,007.2** | **3,215.4** | **3,737.4** | **5,739.6** | **5,639.2** | **8,279.5** | **10,049.4** | **3,202.2** | |

Source: BSP

Through the years, accumulated stock data based on the country's net international investment position (IIP) as of end-March 2018 (preliminary), showed that total external financial liabilities reached US$205.9 billion, while total external financial assets stood at US$171.7 billion. The substantial accumulation of external liabilities was driven by investment inflows and positive revaluation adjustments, where the FDI component is shown in Figure 2.

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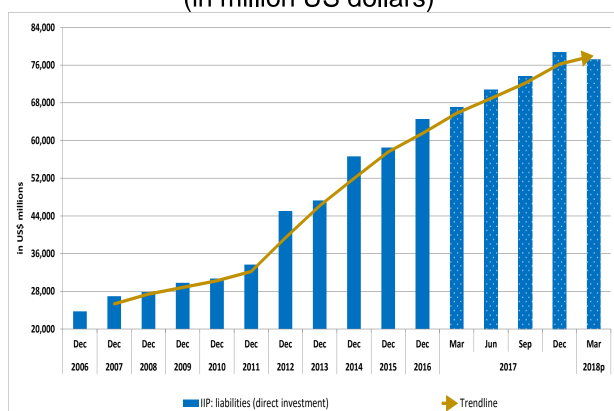
**Figure 2. Stock of Foreign Liabilities (Direct investment): 2006–March 2018**
(in million US dollars)




Source: BSP

## FDI definition, compilation and data sources

What are FDIs and why are they important? Based on the International Monetary Fund's (IMF) Balance of Payments and International Investment Position Manual, 6th Edition (BPM6) (IMF, 2009), direct investment is a category of cross border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is a resident in another economy. Operationally and by convention, a direct investor's significant influence is manifested by ownership of at least 10 percent of the company's equity shares. Less than 10 percent ownership is considered as portfolio investments.

Looking at the details of FDI data (Table 1), it can be seen that for the period 2010 to April 2018, debt instruments have consisted the bulk of FDI flows. Debt instruments consist of other direct investment capital (i.e., intercompany debt transactions) covering the borrowing and lending of funds such as debt securities and suppliers' credits between direct investors and subsidiaries, branches, and associates.

There are possible reasons why affiliates and subsidiaries utilize debt instruments or intercompany borrowings, as follows: 1) to shift resources to a business unit that experiences a shortfall and is thus easier to enforce as financial debt and repayment given the relationship of the transacting firms; 2) to shift funds within business units that utilize a common currency so as to avoid exchange rate fluctuations if sent to a foreign country that uses a different exchange rate; and 3) to aggregate funds in a business unit for investment purposes (AccountingTools, 2018).

It is also possible that there are tax or incentives considerations (Buettner & Wamser, 2007) or business decision of the parent-affiliate management. Certain debt instruments are also tradeable and thus debt obligations can be transferred to other parties.

Meanwhile, for almost five (5) years in a row (i.e., 2014-2017), equity capital infusions to the Philippines were consistently on the uptrend. Equity capital comprises equity in branches, all shares in subsidiaries and associates (except nonparticipating, preferred shares that are treated as debt securities and included under direct investment-other capital) and other capital contributions (IMF, 2009).

Reinvested earnings, on the other hand, appears to be stable. These consist of the direct investor's share (in proportion to direct equity participation) of earnings not distributed as dividends by subsidiaries or associates and earnings of branches not remitted to the direct investor. If such earnings are not identified, all branch earnings are considered, by convention, to be distributed. Because undistributed (reinvested) earnings result in additions to direct investors' equity in subsidiaries and branches, these earnings are included as direct investment capital transactions in amounts equal to (and with opposite sign) the corresponding entries recorded under direct investment income (IMF, 2009).

Data sources for the different components of FDI, as compiled by the BSP are as follows:

1) Equity capital placement
   - International Transactions Reporting System (ITRS);
   - BSP Investment Registration Records;

- o Validated press statements/media releases of companies;
- o Company disclosures and financial statements posted at the Philippine Stock Exchange (PSE) website; and
- o Financial statements filed at the Securities and Exchange Commission (SEC)

2) Equity capital withdrawals
   - o ITRS;
   - o BSP Investment Registration Records;
   - o Validated press statements/media releases of companies;
   - o Company disclosures and financial statements posted at the PSE website; and
   - o Financial statements filed at the SEC

3) Reinvestment of earnings
   - o Company disclosures and financial statements posted at the PSE website;
   - o Financial statements filed at the SEC; and
   - o FDI Survey

4) Debt instruments
   - o ITRS;
   - o External Debt Statistics; and
   - o Cross Border Transactions Survey (CBTS)

**FDIs' contributions to economic growth**

There is a rich literature on FDIs, particularly on what are the motivations for investing, impact on the sending and receiving economies and their determinants. To appreciate better the importance of FDIs, it is vital to know what are the types of FDIs and their purpose. Previous research such as by Feldstein (2000) has identified motivations driving companies to undertake different types of FDIs such as:

1) natural resource-seeking FDI—to gain access to natural resources not available in the company's home market;

2) market-seeking FDI—to gain access to new customers, clients, and export markets;

3) efficiency-seeking FDI—to reduce production costs by gaining access to new technologies or competitively priced inputs and labor; and

4) strategic asset-seeking FDI—to go after strategic assets in a local economy, such as brands, new technologies, or distribution channels.

Meanwhile, Nunnenkamp and Spatz (2004) find that for developing economies, FDIs have positive growth effects depending on the characteristics and the interaction of the host country's economy and industries.

Aldaba and Aldaba (2010) have shown that in the Philippines, FDI spillover effects are not automatically generated. Opening up the economy to FDI has contributed to the country's exports of high technology products and overall economic growth. However, the spillover effects of FDI to domestic firms have remained limited due to the domestic firms' weak competitiveness and inability to absorb the technology or knowledge being transferred.

**Determinants of FDIs**

Hornberger et al. (2011), who looked at a set of 30 empirical studies that vary in geographic coverage (i.e., some focusing on transition economies in Eastern Europe and Asia, some on Africa or Latin America only, and some on single countries), and that have been conducted since 2000, finds that: 1) market size and potential; 2) institutional and regulatory quality; and c) trade openness appear as the top three (3) main drivers of FDIs.

Another important factor is the quality of institutions and regulations in the host economy—that is, its investment climate. This factor may be an associated factor to those cited above and may take primacy for foreign companies planning to invest in the services sector. Although lowering effective tax rates can help boost FDI, the effect is eight (8) times as strong for countries with a good investment climate (Hornberger et al., 2011).

Lundan (2006) specifically examined reinvestment of earnings and the factors that encourage them. The author finds that as the stock of FDI matures globally, reinvestment will contribute a growing share of FDI flows, thus should be relevant to policies aimed at investment attraction and retention. Because the main macro-level determinant of investment opportunities is GDP growth or the difference between the rates of growth in the recipient country and the investing country, it is important to note that favorable economic conditions in the recipient country would encourage reinvestment, while favorable conditions in the investing economy would encourage repatriation.

Previous studies on FDIs in the Philippines, such as by Mercado-Aldaba (1994), have shown that trade policy plays an important role in influencing the type of FDI that a country attracts. These studies likewise show that since Philippine trade policy has provided strong incentives for import substitution, FDIs in the Philippines have become heavily oriented toward the domestic market and the country has not attracted substantial amounts of export-oriented FDIs. FDI flows into the Philippines have been largely concentrated in the manufacturing sector. The investment incentive system tends to reinforce the import substituting nature of the economy (Mercado-Aldaba, 1994).

Aldaba and Aldaba (2010) also opined that for FDI spillovers to take place, the absorptive capacity of domestic firms must be strengthened. They argued that with increasing regional economic integration in Asia, opportunities could arise from the growth of regional production networks. Thus, the authors suggested various policies such as: 1) human resource development and training; 2) industrial and technology upgrading; 3) financial support programs for small and medium-sized enterprises; 4) linkages improvement and promotion of subcontracting and outsourcing activities; 5) improvement of infrastructure and logistics and overall investment climate; and 6) capacity building and adequate funding for the trade and industry department and the Board of Investment's (BOI) investments' competitiveness and linkages program.

**Lumpiness of FDI**

FDIs, due to their lumpy nature such as the entry of big ticket items, may not exhibit a smooth upward trend if expressed as growth rates of its flow levels. FDI statistics are released to the public by the BSP on a monthly basis and correspondingly, on a year-to-date basis. Year-on-year growth rates can be affected by the timing of entry of big ticket items, with resulting base effects. Nonetheless, on a stock basis (Figure 1), FDIs are generally on an uptrend, reflective of continued good prospects in the domestic economy, e.g., sustained robust macroeconomic performance and investment grade status.

**Approved Foreign Investments (FIs) and Actual FDI data: Is There a Link?**

Figure 3 suggests that FIs may be a leading indicator for FDI. The difference between approvals and actual FDI flows lies in how approved foreign investment (FI) pledges data available from Investment Promotion Agencies (IPAs)[1] are compiled compared with those based on official BSP compilation of FDI statistics.

FIs refer only to commitments and pledges and do not distinguish the ownership share percentages, whereas FDIs are actual investments that were compiled and released in the BSP's Balance of Payments (BOP).

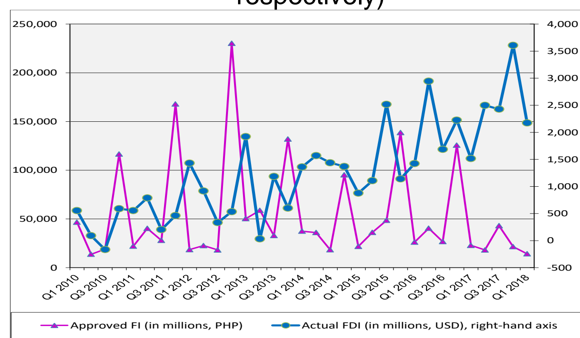
It is quite possible that approved FI pledges may:

a) not materialize at all or do not proceed as committed;

**Figure 3. Actual FDI and Approved Foreign Investments (FI): Q1 2010–Q1 2018**

[1] The IPAs are the BOI, Clark Development Corporation (CDC), Philippine Economic Zone Authority (PEZA), Subic Bay Metropolitan Authority (SBMA), Authority of the Freeport Area of Bataan (AFAB), BOI-Autonomous Region of Muslim Mindanao (BOI-ARMM), and Cagayan Economic Zone Authority (CEZA).

(in million US dollars and Philippine pesos, respectively)




Sources: BSP, Philippine Statistics Authority

b) have lags of several quarters or years from the time the pledges were approved and the actual foreign funds were inwardly-remitted to be recorded in actual BOP data; or

c) have been modified significantly in terms of design, ownership (i.e., 10 percent ownership to be considered as FDI or portfolio if less) and funding source/amount thus affecting the actual classification of industries when recorded in the BOP.

Nonetheless, the role of IPAs in attracting FDIs is very crucial as these agencies provide the incentives. While the approved investments are pledges or commitments in nature, they can be important barometer of actual FDIs.

**Reform measures to attract more FDIs**

The Philippines is currently pursuing concrete measures to address major challenges to attracting foreign investments:

*1) Easing of foreign investment restrictions*

The Philippine Constitution sets some limits to foreign ownership in the country including foreign ownership of land. While much progress has been made in eliminating trade barriers and improving trade logistics, the country's restrictive foreign ownership law[2] has been widely cited as a major obstacle in attracting stronger FDI inflows. For certain industries such as mass media, transportation and communications, the caps or limits are provided for in the Foreign Investment Negative List (FINL)[3] as stipulated by R.A. No. 7042. Increasing foreign ownership (e.g., of banks) is also believed to lead to better governance, with domestic banks benefitting from latest risk management and technologies.[4]

Nonetheless, the 11th Regular FINL aims to open up more sectors to foreign ownership/ participation. It proposes to ease existing restrictions on foreign participation in the following investment areas or activities: a) private recruitment; b) practice of professions; c) contracts for construction and repair of locally funded public works; d) public services except activities and systems that are recognized as public utilities such as transmission and distribution of electricity, water pipeline distribution system and sewerage pipeline system; e) culture, production, milling, processing and trading — except retailing — of rice and corn and acquiring these grains and by-products; f) teaching at higher education levels; and g) retail trade and domestic trade enterprises.

*2) Addressing infrastructure gaps*

The government's strong commitment toward the implementation of its massive infrastructure agenda – the Build, Build, Build program – is expected to raise the economy's growth potential. The said program is envisioned to generate an "impressive multiplier effect" on the economy – increasing the productive capacity of the economy, creating jobs, increasing incomes, and strengthening the country's investment

[2] Republic Act (R.A.) No. 7042 (Foreign Investments Act of 1991 as amended by R.A. No. 8179, 1996) states that foreigners may hold interests in corporations, partnerships and other entities in the Philippines, provided that these are not engaged in an activity that is reserved by law only to Philippine citizens or to entities that are wholly owned by Philippine citizens. The maximum amount of foreign equity that is allowed in a company depends on the type of activity that the company is engaged in. Moreover, the law stipulates that only Filipinos or corporations that are at least 60 percent owned by Filipinos are allowed to own land in the Philippines, while foreigners are allowed to lease land for 50 to 75 years depending on the land's classification. The same ownership cap is applied to nationalized activities, including media and utilities.

[3] Securities and Exchange Commission (2015).

[4] Nomura (2017).

climate. In particular, the government expects to spend more on infrastructure development to decongest Metro Manila, help improve regional connectivity and ease the cost of doing business in the entire country. These projects are envisioned to enhance connectivity, promote growth and development.

*3) Leveraging on the Philippines' young population*

The Philippines can likewise leverage on its young population as one of the key factors that will support sustained strong domestic demand in the medium and long term, hence attract more FDIs. The demographic aspect of the Philippine economy is advantageous from the perspective as a client base or as source of labor, as it remains to have one of the youngest population who can provide a steady stream of capable labor to burgeoning industries.

Human resource development is therefore crucial to translate this projected good demographic dividend, alongside mortality and fertility improvements. For example, Technical Education and Skills Development Authority continues the enhancement of skills through training-for-work scholarship programs targeting priority sectors with a shift towards higher-value services.

*4) Improving the ease of doing business*

An Act Promoting Ease of Doing Business and Efficient Delivery of Government Services, Amending for the Purpose Republic Act No. 9485, Otherwise Known as the Anti-Red Tape Act of 2007, and for Other Purposes, i.e., R.A. No. 11032 (2018) promises to attract more foreign investments to the country.

Signed on 28 May 2018, R.A. No. 11032 amends the Anti-Red Tape Law of 2007 and seeks to make running a business in the Philippines easier and more efficient. The law features a standardized deadline for government transactions, a single facility to run transactions for convenience, a unified business application form, an automated electronic system for the processing of permits, and a central business portal that will receive all business applications.

The law also aims to combat corruption by adopting a zero-contact policy. The government is positive that it will solve the problem of bureaucratic red tape and cut the waiting time.

## Conclusion and implications for policy

In recent years, the Philippines has been attracting more FDIs amid domestic and global developments. Even with healthy FDIs recorded to date, policymakers are on the lookout for better macroeconomic enabling environment to sustain and maximize the benefits from FDIs; offer reasonable incentives, clarity and continuity of reforms; and enhanced promotion of the Philippines as a prime FDI destination.

The Philippines is undergoing economic structural shifts and policies that are responsive to global challenges, and could unlock the potential benefits of even more FDIs, with foreign investors able to differentiate the Philippine economy from others.

Furthermore, engagement of stakeholders for better investor perception and improvement in competitiveness, ease of doing business and institutional and governance reforms cannot be underestimated and may very well complement the sufficient external buffers and domestic liquidity provisions in place.

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