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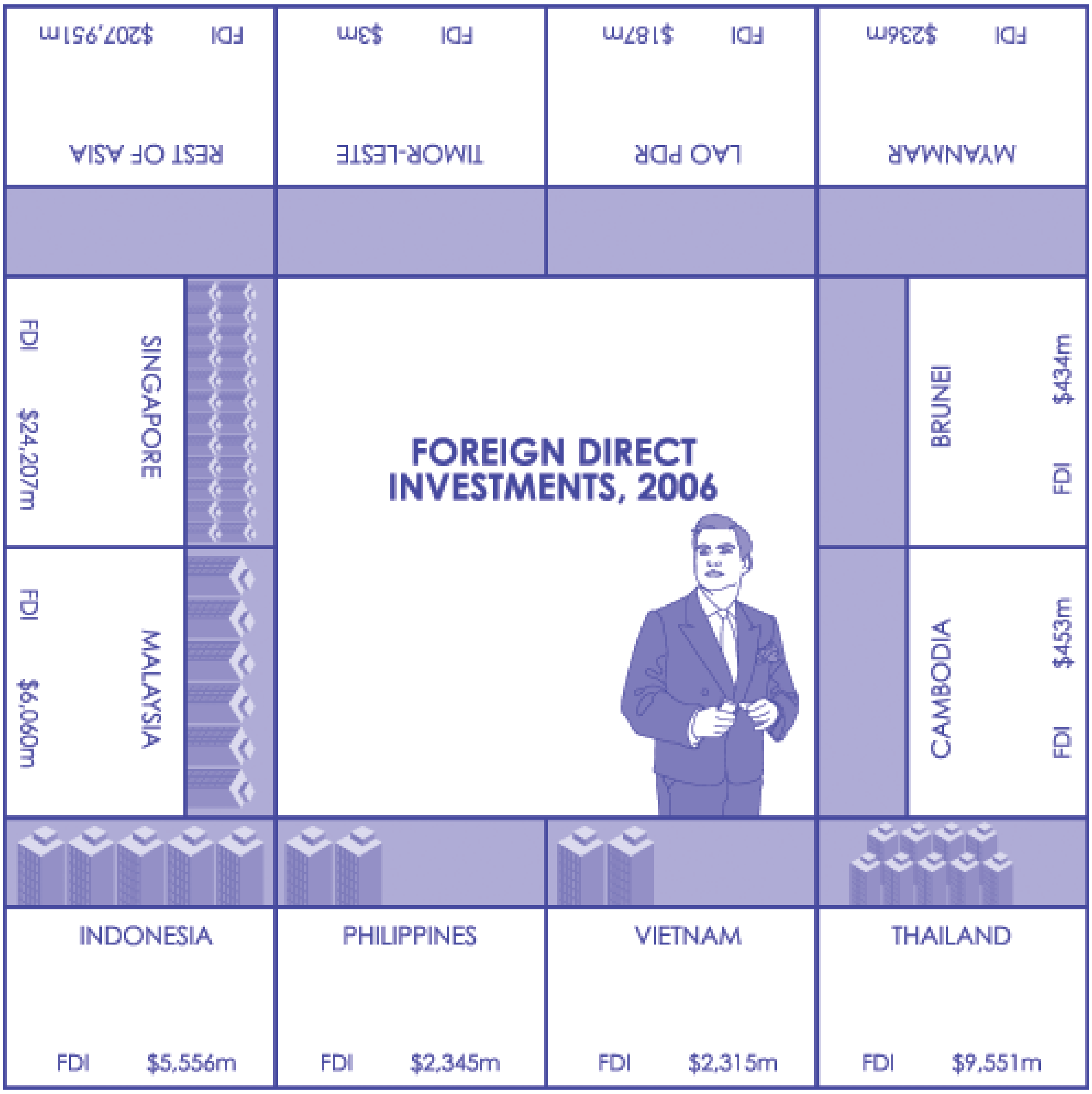
DIRECT INVESTMENT INFLOW TO THE PHILIPPINES CONTINUES TO LAG BEHIND OTHER MAJOR ECONOMIES IN SEA

A Languid Entry



MAKATI BUSINESS CLUB
THE FORUM FOR CONSTRUCTIVE IDEAS

MAKATI BUSINESS CLUB
2nd Floor, AIM Conference Center
Benavidez corner Trasierra Streets
Legaspi Village, Makati City, Philippines
Tel. nos.: 751-1134 to 45
Fax nos.: 750-7405 / 750-7406
E-mail: makatibusinessclub@mbc.com.ph
Website: www.mbc.com.ph

DIRECT INVESTMENT INFLOW TO THE PHILIPPINES CONTINUES TO LAG BEHIND OTHER MAJOR ECONOMIES IN SEA

A LANGUID ENTRY

Basic economics tells us that investment spending is necessary for employment generation and the creation of products and services, as new investments pump-price the economy by injecting funds that goes around the system. Building up a nation's stock of capital goods results in growth and ultimately, the development of a country.

In the recent report released by the National Statistics Coordination Board (NSCB), total approved investments in 2007 reached P385.8 billion, an 8.1% increase over the P357 billion worth of projects approved in 2006. This covers investments pledged by both foreign and Filipino nationals to the four investment promotion agencies (IPAs), namely, the Board of Investments (BOI), Philippine Economic Zone Authority (PEZA), the Subic Bay Metropolitan Authority (SBMA), and the Clark Development Corporation (CDC).

The breakdown of the 2007 investment figures (see Table 1) shows a noticeable drop in local investments from P191 billion in 2006 to P165.9 billion in 2007. Foreign direct investment (FDI) grew 29.8%, pushing total investments up to an overall 8.1% increase. Foreign investors pledged P215.2 billion, led by the Singaporeans who committed P44.2 billion. Investment pledges from Japan of P38.6 billion, and the United States of P36.1 billion followed suit and were concentrated largely in the manufacturing sector.

More than half of the total approved investments registered with the BOI, while PEZA approved 34.6% of the total. Meanwhile, CDC and SBMA, which experienced reduction in projects committed last year, captured 0.51% and 9%, respectively. It is worthy to note the troubling

DOMESTIC INVESTMENTS FALTER

Table 1. Total Investments from all four IPAs (BOI, PEZA, CDC, SBMA)

Foreign Direct Investments			
	2007	=	P215.2 billion
	2006	=	P165.9 billion
	Growth	=	29.8%
Local Investments			
	2007	=	P170.6 billion
	2006	=	P191.0 billion
	Growth	=	(10.7%)
Combined FDI and Local Investments			
	2007	=	P385.8 billion
	2006	=	P356.9 billion
	Growth	=	8.1%

Source: National Statistics Coordination Board

INVESTMENTS LOCUS

Table 2. Approved Investments by IPAs

BOI-approved Investments			
	2007	=	P215.3 billion
	2006	=	P187.6 billion
	Growth	=	14.8%
PEZA-approved Investments			
	2007	=	P133.7 billion
	2006	=	P83.7 billion
	Growth	=	59.8%
	Combined BOI and PEZA-approved Investments		
	Foreign Direct Investments		
	2007	=	P189.7 billion
	2006	=	P88.5 billion
	Growth	=	114.2%
	Local Investments		
	2007	=	P159.4 billion
	2006	=	P182.7 billion
	Growth	=	(12.8%)
CDC-approved Investments			
	2007	=	P1.9 billion
	2006	=	P12.7 billion
	Growth	=	(84.3%)
SBMA-approved Investments			
	2007	=	P34.7 billion*
	2006	=	P72.9 billion
	Growth	=	(52.4%)

Source: National Statistics Coordination Board, Board of Investments
*SBMA Q4 figures are preliminary

decline of more than 50% in investment inflows to the Clark and Subic special economic zones (see Table 2).

The IPAs reported that combined investment pledges made last year are expected to generate 159,585 new jobs. This is 3,407 more than the number of new jobs created in 2006. Private services are expected to absorb 40.3% of the newly created jobs, while the manufacturing and finance and real estate industries will take in 39% and 12.7%, respectively.

The NSCB foreign investment figure reflects registered FDIs representing foreign equity investments, excluding intercompany loans. In contrast, FDI flows in the balance of payments (BOP) accounts includes these loans as it covers all cash transactions coursed through the banking system. These are investments by non-resident placements, including reinvested earnings and net intercompany loans less non-resident withdrawals.

Net BOP FDI flows in 2007 reached $2.93 billion, nearly identical to the 2006 foreign placements of $2.92 billion. The Bangko Sentral ng Pilipinas (BSP), the Philippine central bank, reported that reinvested earning account rose to $567 million. Gross equity capital placements, meanwhile, were channeled largely into manufacturing, services, construction, mining, real estate, financial intermediation, information technology development, multimedia, and agricultural industries.

THE DE-INDUSTRIALIZATION OF THE PHILIPPINES

New investments worth P140 billion in the power industry topped in the total (local and foreign) investments in 2007, accounting for 36% of the total P386.8 billion approved investments (see Table 3). Bulk of the committed investments was pledged by the Singaporean-led consortium, Masinloc Power Partners Co. Ltd., for the Masinloc Power project. The group committed Php 41.8 billion worth of investments to the BOI towards the end of 2007.

The manufacturing sector, on the other hand, posted a decrease in overall new investments, from P152 billion in 2006 to P95 billion last year. This is the third consecutive year that the manufacturing sector posted negative growth. The surge of dollar remittances by Filipinos working abroad resulted in the appreciation and consequent overvaluation of the Philippine peso, which hurt the competitiveness of Philippine export manufacturers. This partly explains the lack of investor interest in the manufacturing sector, as well as the slowdown of the sector's growth.

Manufacturing failed to attract as much FDIs last year. From a total of P112.6 billion worth of approved foreign investments in 2006, it attracted P80.8 billion in 2007. But despite the drop, the sector remained on top of the industry list, garnering 37.6% of total FDIs last year.

POWER UP

Table 3. Total Approved Investments (Filipino and Foreign) by Industry, 2006 and 2007

Industry	Approved Investments (in million pesos)		Growth Rate (in percent)
	2006	2007p/	
Agriculture	4,734.1	1,856.1	(60.8)
Communication	47,042.1	14,221.6	(69.8)
Construction	3,857.5	14,089.7	265.3
Electricity	45,402.6	139,078.3	206.3
Finance & Real Estate	28,833.4	54,927.0	90.5
Gas	-	561.0	-
Manufacturing	151,983.6	94,676.7	(37.7)
Mining	16,146.7	13,775.6	(14.7)
Private Services	29,105.3	37,631.3	29.3
Storage	35.3	1,340.5	3,699.8
Trade	26,332.3	779.9	(97.0)
Transportation	3,530.5	10,328.8	192.6
Water	-	2,537.0	-
Total	357,003.4	385,803.7	**8.1**

p/ SBMA Q4 2007 data are preliminary
Source: National Statistical Coordination Board (NSCB)

SLOW ABSORBER

South East Asia is composed of the countries of Brunei Darussalam, Cambodia, Indonesia, Lao People's Democratic Republic, Malaysia, Myanmar, Philippines, Singapore, Thailand, Timor-Leste and Vietnam. This Asian sub-region has been attracting more and more foreign investors, evidenced by the foreign capital that flows into the region's economies each year. Most of the major economies in South East Asia have maintained positive FDI growth, except for Indonesia. But even as Indonesia struggled to maintain its FDI growth, the amount of investments it attracts remains way above that of the Philippines.

In 2004, FDI inflow to the Philippines amounted to $688 million as compared to Indonesia's $1.9 billion. The following year, $1.8 billion worth of foreign investments entered the Philippines while Indonesia welcomed $8.3 billion. In 2006, foreign direct investments poured into the Philippines reached almost $3 billion, and while Indonesia's FDI inflow dropped by 33%, it still received almost twice the value of Philippine FDI inflow at $5.6 billion.

Looking at the World FDI 2004-2006 data compiled by the United Nations Conference on Trade and Development (UNCTAD) (see Table 4), South East Asia attracted about $41 billion of FDI in 2005 and $51 billion in 2006. In both years the Philippines captured a mere 4.5%, making it one of the lowest recipients of FDI in the region. It lags behind its neighbors who captured larger shares in 2006: Malaysia (11.8%); Indonesia (10.8%); Singapore (47%); and Thailand (18.9%).

The latest figures released by the United Nations reveal that Philippines received $2.7 billion of FDIs in 2007, while Singapore attracted $36.9 billion, Vietnam with $11.3 billion, Thailand with $10 billion, Malaysia with $9.4 billion and Indonesia with $5.9 billion.

THE PITFALLS

The Philippines' failure to attract investments has puzzled economists, especially since corporate profits are high and growing at a steady rate. A PIDS study attributes this to heightened political instability and the continuing lack of a more competitive environment.

Quite similarly, the Asian Development Bank points out that the Philippines needs to institute reforms in order to change investors' perception about these uncertainties, particularly on widespread corruption, bureaucratic red tape, poor infrastructure, crime and security, cost of doing business, and loopholes in Philippine laws and execution of contracts. These were the same investor sentiments reflected in the 2007 Global Competitiveness Report and in the World Investment Prospects Survey 2007-2009 conducted by UNCTAD, which estimated that the Philippines netted only $2.5 billion in 2007, ranking 28th out of 41 countries. This pales in comparison to its neighboring countries like Vietnam, Thailand, Malaysia, and Indonesia, which ranked 6th, 12th, 14th, and 15th, respectively.

But these aren't the only reasons why public and private investment rates are slumping. An assessment by World Bank economist, Alessandro Magnoli Bocchi, on the Philippines' relatively high growth but declining investment identifies three factors why investment does not grow in pace with Philippine GDP. The first reason is that public sector is pressured by weak revenue collections and heavy debt services that it cannot afford to maintain public investment, such as infrastructure, high enough to make the country attractive as a destination.

TINY PIECE OF AN ELEPHANT

Table 4. FDI Inflows 2004-2006

Year	World (in million US dollars)	South-East Asia (in million US dollars)	Philippines (in million US dollars)
2004	742,143	35,245	688
2005	945,795	41,071	1,854
2006	1,305,852	51,483	2,921

Source: World Investment Report 2007, UNCTAD

The second reason is that local capital-intensive industries do not feel compelled to expand existing businesses primarily because they expect low marginal return on each additional dollar invested. Bocchi cites two reasons as to why investors think this way. First, inadequate public services, incentives and infrastructure provide no reason for the private sector to invest. Examples of these are the lack of well-paved roads in the country, and the insufficient supply of power and clean water in many regions.

Another reason is the continuing rent-seeking behavior practiced by a few big companies with solid political connections. They enjoy legislated barriers to entry and oligopolistic market power. PIDS president Josef Yap refers to them as the "traditional elitist conglomerates" that reap high profits but do not re-invest these since the marginal returns on new capacity are lower. Thus, the high rents charged by these producers, such as power and shipping, discourages other investors to the Philippines, underpinning the country's weak investment performance.

DUTCH DISEASE

In a study of the Philippine Institute of Development Studies (PIDS) entitled "What's in store for the Philippine economy in 2008," the possibility of the Philippines suffering from "Dutch Disease" was raised. The "Dutch Disease" is an economic phenomenon referring to a booming economy, brought about by increased revenues from the exploitation of natural resources, that is accompanied by a slowdown in the manufacturing sector. The theory, established after Netherlands discovered large supply of natural gas deposits in the North Sea in the 1960s, has led to its economic progress but at the expense of its other major industries, particularly to the Dutch non-oil exports. The sharp appreciation of the guilder, Netherlands' currency, rendered many of its domestic sectors uncompetitive.

In theory, the Dutch Disease may occur from economic development that result from a surge in foreign currency, a sharp increase in natural resource prices, or the influx of foreign assistance. In the Philippines' case, as explained by PIDS, overseas Filipinos take the role of the "natural resources" and their remittances are the "revenues." When the peso rapidly appreciated in 2007, closing at P41.28 against the US dollar at the end of the year, the Dutch disease manifested itself with the deceleration in the growth of the manufacturing sector, a mere 3.3%, in spite of a high 7.3% gross domestic product (GDP) growth.

SYMPTOMS OF THE DUTCH DISEASE

Table 5. Total carbon dioxide emissions of selected countries, 1990 and 2004

Country	OFW Remittances (in thousand US$)	Mfg. Sector Growth (in %)	Philippine Peso end of year (against US$1)
2003	7,578,458	Incomparable*	P55.56
2004	8,550,371	5.84	P56.28
2005	10,689,005	5.28	P53.09
2006	12,761,308	4.6	P49.03
2007	14,449,928	3.3	P41.28

*National Income Accounts (NIA) methodology was revised starting 2004

Source: Bangko Sentral ng Pilipinas, Makati Business Club databank

OFW remittances, however, were not the sole reason for the Philippine peso appreciation last year. The overall weakness of the US dollar, which began depreciating against the euro in 2003, catapulted the value of all Asian currencies to all-time-high growth rates. Foreign portfolio investments grew by 35% or $917.9 million more than the $2.6 billion figure in 2006. The improvement of the country's fiscal position, the strengthening of the peso, and the generally peaceful May 2007 elections attracted foreign investors to invest in Philippine equities and government securitites. These also contributed to the peso's appreciation against the dollar.

The third cause for low investment growth, according to Bocchi, is the nature of the fast-growing businesses, such as electronics, business process outsourcing, and information technology. These businesses utilize relatively more labor than capital and do not need to inject more capital to grow their profits commensurately.

CHALLENGES AHEAD

What the Philippines needs to do to attract more investors is clear. First, it needs to resolve governance issues that constrain private investment. Economist Cielito Habito refers to graft and corruption, bad governance, and sociopolitical unrest as the excess baggage in the country's flight to progress. In his article, he states, "Unless the people see convincing and definitive reform on this nagging problem, regardless of the leadership, our economic prospects will continue to be weighed down by a persistent lack of confidence by private investors, both big and small."

Another challenge is for the government to maintain the high level of investment spending it made last year. Not only will this give the country's GDP an extra boost but, with the availability of better facilities and the formation of knowledgeable, skilled and healthier workforce, it will also improve the country's image as an investment destination. This can only take place, however, if the government increases its revenue collection and effectively fights corruption.

Despite the daunting obstacles that the country needs to overcome, analysts remain optimistic about the Philippines' overall economic growth prospects this year. The expectation is that the country will post a 5 to 6 percent GDP growth, which is still a respectable figure in view of the expected external shocks. Whether it will happen as a result of an upsurge of new investments remains a fervent hope.

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Research by

MA. ROXANNE V. LU

Senior Researcher
Tel. No. 751-1140
e-mail: roxanne.lu@mbc.com.ph