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Foreign investment access and the services industry

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FOREIGN INVESTMENT ACCESS AND THE SERVICES INDUSTRY

QUANTITATIVE POLICY ANALYSIS FOR THE PHILIPPINES

PART I : MAIN REPORT

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The responsibility for the results and conclusions of this study, and for any remaining errors rests only with the main author.

The opinions and conclusions in this report are not necessarily shared by the International Finance Corporation or by the World Bank Group.

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Abstract

This report addresses the following question: If the Philippines changes its access restrictions for foreign direct investment, what will be the impact on the domestic economy, and in particular on the domestic services industry. The report is commissioned by the International Finance Corporation, part of the World Bank Group.

The background is that between 2010 and 2017 incoming FDI contributed only about eight percent to gross domestic capital formation in the Philippines, much less than in most other ASEAN countries. Also the FDI inflow per dollar of GDP is lower in the Philippines than in all other ASEAN countries. FDI in the Philippine services industry is underdeveloped, and the government considers to lift or alleviate existing restrictions on foreign equity participation in services industries. Some 60% of the incoming FDI flows now go to manufacturing, utilities, real estate and financial services industries, while hardly any FDI is attracted in the area of knowledge-intensive business services, transport, telecom, and primary industries.

Many foreign subsidiaries in the Philippine's manufacturing industry form part of so-called global value chains. It means that these subsidiaries do not primarily produce for the local market. Instead they produce intermediary goods that are exported again, making use of abundant Philippine labor and imported inputs. The report identifies the drivers of current FDI patterns and establishes what is the impact of policy-related barriers to FDI. Special attention is given to the role of statutory restrictions on foreign equity participation. The study investigates how current Philippine policies affect the magnitude and pattern of inward FDI stocks. The performance of other ASEAN countries functions as the main benchmark for comparison.

The report has applied a state-of-the-art type of structural gravity analysis to the worldwide patterns of bilateral FDI between countries. This analysis is data-intensive, using information on bilateral FDI patterns between 230 countries, based on a unique database that covers the period 2001 to 2016. The analysis has made it possible to distil a quantitative indicator for the relative costs of doing foreign direct investment in each country, an indicator that also varies over time. It compares the relative cost of doing FDI in a particular country, compared to all other countries..

Given the central research question for this report, particular attention has been given to test the impact of the OECD FDI Restrictiveness index (and its sub-indicators) on the MR terms. The report also investigated the impact of governance indices, business-cost indicators, and the impact of international cooperation agreements like preferential-trade agreements and bilateral investment treaties. Using these results, it was possible to do quantitative policy simulations for the Philippines. We used four potential reform packages for attracting more inward FDI differing along two dimensions: *feasible* versus *ambitious*, and *short-term* versus *medium-term*.

Both the gains in additional FDI and the domestic knock-on effects are very substantial. We compared the (expected) outcomes of a changed FDI policy with the goals that the Philippine government has formulated in the Philippine Development Plan 2017-2022. The report concludes that the four FDI policy reform packages will not be enough to accomplish a structural change in the Philippine economy. To accomplish structural transformations as the Development Plan desires, it will be necessary to apply an active and selective FDI acquisition policy in order to secure that more of the new FDI go to services industries. The report provides criteria for such a policy.

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