INVESTMENT INCENTIVES, PRIVATE INITIATIVE AND INDUSTRIAL POLICY

Epictetus E. Patalinghug

This paper examines three areas of concern. The first relates to the confusing definitions of "investment" among concerned government agencies affecting responses by investors. The second examines responses of private firms to various types of incentives such as in cases of assessing options for capital investments. The third area looked into is with respect to industrial policy issues and focuses particularly on the role of government in priority identification, in location decision and pricing among others.

In March 27, 1991, the Board of Investments (BOI) submitted to President Corazon C. Aquino for her approval the 1991 Investment Priorities Plan (IPP)[1]. IPP is a list of specific and generic activities where investments are to be encouraged through the grant of incentives. In contrast to the 1990 IPP which contained 261 areas, the 1991 IPP lists only 95 areas. The implication is that concentrating government's efforts on fewer priority areas will minimize the loss of government revenues due to the granting of incentives to BOI-registered projects. Fiscal incentives such as income tax holidays, duty-free importation of capital equipment, net loss carryover, and accelerated depreciation of capital equipment are commonly used as mechanisms to attract investments. However, it is not quite clear whether the granting of incentives to some projects is necessary if these projects would have been implemented, anyway, even without these incentives.

This paper (a) gives an analysis of the conflicting definitions of investment in the Philippines, (b) assesses the relationship between incentives and private initiative, and (c) evaluates some industrial policy issues affected by BOI measures.

DEFINITION OF INVESTMENT

The definition of foreign investment varies among the different government agencies monitoring this variable. The Board of Investments (BOI) treats investment as the equity contributions of foreign business entities in proposed projects and the expansion or rehabilitation of existing projects. On the other hand, the Central Bank (CB) defines foreign investment in terms of foreign equity investment of newly registered corporations, and the changes (increases or decreases) in foreign equity of existing corporations. The concept of foreign investment as defined by the Securities and Exchange Commission (SEC) is similar to that of CB. However, the SEC figures do not fully account for the changes in capitalization of foreign banks and other foreign corporations. Thus, data compiled by BOI, CB, and SEC not only differ but are also incomparable.[2]

Table 1 shows that the BOI concept of investment tends to overestimate the level of investments. The reason is simply that BOI based its estimates on approved project costs of BOI-registered projects. A project applying for BOI approval is required to state in its registration form the expected project cost at the initial year and five years thereafter. Project costs are therefore strictly in the form of pledges or commitments that may not be realized in the presence of adverse political and economic developments after BOI approved the project. Furthermore, the definition of project costs may likewise include expenditure items which cannot be classified as contributing to capital formation. For instance, pre-operating expenses are counted as part of total project cost, but looking at investment as a process of capital accumulation, only the fixed assets component of total project cost can be strictly classified as "in-

[1]The *Omnibus Investment Code of 1987*, (p. 14), specifies that the BOI shall submit to the President an Investment Priorities Plan not later than the end of March of every year. On May 21, 1991, President Aquino has officially approved the 1991 IPP under Memorandum Order No. 363 (dated May 14, 1991).

[2]These concerns are likewise addressed by BOI-IFC Advisory Project to Strengthen the Collection and Analysis of Foreign Direct Investment Data in the Philippines (1990).

vestment." If the level of investments affects economic expectations, the statistics reported by BOI and SEC are, at best, contradictory and therefore not a useful information to base one's investment expectations. For instance, in the business pages of a Philippine newspaper,[3] BOI is reported to have set an investment target of ₱85 billion for 1991, 21 percent lower than the ₱108 billion it reported to have attained in 1990. Another daily[4] reported that the level of investment based on BOI-approved projects covering the months of January and February of 1991 has reached ₱29.37 billion. However, a rational individual or business firm trying to use publicly-generated information to make business decision will be confused when reading another business news[5] which reported that SEC "placed foreign investments from 1986-1990 at ₱16.5 billion" or "new corporate investments dropped by 27 percent in January 1991 to ₱441.7 million from ₱604.9 million in December last year". Inflow of investments is so fantastic using BOI statistics, but so dismal using SEC data, so much so that SEC has decided to throw its support of Senate Bill No. 1276 which contains a provision restricting a foreign firm's domestic borrowing to only 10 percent of its equity. It has been argued (Tullao 1989) that statistics coming from CB are the most accurate because discrepancies and limitations of statistics generated by BOI and SEC are corrected. Although SEC data account for the withdrawal and the non-actualization of proposed investment of foreign companies, it cannot be relied upon to account for the withdrawals of investment of foreign banks. But it is evidently clear that BOI's investment information is not able to account for the withdrawal and non-actualization of committed project costs in BOI-approved projects.

Table 1

ESTIMATES OF FOREIGN INVESTMENT IN THE PHILIPPINES
(In Millions of U.S. Dollars)

Year	Central Bank	Board of Investments	Securities and Exchange Commission
1980	106	208	47
1981	172	233	31
1982	16	256	74
1983	105	268	39
1984	9	234	35
1985	12	132	80
1986	127	78	43
1987	307	167	76
1988	936	451	156

Source: Board of Investments

On a broader definition of investment which covers both domestic and foreign investment, investment data are still plagued by the problem of lack of comparability. For instance, BOI views investment as equity contributions of both domestic and foreign business entities in new or expansion projects. On the other hand, the investment concept used by the National Economic and Development Authority (NEDA) is the change in gross domestic capital formation which covers both fixed capital and changes in inventories. NEDA's concept of investment emphasizes the additional productive capacity of the economy as a result of increases in the capital stock. As shown in Table 2, BOI's and NEDA's

[3] "BOI Scales Down Target," *Philippine Daily Inquirer*, February 2, 1991, p.13.

[4] "Investments Hit P29 B in Jan.-Feb.," *Manila Bulletin*, March 15, 1991, p. B.1.

[5] "MNCs Nix Bill Limiting Credit Access," *Philippine Daily Inquirer*, March 14, 1991, p. 15; "New Corporate Investments Drop by 27% in January," *Philippine Daily Inquirer*, March 10, 1991, p.17 withdrawal and non-actualization of committed project costs in BOI-approved projects.

definitions of investments create investment statistics that are not comparable. It must be reiterated, however, that although different concepts of investment emits confusing signals at the micro-decision level, it is not as problematic at the macro-aggregate level. For example, an empirical study (Tullao 1989) found out that investment is statistically related to gross national product (GNP) regardless of whether the BOI or the NEDA concept of investment is employed.

INCENTIVES AND PRIVATE INITIATIVE

It has been observed (Manasan 1988) that ASEAN countries are equally competitive with and without investment incentives, and instead of outbidding each other in attracting foreign investment, they should cease to misallocate their scarce national resources by providing less generous incentives and putting up a uniform set of incentives for the region. Another issue related to incentives is their distortionary effect on relative factor use. For instance, BOI incentives are said to lower the user cost of capital, raise the private rate of return in preferred areas of investment and are likely to favor capital-intensive projects [Power and Bautista 1979; Manasan 1988]. Income tax holiday and exemptions from duties and taxes on imported capital equipment are the two most important incentives that create a marked reduction in the user cost of capital. For instance, a proposal[6] is currently floated to exempt capital equipment importations for BOI-approved export-oriented projects, regardless of date of registration, from the nine percent import levy, while letting domestic industries bear the burden of the nine percent import levy. This proposal will maintain the capital-intensive bias of the country's incentive scheme. Furthermore, given the unimpressive monitoring performance of BOI, what prevents firms from shifting the levy-exempted machinery from export-oriented projects to domestic- oriented operations of mother companies? Consider the following news item: "The Board of Investments (BOI) has cancelled the certificates of authority of 30 foreign companies ... for non-submission of periodic reports."[7] Actually the failure to submit reports on foreign exchange remittances is explained by the inability of firms to continue to operate as well as its failure to export its products. However, some of these firms have been dormant as early as May 1988. It is therefore proper to inquire if mere cancellation of registration certificates is adequate considering that the *Omnibus Investments Code of 1987* provides that "in case of cancellation of the certificate granted, ... BOI may, in appropriate cases, require the refund of incentives availed of and impose corresponding fines and penalties". Incentives availment is quite guaranteed once a firm gets BOI approval based on its estimated foreign exchange earnings, projected annual output, projected purchase of raw materials and supplies, projected annual labor payments, projected economic rate of return, projected financial rate of return and estimated project cost, among others. While the extension of the tax exemption is allowed if registered enterprises satisfy minimum targets such as net foreign exchange earnings, capital-labor ratio and rate of utilization of indigenous raw

Table 2

ESTIMATES OF INVESTMENT IN THE PHILIPPINES (In Millions of Pesos)

Year	Board of Investments[a]	National Economic and Development Authority[b]
1971	530	9,919
1972	578	10,890
1973	1,002	14,634
1974	2,559	25,053
1975	870	33,840
1976	1,510	41,993
1977	890	44,369
1978	1,475	51,348
1979	2,752	67,687
1980	4,276	81,153
1981	5,541	93,261
1982	6,662	96,521
1983	5,217	102,526
1984	6,114	91,951
1985	4,701	85,402
1986	3,146	81,106
1987	8,360	110,394
1988	—	14,353

Sources: Board of Investments
1989 Philippine Statistical Yearbook

[a]Amount of investments approved under P.D. 1789 and P.D. 218.

[b]Gross domestic capital formation

[6]"Refinements on Import Levy Sought," *Manila Bulletin*, April 1, 1991, p. B-1.

[7]"BOI Cancels Permits of 30 Foreign Firms," *Philippine Daily Inquirer*, March 17, 1991, p. 17. Recently, BOI has cancelled the registration of an export-oriented adhesives manufacturing firm, due to the complaints filed by the Adhesives Manufacturers Association of the Philippines accusing this foreign firm of violating the terms and conditions of its registration by selling most of its products to the domestic market. "BOI Revokes Taiwan Firm's Registration," *Manila Bulletin*, April 6, 1991, p. B.1.

materials, cases of disincentives in terms of fines, penalties or assessment of foregone taxes are quite rare for non- performing registered firms. A group within the Philippine Chamber of Commerce and Industry (PCCI) has recommended to BOI to give local industries equal treatment with respect to new investments. In this spirit, implementing a policy of exempting export-oriented firms but not domestic firms from the burden of the nine percent import levy is violating this equal-treatment principle. PCCI has likewise voiced its concern that fiscal incentives should not be used as a principal mechanism for attracting or inducing investments since it entails a loss of government revenues and requires other sectors to carry the burden of increased taxes to compensate for the foregone revenues as a result of granting tax-exemption incentives to BOI-registered projects. BOI's latest move to trim down the investment priority areas from 261 in 1990 to 95 in 1991 must be interpreted as a positive response to heed the concerns, raised by PCCI, the Senate, and other government agencies (such as NEDA and Department of Finance), of minimizing the revenue loss under a BOI-designed investment program. A study on the effects of trade and exchange rate policies on export production incentives (Bautista 1985) shows that fiscal and financial incentives provided to BOI-registered enterprises have partly offset the bias against industrial exports created by the tariff structure and indirect taxes, but the bias against agricultural exports continued.

INDUSTRIAL POLICY ISSUES

The most important issue in industrial policy is the appropriate role of government. There are those who argue that the government should identify and foster the growth of strategic industries because without active government support, private firms will find it increasingly difficult to achieve market viability in a highly competitive environment. Others prefer a predominantly non- interventionist stance towards the industrial sector. Nevertheless, it has been shown that most less developed countries use wide-ranging and extensive policy measures to intervene in the industrial sector such as location of production, prices of products, the level of production, type of ownership, and nature cf market competition. It has also been pointed out that many of these industrial policy measures could have offsetting effect on the attainment of other development objectives. For instance, a regional dispersal policy may promote industrial growth in the depressed areas but it induces the establishment of new industries in a high-cost area; fiscal incentives may attract investments, but its non-neutral effect on factor price may encourage capital-intensive methods of production; or incentives may not have a substantial effect on the overall level of investment, but they influence the composition of total investment in favor of manufacturing and against agriculture.

A focused 1991 IPP has narrowed down the BOI industrial thrust to five sectors: (1) basic and strategic industries, (2) resource-based industries, (3) inputs to export industries, (4) support facilities and services to industries, and (5) tourism-oriented services. The rationale behind this BOI policy seems to "be able to concentrate its promotional resources on few priority activities that have greater chances of attracting investors."[8] This brings us to the issue raised by the private sector to exclude foreign investors from industries that are already adequately served by domestic producers. During the investment policy review conducted by the Joint Congressional Committee on Economic Affairs, BOI has recommended (as early as January 1990) the amendment of the *Omnibus Investment Code of 1987* so as to provide a negative list of investment areas where foreign investors shall be prohibited. Incidentally, the just enacted Foreign Investments Act of 1991 has already incorporated a provision on negative list. Even without the existence of the "negative list", the Code authorizes BOI to disapprove applications by foreign firms when an area is already considered overcrowded. Nevertheless, BOI segregates a market into "domestic" and "export". A firm which offers to fill the export requirements of domestic firms is considered as belonging to an "indirect" export market, and not to the domestic market which may have already been overcrowded.[9]

The determination of "priority" sectors, the recommendation of adopting a "negative list", and the definition of an "overcrowded" market dramatize the interventionist rather than promotional nature of BOI in the economy.

Another point is the issue of industrial location policy. IPP guidelines categorically state that "the Code grants additional incentives to firms that locate in less developed areas in the regions... limits incentives to firms that locate in congested urban centers."[10] It is therefore disturbing why a "People's Car Program" participant locating in rural Cebu

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[8] "BOI Trims Down 1991 IPP Areas," *Manila Bulletin*, March 28, 1991, p. B-1.

[9] This fine distinction between market orientation spills the difference between approval or disapproval for a foreign firm to enjoy incentives as a BOI-registered firm. "BOI Explains Dole Expansion," *Manila Bulletin*, January 24, 1991, p. B-1.

[10] Board of Investments, *1990 Investment Priorities Plan*, (Manila: May 8, 1990), p. 21.

will not be encouraged to produce a 1.7-liter diesel-fueled passenger car model on the reasoning that the prevailing supply of diesel oil is problematic.[11] During recessionary times, it is extremely difficult to attract capital investment in a car manufacturing venture because demand is slumping. And it is doubly difficult to understand why BOI pretends to use its "knowledge" of the oil market in blocking a business venture when it should have had the responsibility of promoting and approving such ventures during these difficult times. Considerations dealing with regional location rural employment and source diversification should prompt BOI to overrule considerations related to the "Car Development Program" which employs only 6,500 workers as of December 1990.[12] There are times when BOI policies should not be used as entry barriers in some industries. The Car Development Program (CDP) is no different from its predecessor - the Progressive Car Manufacturing Program (PCMP) which is a mechanism to limit entry and share the market among the chosen few (4 firms under PCMP and 3 firms under CDP).[13] Such a monopolistic market structure guarantees that corporate strategy is characterized by output restriction and corresponding increase in price. Cost-oriented pricing is dominant in oligopolistic market because consumers are given few alternatives under such a BOI-sanctioned industrial scheme. This explains why a car manufacturing firm has petitioned BOI to raise car prices by an average of 30 percent amid a drop of 65.4 percent in car sales incurred in the previous month.[14] In a competitive market, these figures imply that the firm is facing a price elastic demand for its products which should have required price rebates or price reductions to stimulate total sales.[15] Instead what we observe is a continuous increase in car prices during recessionary period when demand is slumping. Demand- oriented pricing is thrown out of the window when an industry has the enforcement mechanism (e.g. BOI's CDP) to close the market from potential entrants and shield itself from the competitive pressure and the optimal determination of efficient prices and outputs.

Finally, the procedure of measuring the benefits of BOI- registered projects needs to be reexamined. A project under a given industry has to be monitored in terms of its *incremental* contribution of the following targets: employment generation, foreign exchange earnings, utilization of indigenous raw materials, value added impact, and so on. It is therefore not appropriate to attribute the value- added effect, foreign exchange earnings, employment generation, and utilization of indigenous raw materials of the *entire* industry or of the firm where the project belongs as the project contribution of BOI incentives to the economy during a particular period when these incentives are availed of. A monitoring on per project benefit-cost performance over time will definitely determine whether incentives affect the level and composition of investment, benefits exceed costs, or these so-called "benefits" would have been realized anyway even without these incentives.

CONCLUSION

An analysis of Board of Investments incentives and private sector response indicates some ambiguities. In the first place, definitions of investment used by Board of Investments, Central Bank, Securities and Exchange Commission,and National Economic and Development Authority differ in concept and are not comparable. It has also been observed that the monitoring of projects by BOI beyond the approval period needs to be improved. And development objectives for a successful industrial policy ought to be given preference over entry- deterring rationalization schemes. The case of the car industry has been illustrated as an example where the development objectives of employment generation, regional dispersal, utilization of indigenous raw materials, value-added contribution, foreign exchange earnings, technology transfer, and source diversification have been disregarded in favor of a concentrated market structure where price and output decisions ignore the price sensitivity and brand preferences of the consumers. Fortunately, the provisions of the Foreign Investments Act of 1991 (R.A. 7042) have indicated that enterprises not seeking to avail of incentives under the Omnibus Investments Code of 1987 need not apply for registration with the Board of Investments. Under this Act, no prior approval is needed. Upon registration with the Securities and Exchange Commission (SEC), corporations can invest 100% of its capital in areas not covered by the negative list. This Act is practically an assault on BOI's role as a barrier to entry in the Philippine economy.

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[11] "Transform, GM May Abandon Car Project," *Manila Bulletin*, February 27, 1991, p. B-1.

[12] "Import Levy Hits Car Firms Hard," *Manila Bulletin*, February 1, 1991, p. B-1.

[13] Car Development Program participants are: Toyota Motor Philippines Corporation, Philippine Automotive Manufacturing Corporation, and Pilipinas Nissan, Inc.

[14] "Cars to Cost 25% More," *Philippine Daily Inquirer*, February 7, 1991, p. 11.

[15] "Car Firms Suffer From Poor Sales," *Manila Bulletin*, April 8, 1991, which indicated that customers shift their preference from the high-priced car models of the Car Development Program to the lower-priced "Kia Pride" model of the People's Car Program.

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