

Growth, Development and Institutions
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Parallel Sessions: Investment

Investment Incentives and FDI: The Philippine Experience

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Main Objective

- Analyze the impact of investment incentives on FDI inflows
- Relative to the experience of our neighbors, has the Philippine investment incentives program for foreign investors been successful in attracting FDI inflows?
- What has the past decade taught us?



Presentation Outline

- FDI policy
- Investment incentive program
- FDI trends & distribution by sector
- FDI performance: a comparative analysis
- Lessons learned



FDI policy reforms

Foreign Investment Act 1991

List A

reserved for Filipinos due to Constitutional constraints: mass media, cooperatives, small-scale mining

List B

reserved for Filipinos due to health, defense, & moral reasons; protection of SMEs

List C

Areas where adequate number of firms exist to serve the economy



FDI policy reforms

Foreign Investment Act 1996

List A

- retail trade liberalization (March 2000) allows 100% FDI with minimum equity US\$7.5million
- Foreign Bank Liberalization (1994): 10 new foreign banks
- rural banking completely closed to FDI
- restrictions on licensed professions, pyrotechnics & firecrackers; ceilings on financing, advertising, domestic air transport, commercial deep sea fishing

List B

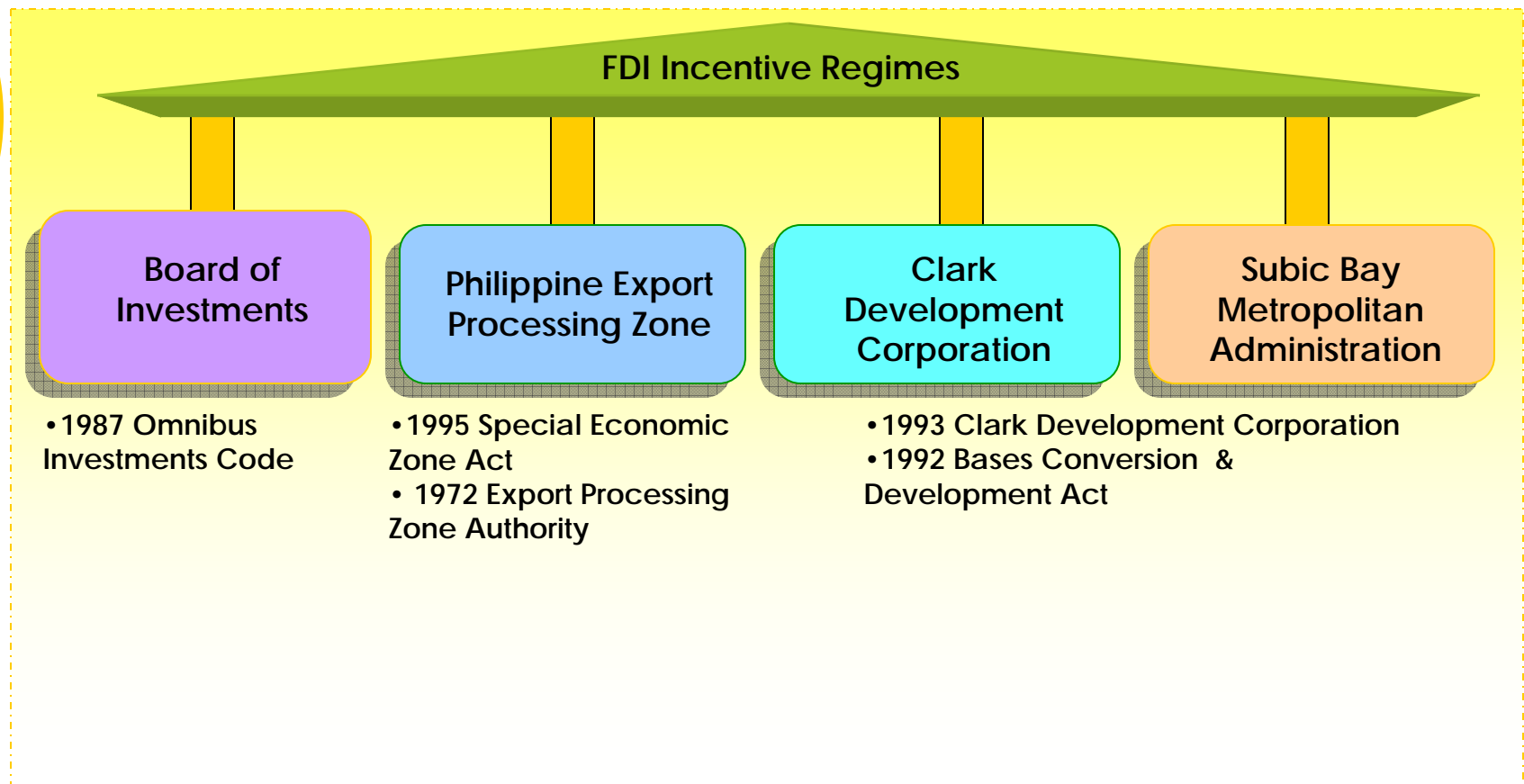
- restricts to 40% FDI in firms engaged in national security, defense, public health & safety & non-export firms with less than US\$200,000 capital



Remaining FDI restrictions

- Land ownership
 - lease for 50 years, renewable once for another 25 years
- BOT projects
 - foreign ownership limited to 40%
- Omnibus Investments Code
 - for incentives linked with export performance, export requirements for foreign firms are higher (70%) than domestic firms (50%)

Tax & other fiscal incentives to FDI





FDI Incentives

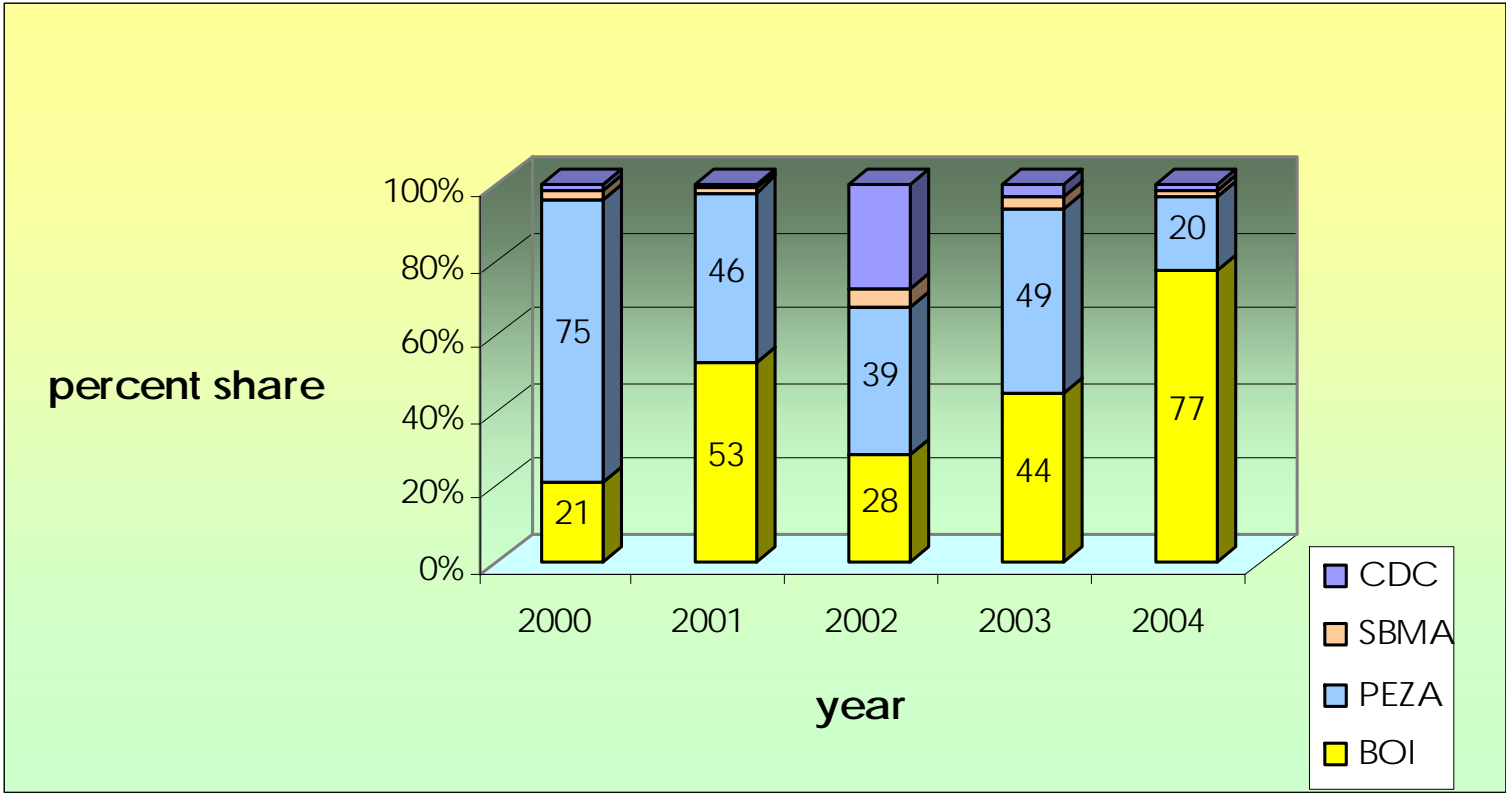
	Investment Regime	BOI OIC	PEZA	SBMA & CDC
I n c e n t i v e s	Income Tax Holiday	3-8 years ITH	3-8 years ITH	No ITH
	Others	After ITH, payment of the regular corporate tax rate of 35% on taxable income	After ITH, exemption from national & local taxes, in lieu of this special rate of 5% tax on gross income	5% tax on gross income in lieu of all local & national taxes
	Importation of raw materials & supplies	Tax credit	Tax & duty exemption	Tax & duty exemption
	Imported capital equipment, spare parts, materials & supplies	Tax & duty exemption on spare parts (duty & tax free importation of capital equipment expired in 1997)	Tax & duty exemption	Tax & duty exemption
	additional deductions from taxable income	training expenses	training expenses	training expenses

National & local taxes: gross receipts tax, VAT, ad valorem, excise, real property tax

Allowable deductions: direct salaries, wages, production supervision salaries, raw materials, supplies & fuels, goods in process, depreciation, rent, utility charges, financing charges

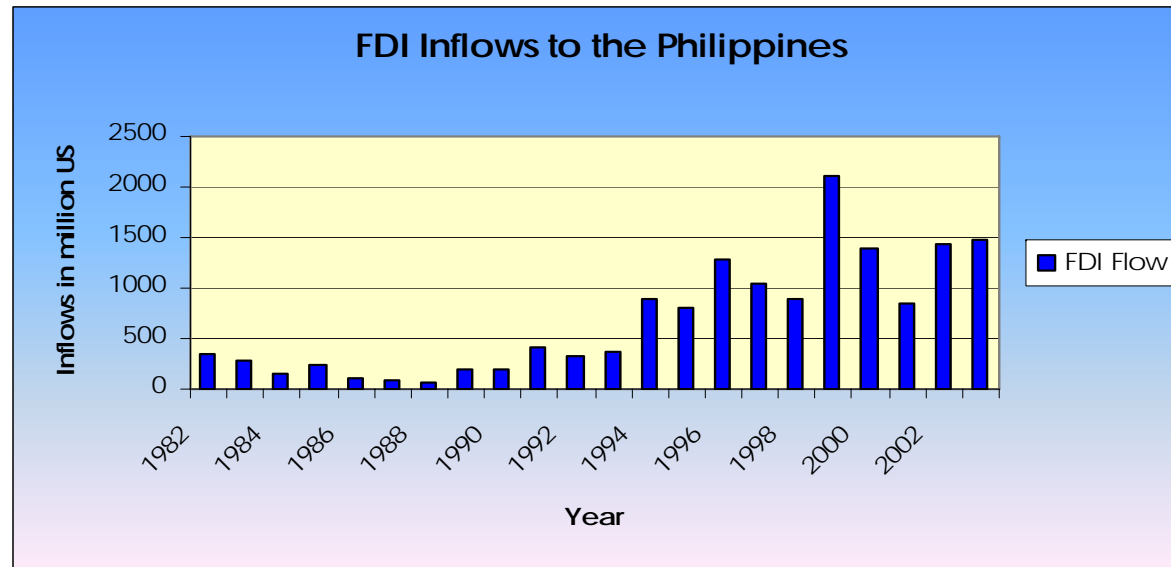


Approved FDI by Agency



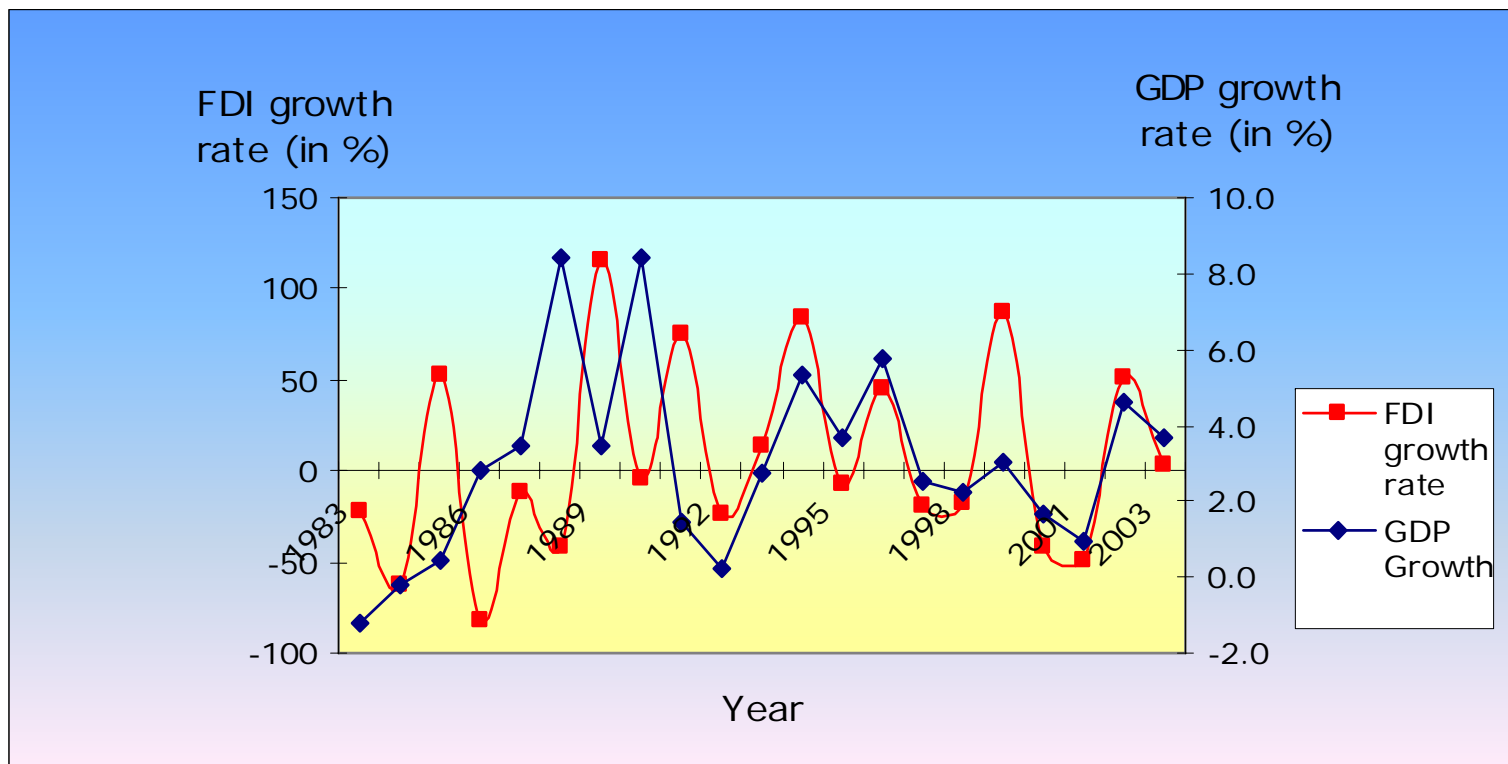


FDI Trends



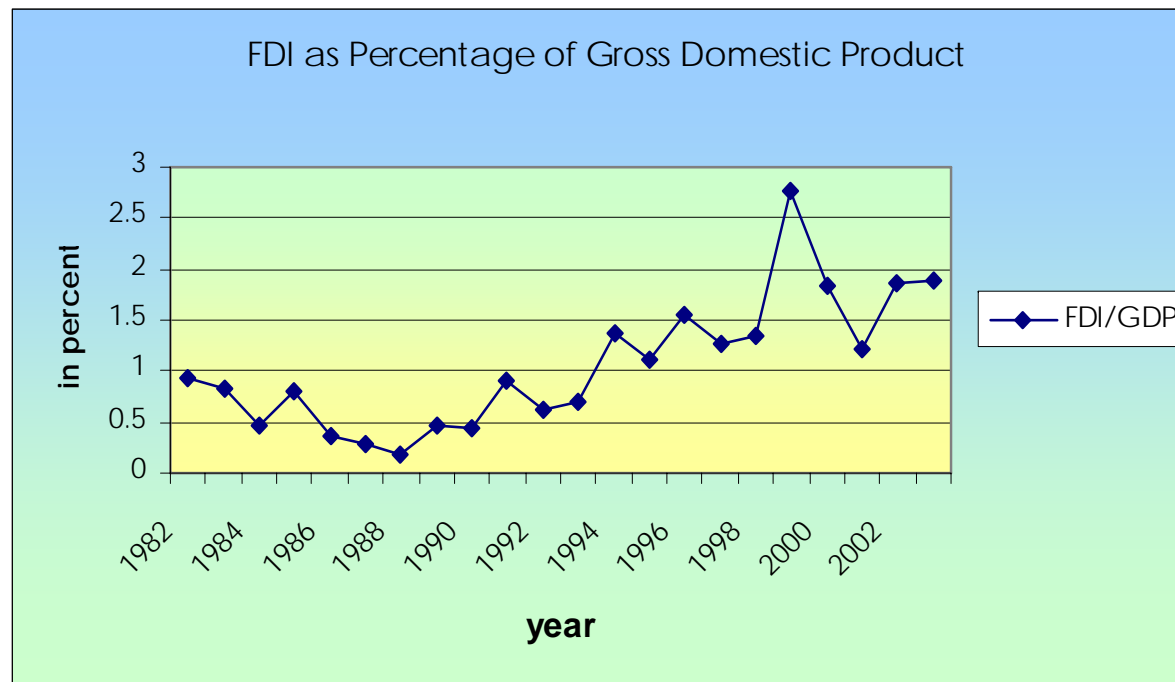
Period	Average FDI Growth Rate (in %)
1983-1989	-7.5
1990-1999	23.4
2000-2003	-8.7

FDI & GDP Growth





FDI Trends



Average FDI/GDP

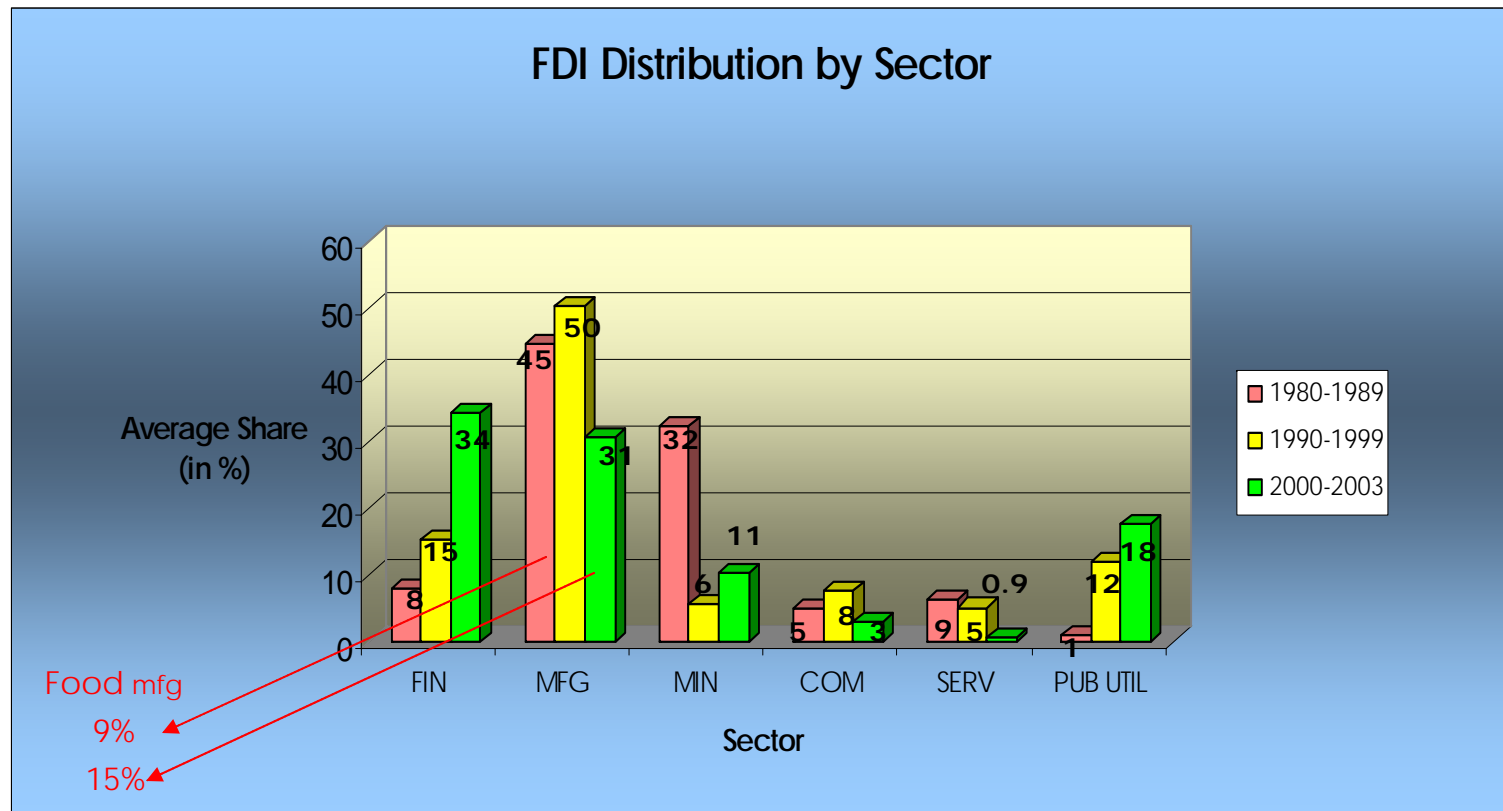
0.54% 1980s

1.21 1990s

1.7 20s



FDI Distribution

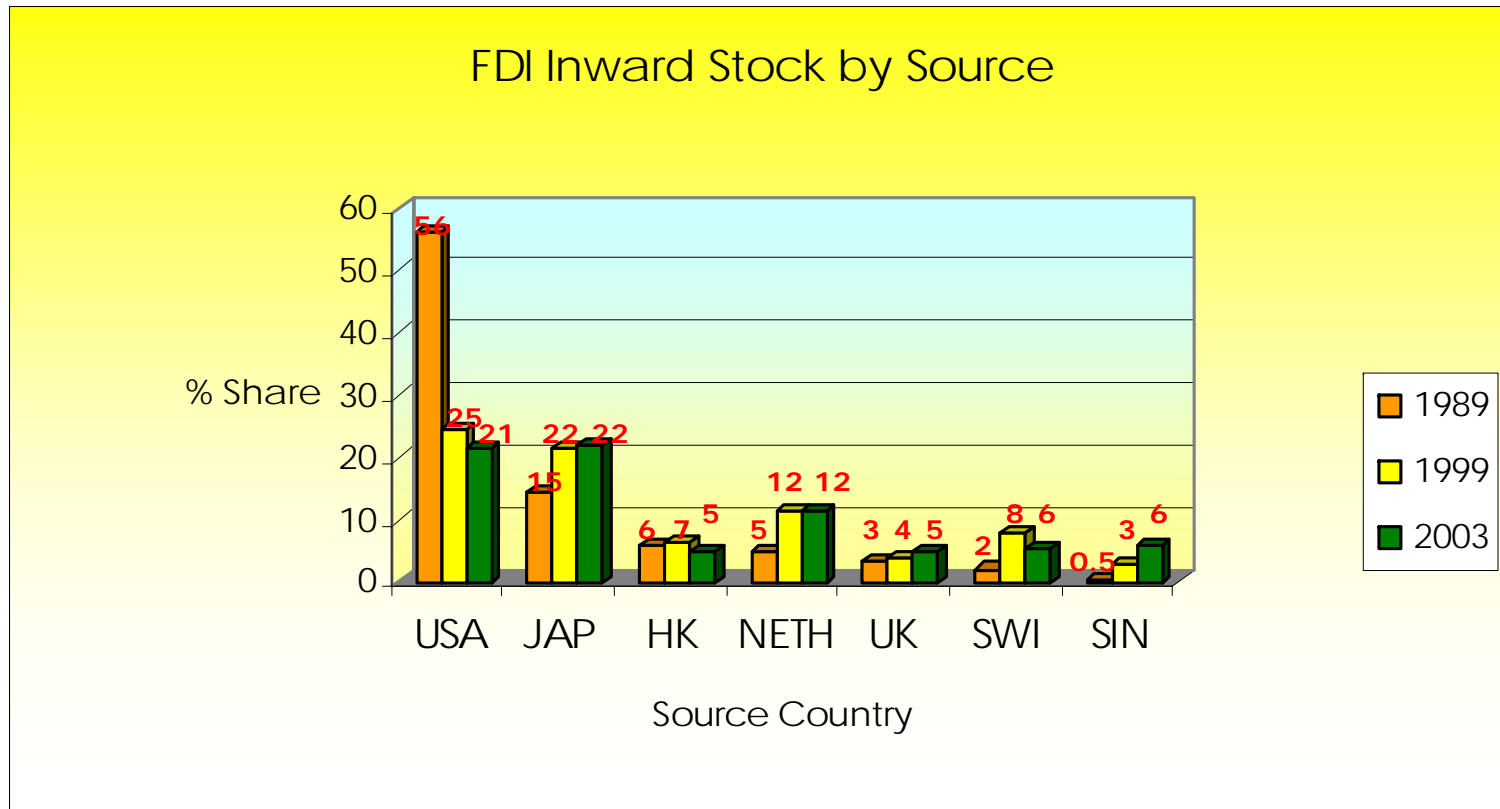


Mfg: electronic components assembly, food, transport, chemicals, petroleum & coal, basic metal

Public Utilities: telecommunications

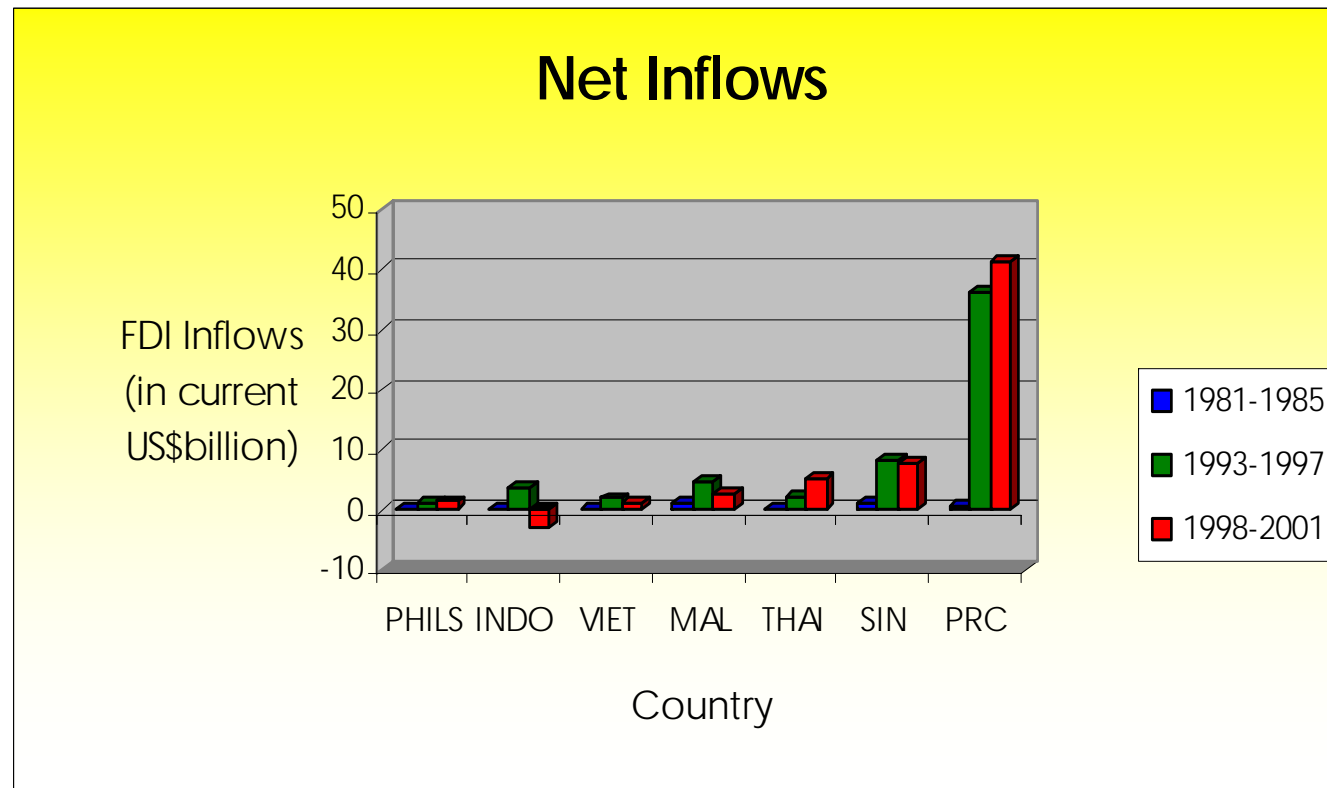


FDI Sources



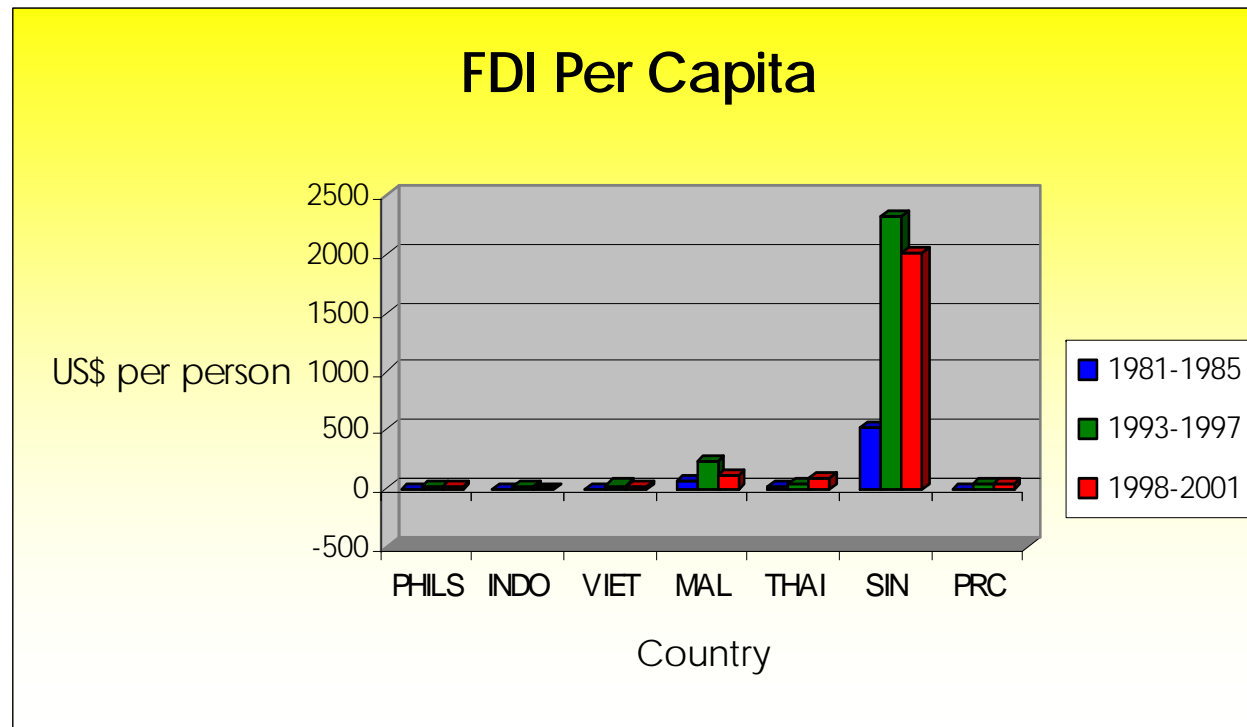


Comparative Performance





Comparative Performance





Competitiveness Indicators: Country Rankings

Country	Growth Competitiveness Index		Macro Environment Index		Public Institution Index	
	2004	2006	2004	2006	2004	2006
Malaysia	29	26	27	31	43	18
Thailand	32	35	26	28	37	40
Phils	66	71	60	62	85	88
Indon	72	50	64	57	76	52

Source: World Economic Forum, Global competitiveness Report, 2003-2004 (102 countries); 2006-2007 (125)

Macro: macro stability, country credit risk, wastage in government expenditures

Public institution: enforcement of contracts & law, degree of competition



Cost of Doing Business Indicators

Country	Number of start-up procedures		Time to start a business (days)		Cost to register Business (% of per capita GNI)		Procedures to enforce a contract		Time to enforce a contract (days)		Employment laws index: range 0 (less rigid) to 100 (very rigid)	
	2004	2006	2004	2006	2004	2006	2004	2006	2004	2006	2004	2006
Phils	11	11	59	48	24	18.7	28	25	164	600	60	39
China	11	13	46	35	14	9.3	20	31	180	292	47	24
Mal	8	9	31	30	27	19.7	22	31	270	450	25	10
HK	5	5	11	11	2	3.3	17	16	180	211	27	0
Indon	11	12	168	97	15	86.7	-	34	225	570	57	44
SKor	12	12	33	22	18	15.2	23	29	75	230	51	34
Sing	7	6	8	6	1	0.8	23	29	50	120	20	0
Thai	9	8	42	33	7	5.8	19	26	210	425	61	18
Viet	11	11	63	50	30	44.5	28	37	120	295	56	37

Source: World Bank, Doing Business Benchmarking Business Regulations, 2004 and 2006.



Utility costs

Country	Electricity (US\$/KwH)	Water (US\$/cubic meter)	Sewer (US\$/cubic meter)	Telecom (US\$/minute to the US)	Internet (US\$/mo. T1 line equiv)
PRChina	0.08	0.21	0.18	0.25	5452
Indonesia	0.07	0.59	0.80	1.00	4863
Malaysia	0.07	0.51	0.66	0.24	4388
Philippines	0.10	0.21	0.19	0.30	5452
Thailand	0.06	0.31	0.17	0.56	4283
Vietnam	0.07	0.25	-	1.30	7497

Source: MIGA & World Bank, FDI Competitiveness in Asia, 2004.



Real estate costs

Country	Land acquisition costs (US\$/square meter)	Building Construction costs (US\$/square meter)	Facilities Lease (US\$/square meter gross/mo.)	Office Lease (US\$/square meter gross/mo)
PRChina	35	97	-	25
Indonesia	66	221	7	11
Malaysia	60	282	-	12
Philippines	61	1022	5	7
Thailand	52	329	2	5
Vietnam	-	-	3	12

Source: MIGA & World Bank, FDI Competitiveness in Asia, 2004.



Corporate tax rate

Country	Rate
PRC	30% national tax 3% local tax
Indonesia	10% first Rp50M 15% next Rp50M 30% exceeding Rp100M
Malaysia	28
Philippines	35
Vietnam	28
Thailand	30

Source: The Economist Intelligence Unit (2004)

Marginal effective tax rate

	Philippines	Thailand	Singapore	Malaysia
With interest deductibility	47	46	33	30
Adjusted for customs duty concessions	40	35	33	22
Adjusted for tax holidays	21	7	14	22
Adjusted for depreciation carried forward	21	7	-7	22

Source: Foreign Investment Advisory Service (1999)



Tax Incentives: Selected SE Asian Countries

Tax Incentive	Philippines	Malaysia	Thailand	Indonesia	Vietnam
Tax holidays	3-8 years	5 years on 70-100% of statutory income & 10 years for companies of national interest	3-8 years	3-8 years for new enterprises in 22 sectors	Up to 8 years
Reduced corporate income tax rates	for zones, exemption from national & local taxes & instead a special 5% tax on gross income	3% for offshore companies in Labuan & 10% for foreign fund mgt companies	50% reduction for 5 years for enterprises in investment promotion Zones		25% foreign investors & 10, 15, & 20% for 10+ years when certain criteria are met

Sources for Malaysia, Thailand, Indonesia, & Vietnam: Chalk (2001) & PWH Coopers (2001) as cited in Fletcher (2002)



Tax Incentives: Selected SE Asian Countries (cont'd)

Tax Incentive	Philippines	Malaysia	Thailand	Indonesia	Vietnam
Import duty & VAT exemptions	Tax & duty free importation of equipment & raw materials for zone enterprises; tax credit on raw materials & supplies for BOI-registered firms	Exemptions & reduced import duty & VAT rates on inputs in certain sectors specially exporters	Exemptions & reduced duty & VAT rates on inputs in certain sectors specially exporters	Exemptions & reduced import duty & VAT rates on inputs in certain sectors especially exporters	Exemptions & reduced import duty & VAT rates on inputs in certain sectors
Investment allowances & credits	Immediate expensing of major infrastructure investments by export enterprises in less developed areas	Investment allowance of 60-100% of qualifying capital expenditure	Allowance of 25% for investment in infrastructure	Reduction of taxable income by up to 30% of investment in priority sectors	If profits reinvested for 3 consecutive years, a portion or all of corporate income tax maybe refunded

ADB-WB Survey in the Philippines: major constraints to business



General Findings (domestic & foreign firms)

- Macro instability
- Corruption
- Electricity
- Tax rates

Foreign firms

- Customs regulations
- Telecommunications
- Labor regulations
- Crime
- Labor skills



Broad Conclusions

- FDI liberalization & changes in incentive policy crucial in FDI improvements
- Competition for FDI resulted in a complex investment incentive system
- Overall FDI performance has lagged behind the country's neighbors
- Tax incentives were not able to compensate for the relatively weak fundamentals and poor investment climate



Broad Conclusions

- Tax incentives have direct negative effect on revenues
- Some incentives address need to reduce economic distortions
- Assess impact of tax incentives on FDI
 - Which tax incentives are valued most by investors
 - Impact of incentives given by economic zones on statutory rate