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ScienceDirect

Policy and Society 33 (2014) 39–52

policy and society

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The political economy of foreign direct investment—Evidence from the Philippines☆

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Abstract

Much of the conventional wisdom about the political economy of foreign direct investment suggests that many developing country governments lower regulatory and/or legislative standards in order to woo potential investors. Using the case of the tobacco industry's efforts to influence excise tax policy reforms in the Philippines, we find a much more complex reality. Over a period of more than 15 years of concerted efforts and significant financial investment, a large multinational tobacco firm was consistently unable to realize its tax policy goals with serious, negative implications for the firm. In the most recent major policy confrontation over excise tax reform that led to one of the largest tax increases on tobacco products ever in a developing country, a number of major variables mitigated the powerful firm's influence. These variables included strong support for tax reform from a number of influential political actors and a well-organized civil society movement, which led to broader public support for both public health and fiscal reasons. Global governance around economic policy and the effects of domestic institutional structures also had marked effects on the outcomes.

1. Introduction

Cigarette smoking is hugely popular in the Philippines – according to the 2009 Global Adult Tobacco Survey, nearly half of adult males smoke (CDC, 2010), which makes it the country's largest risk factor for non-communicable disease. Not surprisingly, with a combination of steady recent economic growth and a large, young and growing population of more than 100 million people, multinational tobacco firms have long coveted this market. In the 1990s and 2000s, tobacco giant, Philip Morris International (PMI), aggressively pursued a greater share of this important market, which had been dominated for many years by a domestic producer, Fortune Tobacco Company (Fortune). Along the way, PMI has sought to influence domestic policies that affect its ability to do business, including taxation

☆ This research was supported by a sub-agreement from the Johns Hopkins Bloomberg School of Public Health with funds provided by the Bloomberg Initiative to Reduce Tobacco Use. Its contents are solely the responsibility of the authors and do not necessarily represent the official views of the Bloomberg Philanthropies or the Johns Hopkins Bloomberg School of Public Health.
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http://dx.doi.org/10.1016/j.polsoc.2014.03.002

and regulation. The firm ultimately succeeded in increasing its market share dramatically in large part through massive investments and a strategic joint venture, but perhaps somewhat counter-intuitively, its success in securing favorable policy has been mixed, and even limited in one key area, taxation.[1]

The political and economic effects of foreign direct investment (FDI) in low- and middle-income countries (LMICs) by multinational corporations (MNCs) has important theoretical implications that resonate deeply within the broader discussion of the political economy of trans-border capital flows. Without doubt, there has been a dramatic increase in FDI to developing countries in recent decades. According to the United Nations Committee for Trade and Development (UNCTAD), in 1994, developing country FDI inflows surpassed $100 billion (USD) for the first time; less than two decades later in 2012, inflows had surpassed the $700 billion benchmark (UNCTADSTAT, 2013). Furthermore, firms across a wide variety of sectors – mining, pharmaceuticals, tobacco, food, and liquor, to name only a small handful – have actively sought to invest in LMICs. Often, the corporations making these investments are enormous – for example, in the cases of tobacco, liquor and mining, among other sectors, the sheer economic size of the parent companies of firms engaged in FDI is sometimes greater than many of the countries in which the firms are investing. The potential to affect the broader political economy of these countries is large and worthy of both theoretical and empirical consideration.

Notably, considering the possible political, economic and normative implications of large-scale FDI, how these types of investments affect the political economy of a country has not been well conceptualized theoretically or examined empirically in systematic ways. While the scholarly literature on the political economy of FDI has focused for many years on countries' efforts to attract investment, there has been only limited inquiry into what happens after investment: how these flows of capital might be affecting key aspects of the political economy, including particularly policymaking and/or regulation.

In order to begin to consider the political economy of FDI, we utilize the important case study of the tobacco sector and related policy and regulation in the Philippines. Specifically, we evaluate the recent development of one of the most important tobacco control policy and regulatory areas, taxation (see WHO, 2010), before, during and after a set of large investments by PMI, the world's largest non-government tobacco company.[2]

We examine two competing narratives that represent extreme ends of the theoretical spectrum. At one end is "capture" or near-capture of the government by the investor on a relevant policy issue. As the argument goes, the coveting of FDI by the host state increases the political influence of the foreign investor. This may be true first when a future investment is under negotiation and policymaking and/or regulation affect the attractiveness of the investment. This may also be true after an investment has been made (post-establishment) because the future attractiveness of a host state to foreign investors depends partly on established investors being satisfied with their treatment. At the other end of the spectrum lies a foreign investor receiving treatment less favorable than domestic investors in policymaking/regulation. This might occur because domestic investors are better politically positioned to assert their private interests or because a bias toward domestic investors is viewed as being in the public interest (such as in the case of some industrial policy).

As the discussion below demonstrates, different groups advance these competing narratives. Concerns about "regulatory-chill" and "race-to-the-bottom" are advanced by proponents of environmental and health regulation. On the other hand, large multinational companies express concern about their treatment abroad and pursue protection through legal instruments such as investment contracts and international investment agreements.

There are considerable barriers to evaluating how the foreign character of an investor affects policymaking and/or regulation empirically. In particular, identifying the counterfactual of how an investor would have been treated but for its foreign status is fraught with difficulty. As such, this paper examines the issues in light of extensive interview research with a view to building theory around the conditions under which each narrative might hold true.

The case of FDI in the tobacco industry in the Philippines offers an excellent "most likely" case because of the high likelihood of successful political interference from a major foreign investor in government policymaking. First, there is substantial evidence that the tobacco industry continues to be exceptionally powerful in the Philippines (Alechnowicz, 2004; SEATCA, 2014). In the mid-1990s, Philip Morris' advertising firm, Leo Burnett, suggested that

[1] There is ample evidence, including from court documents, that PMI has created problems for the general implementation of the Tobacco Regulation Act of 2003 (RA 9211), particularly through domestic litigation with the Department of Health.

[2] The government-owned China National Tobacco Corporation is the world's largest tobacco corporate entity.