

Sicat, Gerardo P.

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**Reform of the Economic Provisions of the
Constitution: Why National Progress Is at Stake**

by

*Gerardo P. Sicat**

*Professor Emeritus, School of Economics
University of the Philippines

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Reform of the Economic Provisions of the Constitution: Why National Progress Is at Stake

by

Gerardo P. Sicat

Abstract

The Philippine Constitution contains many strong restrictions targeted against the flow of foreign capital in specific areas of economic activities. These restrictions were the same ones that were incorporated into the nationalistic provisions of the 1935 Constitution when its framers were anticipating future political independence. This paper discusses the beneficial aspects of lifting or liberalizing these restrictions on foreign capital in the Philippine context. Specifically, the restrictions relate to the prohibition of foreign individuals to engage in land ownership, in the exploitation of natural resources, and the ownership of public utilities. Corporations are allowed to participate in these activities only if they have equity ownership only to the maximum extent of 40 percent. In other words, foreign capital can only be a strict minority participation in corporate enterprises to be allowed in these economic activities. These provisions have hurt Philippine development over the years. Despite the liberalization of many aspects of the economy, including those in the area of trade, industry, and other aspects of the economy, these economic restrictions continue to hold because they are part of the Constitutional document. Some of these provisions of the Constitution could be relaxed through more liberal citizenship rules. But the basis of citizenship – *jus sanguinis* or blood relations– is also very restrictive. The need to improve the performance of the Philippine economy requires that these restrictions be examined and reformed. A direction of such reforms would be to place them out of the Constitutional framework – as is the case with most modernizing countries – and put them within the realm of ordinary legislation. In this way, they can be debated more openly and the policies could be suited up to changing conditions and the need for change of the economy.

Subjects: Philippine economy; Economics and Law; Constitutions; Economic development, Foreign direct investments, Economic restrictions.

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The current Constitutional debate

I would like to thank the organizers of this forum – the AIM Policy Center – for the opportunity to discuss the economic provisions of the Constitution. Today’s hot topic is the nation’s crisis of the presidency. But the *other* hot topic of the day is the reform of the Constitution.

Much of the current discussion of Constitutional change is focused on the reform of the political institutions – to change the form of government from presidential to parliamentary. The other issue is the proposal to carve up the country into several states and constitute a federal system. The heated discourse fostered in the media – on TV and in the print media – has all but ignored the economic provisions that need change.

Our crisis of the present is an economic crisis and the right course of action in any constitutional reform would be to face the nature of the beast – to amend the constitutional barriers that prohibit attaining greater economic progress. And these

* Professor Emeritus, School of Economics, University of the Philippines. Paper prepared for the Asian Institute of Management Policy Center Conference on Revisiting the Economic Provisions of the Philippine Constitution, held at the Manila Peninsula Hotel, August 29, 2005. [This slightly revised paper was also in presentations before other forums on Constitutional Change. Among these are the Diliman Governance Forum on Charter Change, held on September 9, 2005, at the Pulungang Claro M. Recto, Bulwagang Rizal, UP Diliman, Quezon City, sponsored by the Philippine College of Public Administration and Governance (NCPAG), College of Social Sciences and Philosophy, Third World Studies Center, and the Department of Political Science; and the Forum on Constitutional Change sponsored by the Program for Development Economics- UP School of Economics and the Philippine Legislators Committee on Population and Development Foundation, at the Macapagal Hall, on September 13, 2005.]

provisions are the economic provisions, not the political institutions (although some changes in the political institutions would be desirable.)

The crisis facing the nation today is *economic*. The political face of this crisis is the discontent with the constitutional basis of our nation. *The economic provisions of the Constitution are the barriers that make us into a high cost economy thereby burdening the country with loss of competitive capacity.* The country has reached a point that requires the relaxation of these limitations on foreign capital so that we can raise the level and quality of national economic performance. Foreign direct investment will provide the quickest way to generate more capital to raise the economy's overall performance.

Many of our leaders are focused on the reform of the political institutions. Even if there were desirable elements in those changes, if we did not deal decisively with the economic provisions of the Constitution, we would be essentially barking up the wrong tree if all our efforts were focused on the political issues. Many Filipinos seem to think that the problems that we face are essentially economic but we turn around to fix the political institutions. The economic provisions are where the fixing needs to be done, first and foremost. In order for us to understand why, some of us need to bring light to the debate.

In the course of sixty years of political independence, we learned that the restrictive policies of discriminating against foreign direct investment and of promoting trade and industrial protection that we incorporated into the corpus of economic policies had become a major bottleneck for growth. In fact, the ideas that led to these restrictions had made many of our countrymen become insular in their thinking, that only restrictions would make us go forward. But our experience had proved us wrong.

So, slowly, but correctly, the country dismantled these excessive protection and we liberalized parts of the economy. We changed the basic economic policies that we could change. These were those that covered trade and industrial restrictions. We removed many barriers that were within our control in relation to the promotion of foreign direct investment. We did not do these alone. By getting into international arrangements like ASEAN and WTO we aligned our economy with a changing world.

But today, these restrictions in the Constitution remain, even as we want greater participation of foreign factors of production to improve our economic performance in relation with the production of goods in the economy, including exports. Moreover, the critical needs of the country are tied up with enlarging and improving the country's infrastructure services. These are at the heart of the issue of encouraging the expansion and efficient development of our public utilities and the heavy industries and commercial subcontracting that emerge out of the interaction of the economy.

The economic liberalization in terms of industry, finance, banking, and international trade depends on an acceleration of certain types of services that could only be enlarged with a much larger participation of foreign direct capital in the economy. Infrastructure investment is one such requirement.

The economic provisions – barriers to greater efficiency and competitiveness

There are three main provisions of the Constitution that unduly restrict the nation's ability to move forward today. These provisions are central to the issue of raising foreign direct investments in our country and to the improvement of the country's infrastructure problems if the country is to undertake these investments without further incurring additional debt.

The first provision concerns the prohibition to foreigners to own land. The second is the exclusion of foreigners from the exploitation of the country's natural resources. The third refers to the limitation placed on foreign capital in public utilities sector.

Under the Constitution these limitations are not absolute. If foreigners have only a limited participation as defined by its minority position in the equity ownership of corporations, they would be allowed a role. Foreigners could be engaged in any of these activities if their investments were only up to the 40 percent of the total equity ownership of the company. In short, foreign participation would be feasible (and in fact considered desirable) provided that that capital would be in a minority of 40 percent equity contribution to the company. To put it in terms of national capital ownership, only corporations that are at least 60 percent Filipino owned and controlled are allowed to operate in these restricted areas of economic activity. In the context of our present need for foreign capital, these limitations are unduly restrictive. This is borne out of past experience where corporations run under this pattern had not helped to move our country further forward due to limited risk capital put in place. There is inefficiency and lack of access to capital – the world capital market especially.

However, these were the Constitutional guidelines that we as an independent nation have followed in directing of foreign capital into the restricted sectors of the economy. Even though such provisions did not apply to the rest of the economy where foreign capital was in general welcome, these restrictive provisions were the basis of our formative rules about the role of foreign capital throughout the early years of independence. Remember that these provisions were essentially those enunciated in the 1935 Constitution. Under subsequent amendments of the Constitution, none of these policies were ever questioned. In fact, many even wanted further restrictions. Thus followed a long period of development policy during which the nation was ambivalent about the merits of foreign capital in general. In fact, it induced a long period of relative discouragement of foreign capital because the dominant atmosphere of economic policy was protectionism and anti-foreign direct investment.

Over the years, the Philippines went forward with a weak record of accomplishment in the attraction of foreign direct capital. Compared to the record of our more economically successful neighbors in the Asian region over the last four decades, ours is rather dismal.¹ Of course, there were periods when that growth surge

¹ For a demonstration of this, a reading of my chapter on foreign direct investment in Gerardo Sicat, *Economics*, vol.3, **Philippine Economic and Development Issues**, chapter 33, including the appendix

was ready to escalate and bring in a greater amount of new investment flows. However, the economy became crisis prone for complex reasons, including the fact that the industries that the country had promoted were economically weak because they depended too much on state support and protection. Today, many Filipinos accept the need for more foreign direct investments in many areas of economic activity. What hurts us in this endeavor is that our laws still harbor essentially the restrictions that were imposed on specific areas from a Constitutional prescription made in 1935.

My proposal to amend the economic provisions does not mean that we have to abolish all restrictions to foreign capital that exist in these provisions. But the restrictions have to be put within a framework that permits our leaders to make the necessary adjustments when it is clearly in the country's interest to do so. I will deal with this issue of process of Constitutional change later. For now, it is important to make a listing of these provisions.

Land

Land as a factor of production is critical to agriculture. It is also important in commerce, industry and the service industries. The property sector is linked to industry in the search for appropriate location and to the very idea of home ownership that most people care about.

The prohibition to own land to foreigners had the effect of protecting Filipino landownership into a monopoly that derives rent from the need of foreigners for land to use. The prohibition against individual ownership assured that a foreigner residing in the country could only be a lessee in a lease rental arrangement. He could not use his family saving to acquire real property based on land. This made the families of expatriates with businesses here forever lessees of their residences. This discouraged them to spend their saving on making housing investment for their own comfort. It penalized them from hedging against rising land costs.

In the case of corporate business, the restriction to minority control in the form of up to 40 percent equity participation had the effect of assuring that control of land would be denied to foreigners within a corporate framework. This assured that Filipinos with landholdings in the country would have control of businesses that would emerge from the use of land and of property assets.

This prohibition did not fully stop foreign investors from investments if they had made a decision to locate in the Philippines. It was possible to short-circuit the process by forming subsidiary corporations involving Filipino partners who owned land and to undertake long term arrangements for the lease of the landsite. This roundabout method created monopoly profits for those who owned land. This second-best arrangement raised land costs to the firm, but it was a consequence of land regulations that made it impossible to acquire land as part of an investment.

to the chapter on the historical precedents to foreign direct investment policy in the Philippine setting, helps to explain the points that are implicit in this discussion. (reference in the appendix).

Did this help in making Filipinos control their destiny as landowners of their country? Actually, this provision on land ownership has limited the expansion and desirability of locating investments in the Philippines on the part of many foreign direct investors that are land intensive in character. As a result, they looked for other countries that offered better policies in terms of this factor of production. That essentially closed the chapter on that beneficial channel for those firms that passed the country by. Except, of course, that in the case of some investments, long term land lease could be obtained, as in the case of the Dole plantation that involved land owned by the government, it was still possible to get foreign investment to set up agricultural activities. But actually, after the Dole plantation, it became difficult to attract further plantations in agriculture. There would be some small investments in palm oil plantations during the early 1980s, but these investments did not survive when land reform was introduced to cover plantation agriculture.

The industrial export processing zones today under the PEZA law mirror the land investment vehicles of earlier days, but undertaken on a different business model. These companies prepare sites and services for investors that locate in them. The corporations that work out as industrial estates allow foreign investment participation and some of the more successful PEZA zones, for instance in Calabarzon and in Cebu, are effective partnerships having foreign equity participation. A liberalization of the provisions on land ownership could induce far more successful investment attraction sites for foreign investors. Then the stakes are larger in terms of investments, those companies would be induced to undertake a more intensive recruitment of foreign investment locators.

The prohibition of foreigners to own land in the country is based on a mistaken notion that Filipinos would control and own their own land and that among these are the millions of landless Filipinos. But land ownership has been widely skewed in favor of a few rich families for years. Even with land reform, this remains to be a feature of the country's landownership pattern. Today, the land is smaller in size and there is a wider list of smaller landowners. This probably happened because of the breakup of land through inheritance as much as by land reform measures. In general, however, land had not become highly productive. The reason for this is the lack of additional demand stimulus arising from land involving foreign investors and of foreigners. This situation had contributed relatively to the poverty of many Filipinos, causing them to become landless because of extreme poverty. In short, landownership by Filipinos had become a distant dream to many of those kept impoverished by the failure of development to reach them. In fact, the ruling elite in the country continues to be the landowning families still.

It is in fact a fallacy that must be exposed for what it is. People did not stop to think that foreigners could not take away the land if they bought it in the country. At best, foreigners would have to sell the land when they leave the country or when they decide not to use it. This act helped to improve land values for every one, especially those who own lands. It also made land ownership as investment more liquid. That is, land could be used for cash more quickly when the need arose.

Moreover, foreigners can't own the land indefinitely. They can't take it with them where they want to go or when they die! But by owning land, they bring tax payments potential to the community where the land is located. By owning the land, it

attaches them to the country and it induces them to invest further in the country. Thus they can help bring in some industry and at least, more expenditure of resources to improve their property. By owning the land, it is possible for the country to exploit their innate skills so that they can contribute to the growth of the domestic industry, improve production processes, and make the country a more productive place. Actually, all these would lead to a higher level of employment for Filipinos. It would also strengthen domestic competition and make the Filipino into a more competitive businessperson. Through the interaction with the foreigner, Filipinos would learn valuable skills.

In brief therefore, such investment can help to liven up the tax base of municipal communities and to help stimulate the growth process. The problem of course is that some of our own people have injected the economic fear of foreigners throughout our young nationhood. That was why protectionism and economic restrictions designed to favor Filipinos had become almost a way of life ingrained in our economic policies that today are hard to reform. This is the reason why, instead of becoming more progressive over time, we have been left behind by other countries in the pursuit of our economic goals.

By adding their income and wealth in pursuit of land investments in the country for their own needs, foreigners would be able to add to the demand for land. As a result, they would facilitate the firming up of land prices. In short, the benefits to the economy would be high if they are allowed to invest in land on their own.

It has been suggested that land ownership is not significant in the decision to invest in that there are companies that have come to the country even without having had this right to own land. There is a kind of self-selection for this type of answer. It often has not been asked of those companies that have chosen another country of investment for the reason that there are other features of investment incentives, including that of ability to own land or control its allocation indefinitely. Moreover, this provision on land ownership has made it difficult to attract land-based investments in agricultural and estate enterprises, where the control over the land for production or for reselling (in the case of real estate companies) is critical.

Our country's landscape is very beautiful. It has fertile soil all across the country. With some private investments in water resource control and in land use, these lands will become more productive. But in many places around the country, there is enormous under-investment in the land. Land has been rendered unproductive for decades simply because investments in the land had been meager. Those who own these lands are either too poor to render them productive and there is little interest among the other landowners who live in the cities and towns. In some cases, they just do not have the capital to render the land productive even though they own the land, despite the land reform program.

Corporations that could run agricultural companies are relatively few because there are not enough entrepreneurs to invest. We have over-logged hills where nothing now grows but cogon. I have seen these all in various drives along the country's highways and side roads – from Aparri, Cagayan Province to Matnog, Sorsogon in Luzon to Surigao and Zamboanga in Mindanao, and around some of our Visayan islands. The country's land potentials are not converted into productive assets

because there is little capital invested in them. It is only where there already exist active agricultural and commercial areas in the country that we find highly productive lands being fully exploited for economic use.

Agriculture, tree plantations, commercial and industrial development could be enhanced with greater vibrancy if there were greater freedom in ownership of land open to those who could afford to invest in their own properties. The same argument would apply in the case of the exploitation of large amounts of public lands for agricultural and environmental reasons (to be discussed below, under natural resources).

Other related reasons follow from the proposition of allowing foreigners to own land in our own country. It would help liven up investment in the country and increase land productivity. It would enlarge the property market. This would benefit all those with active interest in property investments. Another beneficial effect would be the impact on competition within the property and commercial market for land in the country. This would raise construction activity. It could induce encouragement of projects and programs designed to provide housing for the middle income and low-income citizens who need housing, two major neglected sectors of housing investment. It is a matter of design to get these developments spread over a wider basis because there could be greater capital participation by foreigners. Actually, this will enlarge the opportunities for Philippine companies to undertake ventures with foreign capitalists with know-how in these business sectors.

The tourism sector could benefit immensely from allowing foreign ownership of land. Among neighboring countries in the region, tourism has become a major booster for domestic income growth, high employment in the tourist service industries, and the growth of vibrant domestic cottage industries that depend on the tourist trade. The direct impact of tourism on the domestic construction industry is highly underestimated.

Control of the land assets is critical to the inducement for foreign companies to construct large tourism and housing estates in which foreign direct investment is involved. Another aspect of this inducement of tourism estates relates to their involvement in the marketing and other channels of business. It would not be surprising if successful, well-sustained tourism projects would arise out of steady control over land assets. (Of course peace and order are important issues, but the volume of investment also determine how the program prospers.)

Tourism has changed the economies of Indonesia, Thailand, and Malaysia, not to mention Singapore and Hong Kong. All these countries are our immediate neighbors. The growth of Bali in Indonesia, of Pattaya, Chiangmai and Phuket in Thailand, and of many tourist towns and estates in Malaysia are interminable cases to learn from. Some of these places have been growing the way Honolulu had grown in an earlier period of post-World War II America. The same type of growth has been promoted by the expansion of the tourism economies of Cancun and tourist cities on the Baja California side of Mexico, and in many Caribbean islands where foreign expatriates living in their retirement estates or second homes have added great value to the employment and income growth of these countries.

The critical factor here would relate to the ability of foreigners to buy land, real property and second homes. Although these are enclaves where foreigners live, these places have encouraged the growth of domestic jobs and industries internally within these countries, creating opportunities for locals to find prosperous opportunities for livelihood that exploit the tourist dollars. The entry of foreign risk capital to these tourism havens is related to the business environment and home and land ownership opportunities that are made available to foreigners. Therefore, one key element would be the ability of foreigners to own land or to lease it directly for long periods that they as lessees could control.

Many Filipinos, when they move abroad, whether temporarily only or to settle permanently try to own land for investments. In fact, many Filipinos own land or have houses or property assets in foreign countries. These compatriots park some of their wealth in foreign lands. We can make a private survey of rich Filipinos and possibly we will find that some of them own investments in property abroad. In fact, even if they do not move abroad, they are tempted by advertisements to own properties in various real estate ventures in some countries. For instance, just recently, I saw advertisements that got stashed with my newspaper home deliveries the following advertisement: "Own a piece of the American Dream, California lots for as low as P130 pesos per sq. m. at Golden ___ Ranchos." Even here in our country, some business operators abroad are trying to attract the Filipino appetite for owning American real estate." Some Filipinos with extra savings would be induced by such invitations! Once committed to these investments, they no longer become liquid for Philippine economic use.

We should be able to encourage foreigners to park their wealth in our own land, too. Why should the traffic in investment be one way? Why should we not allow foreigners to reverse this flow of assets and invest in property to out country? Many countries are able to strengthen their balance of payments and their economic wealth by attracting foreigners to keep their wealth within their boundaries.

Natural resources

The case for amending the restrictions on natural resources is more easily understood now that even the Supreme Court had ruled recently in favor of foreign participation in the mining exploration and exploitation issue related to service contracts undertaken by the government with foreign companies.

From the beginning, the restrictions placed in the Constitution have been based on the mistaken interpretation of the regalian doctrine on natural resources. It was made to apply to the notion that only Filipino citizens are qualified to undertake the exploitation of Philippine natural resources. But by the regalian doctrine, natural resources belong to the state (or the nation) and that they are there for the welfare of the country's citizens. It does not extend exclusively to the principle that only Filipinos should exploit them. It means that the state can undertake their exploitation so that the nation could benefit from incomes and revenues that are earned from these resources.

Participation by foreigners in the exploitation of natural resources can be justified so long as the state controls their disposition and uses the proceeds from their

exploitation to benefit the nation. Foreign capital and expertise could be used to find mineral reserves and put those reserves under appropriate production sharing arrangement. Additionally, the use of the government's power of taxation would extract the necessary wealth from those resources, thereby assuring that there would be rents that accrue to benefit the Filipino nation. The tax revenues that are earned could then be ploughed back to the nation in the form of public expenditure for the country's development and social programs. That is the essence of the use of taxation and of production sharing contracts as the tools for extracting for the nation the power of eminent domain of the state on all exploitative natural resources activities.

The country's mineral wealth is vast but the exploration and specific discoveries have not been adequate to quantify this claim more fully. There are known reserves of minerals which are today under study for mineral and industrial exploitation. For in general, during the six decades of independence in the past, the amount of exploration activity for mineral wealth had been limited precisely because foreigners had been excluded from participating in this activity. Filipino capital was immensely inadequate in relation to the task, a feature of the exploration industry that is not widely shared by those who believed mainly in the virtues of exploitation of these resources by Filipino citizens. Most of the mineral wealth of the country that was exploited for economic purposes during the post-independence period was discovered before the war in part through the exploration activity of the colonial Bureau of Mines and of American exploration and mineral companies that staked their mineral claims with the government. We benefited from these in terms of exports, incomes, and employment of Filipino labor when the mining sector boomed during the early decades of the post-independence period.

The Supreme Court decision on mining has finally resolved even though only partially the question that has depressed the mining industry since the 1980s. The uncertainty that government service contract arrangements with foreign companies to undertake exploration for minerals including petroleum resources led to a decline in mining. If the government had not engaged foreign companies to look for energy sources during the 1970s, the country today would still be in zero-base territory insofar as oil and gas finds are concerned.

Service contract arrangements were introduced during the 1970s and this permitted the country to engage in actual petroleum exploration activities (rather than simply undertaking small exploration efforts to help manipulate speculative mining stocks in the thin Philippine stock market). The petroleum exploration efforts have not totally been successful probably because the scale of that activity had not been adequate. But still the country has made significant discoveries like the Malampaya gas off Palawan that today fuel part of our energy production as a nation. Also, we have successfully expanded investments in geothermal energy production with the help of foreign companies. These major discoveries have lightened – although not alleviated – our energy resource deficiencies as a nation.

Exploration efforts of that decade were questioned later because of the concern about their constitutionality. That issue helped to put the mining industry into a tailspin of depression during the last two decades. The addition of many other concerns including those related to the rights of the local residents and natives of the

place, have further complicated the issue of how to exploit the wealth of resources that the country has to make our nation economically develop.

Even with the recent Supreme Court ruling on the issue, it would be far better to deal with the issue of participation of foreign capital in natural resource exploitation industries more directly through the Constitutional recognition of the issue. That would firmly put in place the definite language that recognizes the principle to remove potential uncertainties that arise out of Constitutional challenges. That would remove the threat of placing the nation hostage to legal suits that lead to national paralysis arising out of policy issues.

If the restrictions on natural resource exploitation had not been put in the Constitutional document *as in the case of many progressive countries in the world*, the nation would still have grappled with the issue of how much role foreigners would be required to play in the exploitation of our natural resources (indeed, also, in the other issues that define the role of foreign capital in our economic life). This would also be the case when Filipinos undertake economic activities along the same line. *Indeed, such issues should have been relegated to ordinary legislation. Then all the issues of natural resource exploitation – those pertaining to the interests of the nation and of the Filipino people – those that are often defined by nationalistic prerogatives -- would have been joined at the level of legislation in the crafting of the laws that would become the basis of our economic development policies. We would have been able to debate the economic issues and to decide them according to the changing circumstances that define the challenges facing us.*

The realm of strengthening the provision of jobs in the countryside rests a lot on the maintenance of the policy allowing foreign participation in the mining industry. This could be made to extend to the provision of exploitation rights for reforestation purposes and to strengthen the incomes that could be derived from forestry. The potentials for tree plantations in the Philippines are high, and fast growing varieties of forest plants for the production of pulp and other products could be turned into major industries, if the government would explore the future of this route.

The country has let opportunities for greater participation of foreign capital in natural resource exploitation in the past slip by. Foreign capital could be introduced to deal with industries that help in reforesting the country. Such ventures would eventually lead to the reforestation of the country's barren hills in no time at all. It would also lead to forest-based industries in the country. Also, corresponding opportunities also abound in the case of aquatic resource exploitation.

During the 1970s when I was active in the government, there were many proposals to undertake industries based on forestry that would depend on concessions for forestry development and exploitation. Of course, in those times these were Constitutionally infeasible. The proposals came from companies based in developed countries, notably from Japan and from the United States. Reforestation of vast tracts of land could be undertaken. Only this would imply secluding large tracts of land that would allow the industrial planting of trees according to a pattern of steady forest practices. With fast growing varieties that are feasible in our tropical landscape, the benefits of these would be manifold.

First, they would guard the uplands from erosion and thereby help improve the lowlands for agriculture. They would readmit wildlife where it was destroyed or driven away before. Then, they would create vast opportunities for new industries based on wood products. Such projects would have the potential of generating long term employment for the people in these communities. Those jobs and industries would provide a steady source of economic stability in the countryside.

Right in Subic Bay Freeport Zone, for instance, we have a Japanese company processing timber that is shipped from timber concessions that it owns in New Zealand. The trees are cut from the tree plantation that is configured for a 30 year cycle of tree planting and cutting. This is truly a case of long term investment in land. With our tropical forest conditions, trees would grow faster, and output for pulp and timber would be feasible at shorter time. Land that would be used for thirty year forestry practices would involve the growing of more hardy timber that grow longer and slower and are used for construction.

There are today large areas of land that could be productively turned into major forestry concessions for the growing of trees for pulp and other uses. These would strengthen the inflow of long term capital, an increase in employment, and a growth in sophistication of the industrial uses for which these plants could be put to good use. The challenge for the nation is to provide a stable legal basis for attracting foreign capital so that we can encourage such projects.

Public utilities

The participation of foreigners in public utilities does not require the same length of discourse that was devoted to the discussion of the Constitutional restrictions on foreigners regarding land ownership and the exploitation of natural resources. By now, if the exposition has been convincing enough, the amount of prejudice and ignorance regarding these issues would already be sufficiently exposed.

The services that have been delivered by our public utilities represent a known and quantifiable experience to most of us. Poor quality of service from public utilities during the first fifty years of independence has marked that experience. Electricity provision has been erratic – not only in the Metropolitan Manila area but more so in our more remote cities and towns. Telephone service was very bad until recently. Until we liberalized the telephone industry, we had lived with a service that was not only erratic but also nationally embarrassing. There were too few telephones made available. Of those in service, the dial tone was often not available even though the phone was not busy. It was easier to call the US than our neighbor. Today, those who can use the ubiquitous cellphones will have forgotten what a challenge it was to make telephone calls between mere neighbors and businesses.

Some of the problems were of course tied up with the regulatory issues related to the public utilities. Somehow, political factors have infiltrated the task of public utility regulations. The government had gotten too busy injecting political concerns to the pricing of public utility services, often interfering so as to further aggravate the already poor quality of existing service. But the concern had been more on pricing rather on the quality of service. Populist politics has had to do with the rapid

deterioration of public utilities in the country. Price adjustments were not given on time and were often inadequate to provide sufficient rate of return to the utilities.

Before the war, our public utilities were the foremost in quality and extent of coverage among the countries of Southeast Asia. That's why we were considered a place of hope in the region. We were a country (though then a colony) in which there was a lot of foreign in-migration of workers from Asia and from Europe. We were a cross-road of the American empire, and we benefited from its largesse and economic efficiency through the inflows of American capital in a lot of economic sectors. That growth enabled many Filipinos to become successful businessmen of the period.

With independence, the Constitutional limitations on public utility were suspended at least for those public utilities that were owned by American capital because of the parity amendment. That took effect from 1946 to 1973, when the Laurel-Langley agreement expired. Despite the fact that our public utilities were restored immediately after the war because of the war damage program that rehabilitated a lot of destroyed property and investments, from that time on to the present, public utilities had not progressed as well.

The reason was that we kicked out the capital that was already in place, told it practically that it had no hope of further growth under the same arrangements involving ownership as before. At some time in the future, that capital would have to sell out to Filipino citizens. It was a case of putting force majeure on them, by virtue of the political supremacy over the rules of the game that was now in Filipino hands. So, in effect, we forced their early divestment or the parity amendment expiration put the deadline as doomsday for that capital. This put them in a position of little choice. They were forced to sell to buyers who had the power to offer relatively low prices for the assets that they were acquiring. In this context, it was like making a fire sale of those assets to the parties that had the power to buy them out.

The effect of these restrictions and their reality in application took away the incentives for existing foreign investors to improve on their public utility services. They had to divest in due time and their actions were mainly designed to make a sellout of their interests. During the 1960s and the early 1970s, the divestments took place – they were in electricity service, in transportation companies [land and shipping], in telephone and communications. Water and sewerage then was a public function and was not held by foreign investments but was a service that the public works department provided.

The companies that acquired many of these public utilities belonged to the richest and powerful families in the country, but matched against the requirements of rendering the required services from the public utilities, their resources were still inadequate. In short, they were undercapitalized. As a result, they could not provide the required investments that could have improved the public utility services that the country needed. They had to expand service slowly and mainly through borrowing. After a point, however, that borrowing capacity was reached because of their limited capital. Thus, they could not pursue large investment expansion projects to enlarge the quality of service. (Of course, the politics of rate-setting for public utilities also often made it less propitious to undertake expansion of the service because profits were constrained when the government applied the squeeze.)

This in part explains why our economic development during the postwar period had been severely handicapped. The public utilities failed to deliver the services that were needed to make the country more prosperous. Discouragement of foreign risk capital in the area made the country dependent on undercapitalized ventures that Filipino investors operated. This contributed to the country's lag in public utilities as our neighbors in the region were improving their own utilities.

The policy on the participation of foreigners in the delivery of public utilities can be relaxed to enable the public utilities to strengthen their capital base. The fixation on the 60-40 equity Filipino-foreign equity rule for the companies providing public utilities has prevented the entry of sizable risk capital in the public utilities sector. The 40 percent foreign equity could be raised in many possible ways (and the 60 percent reduced in the process). It would be possible to liberalize the participation of foreign risk capital in the area by encouraging experienced and strategic investors to expand services. Inducements later could be added so that the general public could participate in their public listing in the exchanges to encourage broadened public ownership by Filipinos through mechanisms of selling equity through the capital market in the stock exchange. This would make ordinary Filipino savers participate in the progress of their own utilities.

What the country needs to devise for the long term is to liberalize the participation of foreigners so that we can allow the greatest opportunity for the improvement of the services that we as citizens expect from our public utilities. These could be undertaken through ordinary legislation. The safeguards would still include useful policies that would allow Filipinos to invest in the provision of public utilities, but to allow greater participation by foreigners and a wider list of investors. There is need to open up corporations that are providing public utilities, and here state policy should encourage a wider ownership of these utilities through the stock market.

Citizenship

Many of the difficulties that are expressed in our Constitution about the role of foreign capital in our national life and in the economy could have been eased via another route – the basis of citizenship. But here, we shot ourselves in the foot too, when the Constitution was crafted.

Our Constitution framers chose the strictest basis for citizenship – *jus sanguinis* – or citizenship by blood relations. Our paranoia as a nation is rooted in the application of the *jus sanguinis* principle of citizenship. For years, we made it difficult for Chinese who were born in our country to become citizens for lack of proper blood connection. It was only by an act of liberalization of the process of obtaining citizenship that this problem was eventually partially remedied.

We could liberalize many of the restrictive aspects of the Constitution by simply adopting the *jus soli* principle of citizenship – or the principle of citizenship based on the place of birth. This is the effective rule used in some countries, like the United States. But even if we did this, many of the difficult issues on economic restrictions that are made against foreign capital in our national economy cannot be solved through the liberalization of citizenship rules. Changing the basis of citizenship

would not be sufficient. But it would ease quite a lot of the tensions that result from the exclusion of foreigners in our economic life.

Those who consider the *jus sanguinis* principle as an inviolable basis for the citizenship issue should look at the events of the postwar period. Many Filipinos are moving out of the country and are becoming foreigners by virtue of emigration, by choice, by forced economic circumstances that had led them to new countries. Our people vote with their feet – they leave inferior economic environments. In an effort to retain the continued loyalty of Filipinos who have acquired foreign citizenships, we have extended additional privileges to them so that they could restore their citizenship and even partake of voting rights that they had lost when they renounced allegiance to our country. If we had more open-minded basis for citizenship, some of these efforts to keep them would not even be necessary. The avenue for dual citizenship would be there.

Many countries have revised their citizenship rules so that they could attract foreigners with economic resources – large capital investments, special talent, and so on – to become residents if not citizens of the country. We have in part been victimized by the efforts of other countries to encourage the immigration of our citizens who have high educational background and possessed with unique skills. Their gain is our loss. With globalization, this will take place more rapidly unless we have effective measures to make economic opportunities in our own country more attractive.

All these arguments make it imperative that we review the citizenship issue as spelled out in our Constitution. It is a major element in the debate on the economic provisions of the Constitution.

Media

Many would wonder why the media in our country is often very negative about our accomplishments as a nation and those of the government. Even when the government is doing right, it often gets poor treatment from the media. The discussion of scandals, political or otherwise, crime, sex and triviality, and peace and order problems take center stage without letup. Sometimes we get discussion of economic and social issues, but more often these are absent from the general layout of news. Of course, there are a lot of opinion columns and some of the best column writers are probably found in the Philippines in comparison to other countries in the region. But there is a good sprinkling of licentious treatment of many issues that often have marginal significance toward nation building but are useful boosters of circulation for the press. The editorial opinion often neglects major economic and social issues but panders to the sensational issues.

Who controls the press in the country is hard to fathom. The nominal publishers from the mastheads of printed media don't tell us who owns them and controls editorial policy. Part of the heavily political content of news reporting and discussion is in part dictated by who controls the press. Who controls the press determines what topics and issues are newsworthy.

It would be desirable to open the media to foreign ownership. This would provide competition to the domestic press in the reporting of events about the country. It would help to elevate the content of economic and social discourse. The presence of a foreign media would provide the Philippines an additional window to the world and of the world to the country. Perhaps it would encourage a more responsible discourse in the conduct of economic policy. It would also link the country more to the external world.

Constitutional change: Process for revision

So far, I have been careful not to specify exactly how the revision of the economic provisions would take place. The aim of my discourse was mainly to illustrate the problems that we have put ourselves in by writing restrictive provisions on how the country's economy would regulate the role of foreign capital in the Constitution.

Perhaps it would be useful to outline a strategy or approach for revision. Before I go to that process or approach for revision, it would be useful to comment on what Constitutions are expected to provide by way of supporting the economic and social directions of nation building.

The constitutional provisions of many economically successful nations do not include statements on details of economic policies. This is unlike our Constitution where major restrictions such as the ones I have enumerated in his paper are written in the Constitutional document. Other countries achieved great flexibility by dealing with such matters in their ordinary legislation. Their legislative bodies were made free to enact the laws pertaining to the details of national policies affecting restrictions on the role of foreign capital. In our country, the presence of the restrictions in the Constitutional framework rendered it difficult to enact legislation that addressed these questions in a more flexible manner. The legislative body could not undertake remedial measures that bumped into the impositions stated by the specific prohibitions or restrictions stated in the Constitution.

The Constitution is the place where the grand aims of nation building are to be expressed. It is not the place for details of specifying economic policies that might have to respond to changing economic conditions and demands of the people. The details of implementing the goals of nation building are matters for ordinary legislation. If the present leaders make mistakes, future legislation could be undertaken to correct the laws and policies. If the mistakes are made in the Constitution, the nation suffers because correcting the offending provisions would be very difficult to undertake.

In a recent study,² countries that used to have long and heavily detailed Constitutions have moved to amend their stringent provisions. These provisions were mainly centered on economic and other rights. These documents now stress mainly the basic descriptions and structures of political institutions and the protection of the political rights of their citizens and leave the details of economic policies to their political institutions to deal with.

In fact, many countries deal with economic issues through normal legislation, not through Constitutions. Those who pay excessive value to the importance of written frameworks of government ought to remember that the British polity does not

² See Gerardo P. Sicat and Loretta Makasiar Sicat, *An International Comparison of Constitutional Style: Implications for Economic Progress*, UPSE Discussion Paper 0412.

have a written constitution but whose laws have been defined by the ordinary legislation of the British parliament over the centuries. The US Constitution simply wrote the basic framework of government, its structure, the duties of its main officers, and the interrelation of the parts. They developed the core of economic and social legislation through their Congress and the leadership of their President who set the trend of legislative agenda.

Today, after a great romance with excessively detailed constitutions, most of the modern nations of the world have simpler written constitutions. Look at the Constitution of China today and it is less encumbered in the economic framework that is found in the Philippine Constitution. The same is true with a comparison of our 1987 Constitution with the constitutional framework of other countries whose accomplishments we admire in the economic front.

The current crisis of our nation points to the fact that our leaders want to change the constitution because – as many have pointed out – the present one, no matter how recently crafted, is unable to help promote the progress of the nation. The certainty of a Constitutional overhaul is already in the national agenda. Our President in the State of the Nation address this year (2005) said that she would push for Constitutional change.

According to the present process, to change the Constitution requires a three-fourth vote in Congress. The bar for Constitutional reform is much more difficult than the provisions for change in the earlier versions of the Philippine Constitution. However, through an action of the President a Constitutional committee could be called that would formulate the changes that are adjudged to be important. A Convention then could act on these recommendations. In my view, the President needs to define the reform agenda regarding the economic provisions of the Constitution and whatever political reform would be needed. The President, hopefully, would define the agenda of constitutional change and focus on the economic provisions because, although they are more controversial, they are likely to produce much more beneficial effects. Then, she could focus on the political change that she might identify as most needing in change. In this way, the economic reforms would be recognized as having equal status in the priority of needs for change with the political reform that is identified.

The agenda for Constitutional reform needs to be more focused on the parts of the Constitution that require amendment because of their urgency. It should avoid the potential of revisiting the whole document again. It should avoid the zero-base approach that marked the efforts of the framers of the 1987 Constitution in which all parts of the Constitution was subjected to scrutiny and change. By pinpointing the parts of the Constitution that need to be changed, the work becomes simpler, not massive. In this way, it is possible to control the amount of work to be done, to be focused and to achieve the changes in the shortest time possible. In this delineation of the areas of reform, the economic provisions need to be stressed as the most important changes to be undertaken.

The political part of the agenda for Constitutional change appears to be in the direction of unifying the executive functions and legislative functions into a parliamentary form of government. There are synergies to be exploited with the union of the legislative and the executive functions of government. This country's political system would be set right if there are laws that require politicians switching parties to resign their posts immediately after their switch. This is a major problem that causes

party discipline to fail. A parliamentary system with floating party members is an invitation to a very unstable government.

The alternative or supplementary agenda on the political front is the movement toward a change to a federal structure of government. That splits the nation into several states. The motivation is that the states would be more free to set their policy agenda for internal development. The federalists forget that national economic policy dealing with international commerce, taxation of income and of goods, and treaty making would still belong to the central government even in a federal structure. Major issues arise on the sharing and devolution of powers in public spending and of course also in taxation. The sharing of the burden of the national debt again arises from all these problems of devising the budgetary burdens of the states and of the central government. In short, the problems that federalism itself would bring lead to daunting problems, in addition to the complexities that would be brought out by the need to create new structures of government among the new federal states.

At heart, I think that the federalist idea is essentially a more meaningful application of the local government reforms that have been voiced often. Federations of governments evolved from strong states already in place. The states were there before the federation came to be. This is the main story of major federal governments in existence today. The current proposal seeking a federal structure is essentially a desire of weak local units to have more power devolved to them from the center. Also, one example that should be close to home is that the first form of government of Indonesia was a federal form of government. For those old enough to remember, what happened to the United States of Indonesia. It is today the Republic of Indonesia.

Our leaders must recognize that the political changes that are proposed will not do the job unless the economic provisions are successfully dealt with. Binding constraints now make these restrictions impose a burden on national progress. My preferred solution to the problem is to delete these restrictions from the Constitutional provisions while mentioning the general policy of reserving the benefits of growth and social welfare for the benefits of the nation's citizens. As a transitional provision to these changes, the policies invoked in the revised economic provisions would be retained until new legislation addressed those issues directly.

Such a procedure gives the future legislature the flexibility to address these problems more directly in the manner of new economic legislation. The economic issues would then be given their due in the legislative debates that would ensue. In this way, the nation would be able to debate the full nature of how far the participation of foreign direct investment might play in the various areas that I have discussed in this paper. All these policies would be debated in their present context, within the nature of needs for supplementing the requirements of national economic growth, and in the context of promoting greater competition for the Philippine economy.

The problem with the Constitutions that we have framed, beginning with the 1935 Constitution to the present 1987 document, is that we wanted a framework that was cast in stone, so to speak, and not to be broken. We know from the decades of experience that some of our problems of nation building might have been hampered by the inflexibility with which our past leaders had defined the road that they left for us to travel. Despite their good intentions, it is important for the living of today to save themselves from the problems that bind them to specific solutions that appear

like orders from the past and from the dead. *Let not inflexible orders from dead leaders tell us, the living, what to do with our future.*

The nation needs to be educated fully on these economic provisions and how they have hampered our access toward a high level of share of direct capital inflows to help our development. Such an education has to emphasize the beneficial aspects of having more foreign direct capital even in the areas that were thought to be sacrosanct areas where foreign participation was not allowed or allowed only in limited amount. An increase in the country's ability to attract more foreign capital in areas that were formerly prohibited will help accelerate the country's competitive position within the world economy. Delays along the lines of the reforms would simply leave the country farther behind those countries that we consider to be our natural competition that are moving forward well. That would surely worsen the country's economic future.

Reforms that permit an increase of foreign direct investment in sectors that were formerly restricted would strengthen the country's competitive position in many ways. First, it would raise the country's potential to earn more exports. In public utilities, an impact would be to expand the availability of public services at more economical costs. That in turn would make it easier for the country's ability to service its international debt. The entry of a greater volume of foreign risk capital in the economy reduces the need for foreign borrowing to cover the deficiencies in the country's international payments that the government is often required to provide through lack of available providers of the same services. If the foreign capital adds to the rise of the country's export base, the national debt service burden would become lower.

Constitutional revision: political institutions vs. the economic provisions

For the last part of this discussion, it would be useful to focus on the benefits that might be derived if we had a choice to correct the Constitutional course via a choice between the political changes as against amending the economic provisions.

The political changes that are being suggested are to adopt a parliamentary form of democracy or to form a federation of states – in whatever shape that they would take – would involve the following:

- ◆ *The same actors – politicians and bureaucrats – will be involved in implementing them, when adopted.* Our experience is that many changes in laws involving the same people and actors often have limited impact on their behavior afterward. We have a lot of laws that are not adequately implemented despite the good intentions. *Merely changing institutions with the same actors may not change the outcome.*
- ◆ *The resources that are required to put the political changes (if and when adopted) would involve and enormous amount of the government's scarce resources.* The transitional costs will be large in the management of the transition toward new political institutions. The frictional costs of just changing from one system to the other would involve heavy costs in personnel, in training, even in institution building costs. The task of creating new institutions is not an easy one. In the case of the parliamentary system, the cost of the transition could be smaller because

the introduction of the parliamentary system would reduce duplication of institutions. This change requires a merger of the functions of the executive and the legislative. But the parliamentary option would be meaningless and could lead to great political instability if it is not accompanied by the strengthening of political party discipline. The presence of too many parties is a recipe for gridlock and wheeling and dealing. The federal option however would definitely be more costly. It would duplicate many current governmental institutions at the national level and establish them in parallel in all the states. This is likely to cause enormous additional demand on the use of the fiscal resources of the government.

- ◆ *In short, all these political changes will require the use of more government resources.* Hence, the government will be more strained to provide more tax money. If this is not possible, it would induce a demand for greater fiscal deficit since the government expenditure needed for the task alone of governing would be higher – at least during a transitional period that is likely to take years, possibly even decades of institutional learning.

The revision of the economic provisions of the constitution will result in behavioral changes that would lighten the burden of financing national development. The impact will be a marked contrast on the efficiency of the economy, both by virtue of lower transitional costs and of course high beneficial impact on the growth performance of the economy. The entry of risk capital will also reduce the need of the government for much debt finance of activities that the nation cannot afford in terms of investment activities.

- ◆ The economic actors that will be affected by constitutional change would involve *new players that were excluded before in the economy.* Therefore, any positive response on their part will represent the addition of new economic resources to help in the nation's progress. Moreover, the new actors will not require any claim against the use of additional government resources. Foreign direct investors would add new economic resources that would raise investment in the country, with nary any additional debt that could be attributed to the government. Foreign direct investors would carry with them new capital on their own and would bring about a capacity to borrow capital on the basis of their net capital and their existing access to the world's capital markets. Moreover, such new investment flows could be accompanied by human capital resources (trained manpower and a larger entrepreneurial pool into the country) and by greater access to productive technology that would be associated with those investments.
- ◆ At the same time, *the transitional changes in the new economic provisions would not make additional claims on government fiscal resources.* So, they would strengthen the fiscal picture, and they would lead the government to devote more time for using public money for capital formation or for government programs of high priority.
- ◆ *There would not be any massive reorganization of the government to achieve these programs.* If at all, the changes that would be encouraged would involve government agencies that interact with the new investors: government bureaus dealing with new businesses, regulatory agencies that

undertake responsibility in with normal business activities take place, including the regulatory boards dealing with public utilities. But these are agencies that already exist. All that would be needed would be to improve them and strengthen their competence. The required changes would accelerate the improvement of government functions in these areas and would help to promote greater fiscal consolidation of the government since new demand for government resources to finance these changes would no longer be made.

- ◆ In short, all the changes in the economic provisions of the Constitution will only contribute to greater efficiency in the use of economic resources, to the growth of capital formation and investment in the country. The impact of additional foreign capital put in the economy would be to transfer most of the functions of providing support for credit and investment promotion from government institutions to the market place, including the global market place. This will strengthen the economy. Foreign direct investments involve risk capital that has far more extensive networks with the financial markets. Therefore, the likelihood of government liabilities being extended too much would be relieved by the growth of risk and liabilities within the private sector, rather than within the government sector. This development would be beneficial to the nation.

Annex : Further Readings on Constitutional Issues from the Present Author

The present author's thinking on Constitutional issues is the product of studies that he is undertaking on the problems of Philippine economic development. Some of the articles below are (deliberately) not yet published, but they may be accessed in the internet through the website of the UP School of Economics:

[www.http://econ.upd.edu.ph](http://econ.upd.edu.ph)

Once on the website, try to access the Discussion Papers, or search by author's name.

Gerardo P. Sicat, *Philippine Economic and Development Issues*, Anvil, 2003. See *Appendix to chapter 33*, on the historical background of the policy affecting foreign direct investment. [This book is volume III of his textbook, *Economics*, Anvil, Manila, 2003].

Gerardo P. Sicat, "The Market, Social Policy and Economic Performance," *AKI Quarterly* (La Salle University), Vol. 2, No. 2, October-December 2004.

Gerardo P. Sicat, *Philippine Economic Nationalism*, UP School of Economics Discussion Paper 0201, January 2002

Abstract: Not seeing that the power of taxation of the state is the true expression of national patrimony in economic matters, the framers of the 1935 Constitution introduced provisions on the use and disposition of land and natural resources vesting exclusive rights of exploitation to citizens. This also meant restricting foreign investments in public utilities. The provisions were not revised but even elaborated in subsequent revisions of the Constitution. These provisions set a train of restrictive economic policies that helped to compound the mistakes of early industrialization policies. By tying the hands of future generations of Filipinos to deal with specific economic issues in their own time, the Constitutional provisions provided barriers against solving economic problems with realism as called for by changing times and exigency. Judged as

the most likely to succeed in the early years after independence among many East Asian economies, the Philippines became the economic laggard among a group of highly performing economies during the second half of the last century. The brand of economic nationalism that was fostered was exploitative and heavily protectionist in character. It built an economic and political framework that discouraged competition, enhanced monopolies and inefficiencies by nationals, inhibited the growth of international trade and hence postponed by a large margin of time the growth of economic specialization based on comparative advantage. A new kind of nationalism based on principles of competition and comparative advantage is needed. This will be helped greatly by the removal of stringent Constitutional provisions that affect foreign investments. An enlarged regional free trade within ASEAN and accession to the World Trade Organization are factors that will help to sustain this new ethos which will strengthen economic and national aspirations.

Gerardo P. Sicat and Loretta Makasiar Sicat, *An International Comparison of Constitutional Style: Implications for Economic Progress*, UPSE Discussion Paper 0412.

Abstract: Using the United States constitution as yardstick for its essential simplicity and completeness in describing the structure of government, the constitutions of twenty-two countries were studied for their language style, brevity and coverage of provisions. Most constitutions of later years have expanded coverage of institutions and the rights of citizens. The outcome is that constitutions became much longer because of broader content but also because they also cover details of institutional processes and structures. The expansion of concerns of constitutions also incorporated economic and social guarantees of citizens in addition to the guarantees of political rights and individual freedoms. Countries with simpler constitutional frameworks have experienced relative constitutional stability more than countries with long and detailed constitutions. The systemic collapse of socialist states in the 1990s brought about some return to constitutions that are simpler in coverage and which incorporate a balance of political and economic and social rights, including protection of property rights. The last part of the study comments on the implications of these constitutional structures to economic progress.

Gerardo P. Sicat and Loretta Makasiar Sicat, *The Constitution and Economic Progress: When "More Is Less and Less Is More"*, UPSE Discussion Paper 0413

Abstract: This study postulates some relationship between the attributes of constitutions – the style of constitutions regarding brevity, coverage, and presence of economic and social guarantees – with economic factors and the economic performance of countries. Utilizing quantifiable measures of these constitutional characteristics, these economic determinants are used to explain the differences in the economic performance of countries. A simple statistical model is set up to quantify this relationship. Expanded coverage and the presence of extensive social and economic rights in constitutions do not guarantee good economic performance. Extensive coverage of constitutional provisions tends to create a downward effect on the level of economic performance. Excessively detailed constitutional style provides a constraining effect on the level of economic performance. On the other hand, competitiveness of the economy, an economic attribute, raises economic performance.

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