ISSUES ON NATIONALIZATION OF CERTAIN TRADITIONAL AREAS OF INVESTMENTS*

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The Philippines is one of the few countries that has developed a body of laws limiting the entry of foreign investments in certain traditional areas of investments. These laws are known as "nationalization laws". They are however more aptly called "Filipinization laws" since they effectively reserve certain areas of investments to Filipinos, as contrasted to "nationalization" which usually presupposes a takeover of an original foreign investment by the government. In fact, we are one of the few countries which has no history of nationalization of any foreign investment in the country. This is perhaps so because our so-called nationalization laws already reserved certain areas of investments to Filipinos early in the century, thus averting a friction between foreign and domestic investors in traditional fields of investments.

A. *Exploitation of Natural Resources*

To conserve the patrimony of the nation,[1] the exploitation of natural resources is limited to Filipinos or 60% Filipino-owned or controlled corporations or associations.

The objectives of nationalization of the natural resources of the country are: (1) to insure their conservation for Filipino posterity; (2) to serve as an instrument of national defense, helping prevent the extension into the country of foreign control through peaceful economic penetration; and (3) to prevent making the Philippines a source of international conflicts with the consequent danger to its internal security and independence.[2]

It has been said that at the time of the framing of the Philippine Constitution, Filipino capital was known to be rather shy. There was hesitation as a general rule to invest a considerable sum of money for the development, exploitation, and utilization of the natural resources of the country. Filipinos then were not used to corporate enterprises as the peoples of the West. This general apathy meant that the development of our natural resources would not be possible unless foreign capital was

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1 Preamble of the 1935 and 1973 Constitutions.

2 Aruego, THE FRAMING OF THE PHILIPPINE CONSTITUTION, 604 (1949).

encouraged to come in and help in that development. The delegates of the Convention were aware that the nationalization of our natural resources would certainly not encourage the investment of foreign capital in them. Despite such knowledge, there was a general feeling in the Convention that it was better to have such a development postponed until such time when the Filipinos would be ready and willing to undertake it, rather than permit the natural resources to be placed under the ownership or control of foreigners in order that they might be immediately developed, with the Filipinos serving not as owners but as tenants or workers under foreign masters. The delegates believed that at all costs, the natural resources should be conserved for Filipino posterity. Additionally, the nationalization of natural resources, they believed, was an instrument of national defense. They felt that to permit foreigners to own or control the natural resources is to weaken the national defense. It would make possible the gradual extension of foreign influence into our politics and thereby increase the possibility of foreign control.[3]

To date, such beliefs presumably still exist under such euphoric feeling of nationalism, without the realization that economic conditions have so deteriorated though Filipinos are no longer the subservient people of colonial days.

On September 18, 1934, in a speech delivered by Delegate Montilla, he dwelt on the necessity of embodying in the Constitution declarations of nationalistic policies. In the course of his speech, he said in part:

> "The constitutional precepts that I believe will ultimately lead us to our desired goal are: (1) the complete nationalization of our lands and natural resources; (2) the nationalization of our commerce and industry compatible with good international practices. With the complete nationalization of our lands and natural resources it is to be understood that our God-given birthright should be one hundred per cent in Filipino hands... Lands and natural resources are immovable and as such can be compared to the vital organs of a person's body, the lack of possession of which may cause instant death or the shortening of life. If we do not completely nationalize these two of our most important belongings, I am afraid that the time will come when we shall be sorry for the time we were born. Our independence will be just a mockery, for what kind of independence are we going to have if a part of our country is not in our hands but in those of foreigners?"[4]

Despite the move for 100% ownership of capital by Filipinos in corporations or associations in the disposition, exploitation, development or utilization of natural resources, as gleaned from the above speech, the final version was for a 60% Filipino ownership. In a way, this verdict assumed that the Filipinos with 60% ownership can fight for their rights, and that being in control is sufficient.

[3] *Ibid.*, at 605.
[4] *Ibid.*, at 592.

The above principle found its way into the 1935 Constitution,[5] and subsequently into the 1973 Constitution[6] with the following additional provision:

> "The Batasang Pambansa in the national interest, may allow such citizens, corporations, or associations to enter into service contracts for financial, technical, management, or other forms of assistance with any foreign person or entity for the exploration, development, exploitation or utilization of any of the natural resources. Existing valid and binding service contracts for financial, technical, management, or other forms of assistance are hereby recognized as such."[7]

Without the cited provision, doubts were raised as to whether service contracts can be entered into with foreign companies for the exploitation of natural resources. In the early seventies, the proposed service contracts for oil exploration were debated in the halls of Congress, its detractors claiming that service contracts are a means to circumvent the Constitutional provision, the provision therein that net sharing between the Filipinos and service contractors shall not go beyond the 60-40 ratio in favor of the former notwithstanding. To put to rest all these questions, the 1973 Constitution explicitly authorized service contracts, and hence, the subsequent laws enacted pursuant to the said provision in the field of oil exploration,[8] mining[9] and agriculture.[10]

1. *Mining Industry*

In the case of service contracts for mining, a number of issues have cropped up regarding its implementation in cases where the service contractor is also an investor to the extent of 40% in the Filipino corporation which owns the mining rights. It would seem that the foreign investor should be entitled to dividends for its 40% shareholding as well as to the fees due it as a service contractor. Interesting in this regard is the opinion of the Secretary of Justice on service contracts. According to this opinion, the service contract system was obviously intended to enable Filipino citizens and entities to enlist the assistance of foreign capital to hasten the development of our natural resources in capital-intensive and sometimes high-risk ventures. Section 44 of Presidential Decree No. 463 specifically provides for service contracts in mining. Under the said law, the contractor may be paid from "the proceeds of the operation not exceeding forty percent (40%) thereof." It would seem that the service fee that is payable to the contractor may be treated as an exchange or a part of operating costs, deductible from the gross proceeds of the operations,

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[5] CONST. (1935), art. XIII, sec. 1.
[6] CONST., art. XIV, sec. 9.
[7] As amended in the 1981 Constitutional Amendments, Res. No. 2, art. IX, sec. 6.
[8] Pres. Decree No. 87 (1972), as amended.
[9] Pres. Decree No. 463 (1974), sec. 44, otherwise known as the "Mineral Resources Development Decree of 1974."
[10] Pres. Decree No. 151 (1973).

and is therefore paid off before any surplus or income is realized by the mining company that may eventually accrue to the company's stockholders as dividends.

The regulations implementing the law would seem to allow an arrangement whereby the service contract stipulates for: (i) repayment to the contractor of pre-production expenses; (ii) refund of funds actually advanced by the foreign entity; (iii) payment of fair value of services rendered, plus interests at prevailing internationally accepted rates; and (iv) a further 40% share in "the proceeds of the operation".

While payments to a service contractor may be justified as a service fee, and therefore properly deductible from the gross proceeds of the corporation, the service contract could be employed as a means of going about or circumventing the constitutional limit on foreign equity participation and the obvious constitutional policy to insure that Filipinos retain beneficial ownership of our mineral resources. To determine the reasonableness of the total "service fee", the following must be looked into: the valuation of services rendered, accounting of funds advanced, and, most importantly, the manner of computing the "proceeds of operation" and the duration of the sharing in the said proceeds in relation to the exposure of the foreign contractor, i.e., the nature and extent of the risks assumed by the contractor, the magnitude of capital investment, and other relevant considerations like the options available to the contractor to become equity participant in the Philippine entity holding the concession, or to acquire rights in the processing and marketing stages.[11]

In interpreting the above opinion of the Secretary of Justice, it seems that if the services in a service contract are properly valued, they should normally be deductible as expenses of operations, and consequently should not affect the 60-40 sharing between the Filipino and alien stockholders, respectively. In other words, *bona-fide* service fees and returns from equity contributions are not to be added together for the purpose of determining compliance with the Constitutional limitation.

Based on the costs normally charged by the service contractor as cost of operations, there would seem to be only the technology transfer fee, guarantee fee (if any) for borrowed money, marketing and managerial fees. Normally, management fee should not be beyond 2% of project cost. In certain mining operations, such as copper mining, there should be no technology transfer fee since there is no new technology to be transferred, unless there are special characteristics of the copper ore which need application of a new technology.

It has been proposed that service fees be unpackaged and that some guidelines on the allowable fees be formulated.

[11] Sec. of Justice Op. No. 144 (s. 1977).

In the absence of such guidelines and to avoid the possible circumvention of the Constitution, the then Cabinet Standing Committee decided to retain the provision that the fee and dividends should not be in excess of the 40% of the overall returns of the project.[12] Effectively, therefore, there should be no service fee if the contractor is a 40% equity holder. The directive of the Cabinet Standing Committee dated November 10, 1979 reads in part:

> "x x x that the maximum service contract fee is 40% before tax; since the basic idea of service contracts was instituted to develop mineral and other natural resources in the Philippines which either the government or other business could not develop in the meantime, it must be observed, however, that the constitutional limitation as to sharing of benefits is limited to 40%, in the case of foreign equity holders, the return on equity is taxed and therefore the mining service contract fee which could go up to a ceiling of 40% should be treated on parallel basis, and should be considered as pre-tax, without prejudice to the unpacking of certain fees which are compensible directly to other foreign companies."

It would be opportune to view the issue of nationalization of the mining industry with our need for capital and technology to develop our mineral resources vis-a-vis the equitable share of the foreign investor *cum* service contractor in such a venture. With the above rule, the concerns of those who fear that service contracts are a circumvention of the Constitutional restriction are partly resolved. There is still the need, however, to scrutinize each cost item deducted by the contractor from the cost proceeds to determine whether indeed the beneficial gain is principally to the Filipinos.

2. *Agriculture*

In the field of agriculture, service contracts are not as developed. The only law which authorizes service contracts in agriculture is found in Presidential Decree No. 151[13] which provides that:

> "Citizens of the Philippines or corporations or associations which have acquired lands of the public domain or which now own, hold or control such lands under the Public Land Act or any other law, are hereby allowed to enter into service contracts for financial, technical, management or other forms of assistance with any foreign person or entity whenever and wherever such contracts are vital to achieve sound and more expeditious exploration, development, exploitation or utilization of such lands owned, held or controlled by such citizens or corporations."

It should be noted that service contracts for financial, technical, management and other forms of assistance apply not only to agricultural ventures but also to industrial and commercial developments.[14] However, it is required that such contracts have to be approved by the Secretary

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[12] Pres. Decree No. 1677 (1980).
[13] Pres. Decree No. 151 (1973), sec. 1.
[14] Pres. Decree No. 151 (1973), sec. 2.

(now Minister) of Agriculture and Natural Resources (now either the Minister of Agriculture or Minister of Natural Resources, depending on the activity).[15] To date, however, said offices have not established the applicable rules and regulations, and one wonders why the Ministry of Trade and Industry is not included in the approving authority for industrial projects.

Since the above law is limited to lands of the public domain, to authorize owners of agricultural private lands to enter into service contracts with foreign companies and avail of incentives with the Board of Investments, Presidential Decree No. 2032[16] specifically provides that:

> "Filipino citizens and corporations or associations may enter into service contract for financial, technical, management or other forms of assistance with any foreign person or entity for the development of Philippine agriculture, agricultural resources and food production."

However, the above law which is found in the new Agricultural Incentive and Development Act has not been published and is scheduled for further review before implementation.

3. *Oil Exploration*

The problem of sharing, in service contracts, as discussed in mining contracts as well as agricultural projects is not usually attendant in oil exploration because the sharing is between the government and the foreign company. However, the same issue arises as to whether service contracts are in effect a circumvention of the nationalization of the exploitation of natural resources intended to protect the patrimony of the nation. It must be recognized that we need capital and technology to develop our natural resources, and service contracts would seem to be an accepted mode provided that safeguards are properly set up and strictly implemented. If in a service contract for oil exploration, practically all claims of the foreign contractor are deductible, the remaining proceeds which will be divided may be too small a pie to share between the owner and the contractor and that, effectively, the share of the contractor may be more than that of the local investor. Moreover, a distinction should be made between resources that can no longer be replaced and those that can be replenished or restored. For instance, in cases of forest products, the service contract should include commitments on reforestation. Service contracts must also be for a reasonable period and must not be unduly extended as to the share of ownership.

B. *Land Ownership*

The acquisition of private lands is limited to Filipino citizens and to corporations or associations at least 60% of the capital of which is

[15] Pres. Decree No. 151 (1973, sec. 3.
[16] Pres. Decree No. 2032 (1986), sec. 20 (last paragraph).

owned by Filipino citizens. Therefore, realty companies and any business activity where land ownership is involved may be considered a traditional area of investment. The 1973 Constitution provides that:

> "Save in cases of hereditary succession, no private land shall be transferred or conveyed except to individuals, corporations, or associations qualified to acquire or hold lands of the public domain."[17]

Thus, investments of foreigners in any activity where the ownership of land for a factory site is necessary, would be limited to 40% foreign ownership since foreigners cannot own land. It would be necessary in this case to lease the land. However, the maximum period for the duration of the lease of private land is 25 years, renewable for another 25 years upon mutual agreement of both the lessor and the lessee.[18]

This provision has been further limited by the various opinions of the Ministry of Justice dealing with the divested lands of American companies at the end of the Laurel-Langley Agreement and holding that the renewal should be agreed upon within one or two years before the expiration of the 25-period. A lease agreement that specifically states that the lease is for 25 years and renewable for another 25 years is believed to be a circumvention of the intent of Presidential Decree No. 471. Otherwise, the law should have provided for 50 years at the outset as the allowable lease period. This view notwithstanding, practice indicates that renewal is already agreed upon at the beginning of the first 25 years with a reasonable escalation clause on the rental.

With respect to public lands, the same may not be acquired by private corporations. Private corporations at least 60% of the capital of which is owned by Filipino citizens may, however, lease public lands not exceeding 1,000 hectares in area. Under the 1973 Constitution, it is provided that:

> "Section 11. x x x No private corporation or association may hold alienable lands of the public domain except by lease not to exceed one thousand hectares in area; nor may any citizen hold such lands by lease in excess of five hundred hectares or acquire by purchase or homestead in excess of twenty-four hectares x x x"[19]

Foreshore lands are lands of the public domain and are governed by the Public Land Act,[20] as amended. Section 60 of the Public Land Act, which was enacted after the effectivity of the 1935 Constitution, provides the following:

> "Any tract of land comprised under this title may be leased or sold, as the case may be, to any person, corporation, or association authorized

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17 CONST., art. XIV, sec. 14.
18 Pres. Decree No. 471 (1974).
19 CONST., art. XIV.
20 Com. Act No. 141 (1936), as amended.

> to purchase or lease public lands for agricultural purposes. The area of the land so leased or sold shall be such as shall, in the judgment of the Secretary of Agriculture and Natural Resources, be reasonably necessary for the purposes for which such sale or lease is requested, and shall in no case exceed one hundred and forty-four hectares: x x x Provided, further, that any person, corporation, association or partnership disqualified from purchasing public land for agricultural purposes under the provisions of this Act, may lease land included under this title suitable for industrial or residential purposes, but the lease granted shall only be valid while such land is used for the purpose referred to."

The Secretary of Justice, in previous opinions, construed the above provision as authorizing the lease to aliens and alien-owned entities of public lands suitable for industrial or residential purposes.[21] These opinions were principally inferred from the decision in *Krivenko v. Register of Deeds*,[22] where the Court observed that under the Constitution and Sections 23 and 60 of Commonwealth Act No. 141, the right of aliens to acquire public agricultural lands is completely stricken out, undoubtedly in pursuance of the constitutional limitation. Land of the public domain suitable for residence or industrial purposes may only be leased, but not sold, to aliens, and the lease granted shall only be valid while the land is used for the purposes referred to. The exclusion of sale in Commonwealth Act No. 141 is undoubtedly in pursuance of the constitutional limitation that the term "public agricultural land" includes land for residential purposes.

It must be noted that the Secretary of Justice reversed his previous opinions by ruling that "except as provided on the Parity Amendment to the 1935 Constitution, aliens and alien-owned corporations may not lease public agricultural lands suitable for commercial or industrial purposes."[23] Citing the language of the 1935 Constitution, the Secretary held that a lease of public lands falls within the specific prohibition contained in the 1935 Constitution against the utilization or development by aliens of public agricultural lands.

In the case of lease by aliens of private agricultural lands, noteworthy is the case of *Smith, Bell & Co., Ltd. v. Register of Deeds*[24] wherein the Supreme Court said:

> ". . . in Consulta No. 136 of the Register of Deeds of Camarines Sur, the CFI of Manila, Branch IV, held that: until otherwise fixed by a superior authority, twenty-five (25) years is a reasonable period or duration for the lease of a *private agricultural land* in favor of an alien. . ."

It would therefore seem that lease of foreshore lands or any public land may not be allowed to foreign companies. Likewise, foreign com-

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[21] Sec. of Justice Op. (s. 1946); Sec. of Justice Op. No. 64 (s. 1948); Sec. of Justice Op. No. 6 (s. 1949).
[22] 79 Phil. 461 (1947).
[23] Sec. of Justice Op. No. 137 (s. 1972).
[24] 96 Phil. 53 (1954).

panies who have industrial plants should lease the lands from Filipinos or from a realty company 60% of the shares of which are owned by Filipino citizens. In this connection, one must note that the 60% of the equity to be held by Filipino citizens in a realty company should be owned wholly by Filipino citizens, otherwise, in the application of the "grandfather rule", such realty company may be construed as a circumvention of the constitutional provision prohibiting the ownership of land by foreign companies.

There have been a lot of problems with respect to land ownership by foreign investors questioning Presidential Decree No. 471 on the leases of private land of up to only 25 years, renewable for another 25 years. This objection becomes even more intense in the light of earlier views expressed by the Ministry of Justice that the renewal should be made during the latter part of the first 25 years and should not be agreed upon at the beginning of the lease period. For projects with long gestation periods, such limitation inhibits long range planning and encourages foreign companies to move out after 25 years. Perhaps it is time that this traditional restriction on investments of aliens be looked into more closely and revised so that leases may not exceed 50 years, leaving it to the lessees to discuss the terms and make provision for escalation during a 50-year lease. This period may be long for certain projects but just right for big projects where heavy investments are involved and where companies desire to be assured that their plants cannot just be moved around after 25 years. It is time that this issue be reopened to clear the air for investment purposes.

There has also been, to a certain extent, a reducing of the conservation of the patrimony of the nation to citizens of the Philippines with the added provision in the Constitution that a natural-born citizen of the Philippines who has lost his citizenship may be transferee of a private land and his residence, as the National Assembly may provide.[25] Additionally, the condominium law allowing the acquisition of condominium units by aliens provided they own not more than 40% of the units is a relaxation dictated by the new trend of lateral ownership of buildings.[26]

C. *Public Utilities*

Under the 1973 Constitution, it is provided that:

> "No franchise, certificate, or any other form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines at least sixty per centum of the capital of which is owned by such citizens, nor shall such franchise, certificate, or authorization be exclusive in character or for a longer period than fifty years. Neither

[25] CONST., art. XIV, sec. 15, as amended by Res. No. 2; art. 9, secs. 5 and 16.
[26] Rep. Act No. 4726 (1966).

> shall any such franchise or right be granted except under the condition that it shall be subject to amendment, alteration, or repeal by the Batasang Pambansa when the public interest so requires. The State shall encourage equity participation in public utilities by the general public. The participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in the capital thereof."[27]

The importance of public utilities to the country was the primary reason for their nationalization. A public utility is a business organization which regularly supplies the public with a service, such as electricity, gas, water, transportation, or telephone or telegraph service, or some vital or basic commodity. It would indeed be difficult to construct a definition that would fit every conceivable case. The distinguishing characteristic of a public utility is the devotion of private property by the owner or person in control of it to such use that the public, generally, has accepted as service, and has the right to demand such use or service of property, so long as it is continued and conducted with reasonable efficiency and under proper charges.[28]

"Public markets are public services or utilities as much as the public supply and sale of gas, gasoline, electricity, water, and public transportation, and consequently are governed by the same constitutional provision on public utilities."[29]

D. *Mass Media*

Under the 1973 Constitution:[30]

> "(1) The ownership and management of mass media shall be limited to citizens of the Philippines or to corporations or associations wholly owned and managed by such citizens.
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> (2) The governing body of every entity engaged in commercial telecommunications shall in all cases be controlled by the citizens of the Philippines."

At this particular time when the 'global village' is foreseen as a future reality, an issue that needs to be confronted is the opening of mass media to minority foreign interest. Perhaps 100% Filipino ownership is a little stringent; what is important is that the control of mass media be in the hands of the Filipinos. Perhaps it is time that our news be less parochial. Making ownership of mass media acceessible to minority foreign investment may prove a beneficial change.

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[27] CONST., art. XIV, sec. 5.

[28] 51 C.J. *Public Utilities* sec. 1 (1930).

[29] Co Chiong v. Cuaderno, 83 Phil. 242 (1949); Co Chiong v. Mayor of Manila, 83 Phil. 257 (1949).

[30] Art. XV, sec. 7.

E. *Presidential Treaties*

The 1973 Constitution provided a wide latitude to the President to allow, by treaty, foreign investments beyond 40% in public utilities, land ownership and the exploitation of natural resources.[31]

Such a provision would enable the President to enter into another Laurel-Langley type of agreement with any country without the benefit of a plebiscite. To a certain extent, the Constitutional constraints on foreign investments in exploitation of natural resources and public utilities have been diluted by the power of the President to compromise by treaty such limitations in the Constitution. In fact, one country has invoked this provision in asking for national treatment of the investments of its nationals in the Philippines. Such a provision may induce other countries to ask for national treatment, particularly when they have the leverage to so insist. To date, such a privilege has not been utilized and rightly so. A repeal is in order.

F. *Other Traditional Areas of Investment*

The 1973 Constitution provides that the Batasang Pambansa shall, upon recommendation of the National Economic and Development Authority, reserve to citizens of the Philippines or to corporations or associations wholly owned by such citizens certain traditional areas of investment when national interest so dictates.[32] This provision is not found in the 1935 Constitution. Such absence notwithstanding, several nationalization laws were passed by the legislative body even before 1973. We can therefore surmise that such constitutional provision is merely to eliminate any doubt that nationalization laws are not violative of the equal protection clause of the Constitution and that they need not therefore hide behind the sometimes questionable exercise of the police power of the State. What is interesting is that the provision speaks of 100% ownership by Filipinos. Subsequent nationalization laws provide for a mere 60% or 70% Filipino ownership. We can therefore conclude that the legal basis for such laws is still the police power of the State.

There are a number of the so-called nationalization statutes which include the specific areas hereunder discussed, as well as the general power vested in the Board of Investments (BOI) to bar foreign investments, by declaring certain businesses as adequately exploited by Philippine nationals or that an alien entity will not contribute to the sound and balanced development of the national economy.[33] Although the BOI law is not strictly a nationalization law, it has indeed the trappings of one.

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[31] Art. XIV, sec. 16 provides that: "Any provision of paragraph one, Section fourteen, Article Eight and of this Article notwithstanding, the President may enter into international treaties or agreements as the national welfare and interest may require."

[32] CONST., art. XIV, sec. 3.

[33] Rep. Act No. 5455 (1968) now Book Two of Pres. Decree No. 1789 (1981).

1. *Retail Trade*

During the preparation of the 1935 Constitution, there were already discussions to nationalize retail trade, i.e. to include a provision in the Constitution that retail trade shall be engaged in only by Filipinos or 75% owned Filipino companies.[34] It was emphasized that Filipino retailers needed legal protection against their foreign competitors because of the latter's broader business experience. It was observed that the foreigners had so entrenched themselves in an air-tight system of financing and credit, cooperative purchasing, interlocking ownership, etc., that a body of poorly organized Filipino retailers could not possibly compete fairly against them. They received preferential treatment from big importers who were entirely foreigners, enabling them to obtain merchandise at very much lower prices than the Filipinos can ever hope to offer under the prevailing circumstances. Mention was also made that the standard of living of some of the foreign competitors was lower than that of the Filipinos, and that such competitors had been in control of the retail trade for so long.[35]

All the above observations may no longer be true: Certainly, the standard of living of the foreigners in this country by and large is higher than that of the majority of Filipinos and Filipinos now control the retail trade business, although not marketing in general.

There were also discussions that should the Constitution not specifically nationalize retail trade, there should be a provision authorizing the legislature to enact a retail trade law. It was the consensus of the Constitutional Convention of 1934 that under the police power of the State, the legislative arm can adopt such a measure. Thus, in 1954, the Congress passed the Retail Trade Nationalization Law limiting retail trade to Filipinos or companies 100% of the capital of which is owned by Philippine nationals.[36]

The Supreme Court, in upholding the constitutionality of the retail trade law, stressed that retail dealers perform the functions of capillaries in the human body, through which all the needed food and supplies are ministered to members of the communities comprising the nation. Unlike in the primitive economy where families produced all that they consumed and consumed all that they produced, man's needs have multiplied and

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[34] Inclusion of the following was proposed in the 1935 Constitution:

"Five years after the inauguration of the Commonwealth Government, only citizens of the Philippine Islands and of the United States, and firms, partnerships or corporations of whose issued stock or capital, at least seventy-five per centum is held and owned by said citizens, may engage in the retail business.

"The operation of this provision shall be suspended insofar as it may be in conflict with any treaty of the United States applicable to the Philippines until one year after the said treaty has ceased to be operative on the Philippine Islands." (Aruego, *op. cit.* at 658).

[35] *Ibid.* at 659.

[36] Rep. Act No. 1180 (1954).

diversified to unlimited proportions under modern times. Now, the retailer is as essential as the producer, because it is through him that the infinite variety of articles, goods and commodities needed for daily life are placed within the easy reach of consumers. The significance of retailing as well as the controlling and dominant position that the alien retailer held in the nation's economy, made it imperative that this traditional business be placed in the hands of Filipinos.[37]

The Retail Trade Law as originally passed has been tempered to a certain extent by a subsequent law[38] exempting the following from retail trade:

> a manufacturer or processor selling to industrial and commercial users or consumers who use the products bought by them to render service to the general public and/or to produce or manufacture goods which are in turn sold by them;
>
> a hotel-owner or keeper operating a restaurant, irrespective of the amount of capital, provided that the restaurant is necessarily included in, or incidental to, the hotel business.

The above law has been assailed as unconstitutional because it denies equal protection of the law on the mere fact of alienage. The Supreme Court ruling on this point is noteworthy and can apply to other nationalization laws, to wit:

> "The alien resident owes allegiance to the country of his birth or his adopted country; his stay here is for personal convenience; he is attracted by the lure of gain and profit. His aim or purpose of stay, we admit, is neither illegitimate nor immoral, but he is naturally lacking in that spirit of loyalty and enthusiasm for this country where he temporarily stays and makes his living or of the spirit or regard, sympathy and consideration for his Filipino customers as would prevent him from taking advantage of their weakness and exploiting them. The faster he makes his pile, the earlier can the alien go back to his beloved country and his beloved kin and countrymen. The experience of the country is that the alien retailer has shown such utter disregard for his customers and the people on whom he makes his profit, that it has been found necessary to adopt the legislation, radical as it may seem.
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> "Another objection to the alien retailer in this country is that he never really makes a genuine contribution to national income and wealth. He undoubtedly contributes to general distribution, but the gains and profits he makes are not invested in industries . . ."[39]

The main target of the law, the alien sari-sari store owners, are perhaps no longer a threat since most of them have already opted to become Filipino citizens. Nevertheless, the concept that this business be left to Filipinos still applies. The relevant issue it seems is whether this nationalization law should be enshrined in the Constitution and whether 100% ownership is not too stringent. While such a requirement fits sari-sari store owners who

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37 Ichong v. Hernandez, 101 Phil. 1167-1169 (1957).
38 Pres. Decree No. 714 (1975).
39 *Ibid.*, at 1175.

are engaged in single proprietorships, 100% Filipino ownership of capital stock in cases of merchandising networks such as department store chains may be counterproductive. At the moment, we are paying technical fees to world-known department store chains who can assist our department stores in inventory control and merchandising. Be that as it may, it may still be preferable to make the limitation by statute. Its amendment in 1975 would not have been possible if it were a Constitutional provision. At that time it was necessary to respond to the situation affecting foreign investors already in the country who were being threatened by suits in view of the various interpretations of the retail trade law. It may not be remiss, however, to come up with a general statement on the matter, if necessary.

The 1935 Constitutional Convention proposed a 75% Filipino ownership. It has been noted that 100% ownership with its "exclusions" would be more acceptable. We have lived with this statute for more than 30 years and can live with it for the next 30 years until the world becomes so cosmopolitan, that nationalization laws will be a thing of the past.

2. *Banking*

Like retail trade, banking is a traditional area of investment that is and should be reserved to Filipinos. Hereunder are the pertinent activities and laws nationalizing them:

Subject Matter	*Minimum Filipino Ownership Requirement (%)*	*Legal Provisions*
Banking institutions including private development banks)	70% of voting stock (60% with President's approval)	Republic Act 337 as amended by P.D. 71 Republic Act 4093 as amended by P.D. 119 Batas Pambansa 61, Batas Pambansa 163
Rural banks	100%	Republic Act 720 as amended by P.D. 122, P.D. 1794, and Batas Pambansa 65
Savings and loan associations, pawnshops	70% of voting stock	Republic Act 3779 as amended by Republic Act 4378, P.D. 114, P.D. 1796, and Batas Pambansa 62
Relending of foreign loans by government financial institutions	70%	Republic Act 4860 as amended by Republic Act 6142, P.D. 81

Banking is an artery of commerce that must be kept in the hands of Filipinos. However, one notes the need for Presidential approval when

the equity of the foreign investor goes up to 40% from the allowable 30% of voting shares authorized to foreign investors. It is believed that a 60% Filipino ownership and control is sufficient. One of the criticisms against our nationalization laws is that the varying precentages required for Filipino ownership and the adding of another layer of 70%, although understandable because of the veto principle of 33-1/3% of foreign ownership, is unnecessary in this case. Our own bankers have reached sufficient sophistication to take care of themselves in dealing with their partners on a 60-40 joint venture.

Related to banking are finance companies and investment houses; 60% Filipino ownership is required[40] in the former and 51% in the latter.[41] The distinction seems to be unnecessary, and a 60% Filipino ownership and control should suffice.

3. *Government Contracts*

In supplying materials or entering into public works contracts with government, there are nationality requirements to be observed, such as:

Subject Matter	*Minimum Filipino Ownership Requirement (%)*	*Legal Provisions*
Public works construction	75%	Commonwealth Act 541, Republic Act 4329, as amended
Supplier to government agencies	75%	Commonwealth Act 138 as amended by Republic Act 76
Reparation benefits	100%	Republic Act 1789, as amended by P.D. 332
Public works and construction for national defense	100%	Commonwealth Act 541

One should note the varying percentages of Filipino equity, and as previously stated, these rules confuse foreign investors doing business in the country. While the so-called "Flag Laws" have their advantages, there must be simplicity in the rules. A 60% equity seems to be sufficient, and this indeed meets with the requirement for preferred areas of investment in the manufacturing field.

4. *Other Specific Areas*

There are also provisions of law which limit investments in certain areas, such as:

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[40] Rep. Act No. 5980 (1969).
[41] Pres. Decree No. 129 (1973).

Subject Matter	*Minimum Filipino Ownership Requirement (%)*	*Legal Provisions*
Domestic construction	75%	Letter of Instructions 630
Overseas construction (Filipino contractor)	60%	P.D. 1167
Recruitment and placement of workers, locally or overseas	75% of voting stock	P.D. 1142
Cooperative associations	61%	Republic Act 2023, Commonwealth Act 565

It is believed that these specified fields do not need nationalization laws and their concerns can be better protected by other means. They only add to the rules on foreign investments which are already voluminous.

G. *Administrative power to reserve certain areas of investments to Filipinos*

The Board of Investments under the Omnibus Investments Code[42] has the delegated power to reserve certain areas of investments to Filipinos. In the preferred areas of investments where the government grants fiscal incentives, the Board effectively reserves certain fields to Filipino-controlled companies by declaring the area non-pioneer.[43] The law, however, in its delegation is quite specific that the exercise of the Board's discretion is limited. The law defines a pioneer[44] undertaking, the rest of the area being considered as non-pioneer activities.

On the other hand, when investment is without incentives,[45] the Board's discretion is broad, pursuant to the language of the law that

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[42] Pres. Decree No. 1789 (1981).

[43] Rep. Act No. 5186 (1967), now Book I of Pres. Decree No. 1789. Article 34 of said law requires 60% Filipino control for those engaged in non-pioneer activities.

[44] Pioneer enterprise is defined as "a registered enterprise (1) engaged in the manufacture, processing or production, and not merely in the assembly or packaging, of goods, commodities or raw materials that have not been or are not being produced in the Philippines on a commercial scale or (2) which uses a design, formula, scheme, method, process, or system of production or transformation of any element, substance or raw material into another raw material or finished goods which is new and untried in the Philippines or (3) engaged in the pursuit of agricultural activities and/or services including the industrial aspects of food processing whenever appropriate, predetermined by the Board, in consultation with the appropriate Ministry, to be feasible and highly essential to the attainment of the national goal taking into account the risks, magnitude of investment, relation to a declared specific national food and agricultural program for self-sufficiency and other social benefits of the project or (4) which produces non-conventional fuels or manufactures equipment which utilize non-conventional sources of energy or uses or converts to coal or other non-conventional fuels or sources of energy in its production, manufacturing or processing operations. Provided, that the final product in any of the foregoing instances, involves or will involve substantially use and processing of domestic raw materials, whenever available. . ." (Pres. Decree No. 1789 (1981), Book I, art. 16).

[45] Pres. Decree No. 1789 (1981), Book II.

alien investment will not be allowed without securing a certificate from the BOI:

> "(1) That the operation or activity of such alien, firm, association, partnership, corporation or other form of business organization is not inconsistent with the investment Priorities Plan;
>
> (2) That such business or economic activity will contribute to the sound and balanced development of the national economy on a self-sustaining basis;
>
> (3) That such business or economic activity by the applicant would not conflict with the Constitution or laws of the Philippines;
>
> (4) That the field of business or economic activity is not one that is being adequately exploited by Philippine nationals; and
>
> (5) That the entry of applicant therein will not pose a clear and present danger of promoting monopolies or combinations in restraint of trade."[46]

By virtue of the above law, activities such as wholesaling, importing and other domestic trading activities have been declared overcrowded, and only limited foreign investments (30%) has been allowed in the country.

There are indeed advantages to this administrative mechanism which enables policies to be changed depending on the current situation. Today there may be an over-capacity of cement mills, but in the future there may be a need for more mills to accommodate exports.

On the other hand, there are also disadvantages in too much administrative discretion and too many uncertainties in determining whether an activity is adequately exploited by Philippine nationals or will not contribute to the sound and balanced development of national economy on a self-sustaining basis.

There are views expressing that perhaps these laws have had their usefulness and that the time has come to allow foreign investment with the minimum of constraints. Even incentive-giving has to have its end when there are no longer market imperfections existing which are to be compensated through such incentives. Whether the time has come is the issue.

Recommendations

Nationalization, to most countries, takes the form of restrictions which they prefer not to have in their statute books. It is recognized, however, that their absence in the statutes does not necessarily mean free admission of foreign investments. There are indeed a number of administrative rules in most countries, developed and developing, that effectively act as nationalization laws. These are less transparent rules than ours and, for purposes of countervailing measures by other countries,

[46] Pres. Decree No. 1789 (1981), art. 46.

less actionable. While, theoretically, we should move to less transparent action, in practice, administrative mechanism without statutory backing is difficult for us, as a country, to implement. It must be advocated, however, that considering our present situation, these restrictions should be at a minimum and must be limited to traditional areas as those provided in the 1973 Constitution and, additionally, to retail trade and banking. There may be a need to provide for authority to nationalize certain areas of investments in general (not only the traditional areas) without requiring 100% Filipino equity as presently provided, but such a power should be used only when absolutely necessary, and as we progress and local business become competitive, should not be used at ail. Such provision must be without prejudice to any law regulating the entry of foreign investments, which although not strictly a nationalization law can provide the administrative mechanism to protect domestic investors from transnational companies which may compete unfairly with our own nationals owing to their size, to the point of driving out a particular business endeavor. We need to institute such a mechanism of self-defense just as other countries have their own non-statutory administrative rules in the admission of foreign investments. The present Section 3 of Article XIV of the 1973 Constitution should therefore read as follows:

> "Without prejudice to the general law regulating the entry of foreign investment, the law making body shall, upon recommendation of the National Economic and Development Authority, reserve certain areas of investment to citizens of the Philippines or to corporations or associations owned by Filipinos to the extent of 60% or such higher percentage as the National Assembly may prescribe."

With respect to service contracts, as previously stated, if we are to develop our natural resources with our present economic situation, we would need foreign capital and technology. The limited results of our oil explorations despite the huge amount that has been spent thereon is indicative of a need for foreign capital in this area. Provided that the necessary safeguards are clearly stated and actually implemented, there should be no apprehension that we will be deprived of what is due us. Certainly, our history on service contracts has not been bad at all. It should be clarified, however, that service contracts must be only for a limited period and will only be allowed in projects involving high risk, huge capital and/or new technology. The implementing law should see to it that the sharing is equitable and in no case should the Filipino share be less than 60%.

With respect to the issue of land ownership, allowable lease period to foreign entities should not exceed 50 years. Perhaps lease of public land by foreign entities should also be allowed. After all, if we do not allow the lease of public land, we may be forced to resort to service contracts that are more complicated than a mere lease.

It is believed that the time has come to recognize that Filipino investors, by and large, can fend for themselves in competition or in joint ventures with foreign investors. When domestic investors are disadvantaged, the government has the administrative mechanism to assist them, provided it has the political will to do so. It must also be realized that time is against us in developing our natural resources on our own, and it is not necessarily bad to have foreign investment give us a helping hand, provided that we make sure they only supplement, not supplant, domestic investment.