# An outlook on the Philippines under Duterte

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The Filipino business community reacted guardedly when presidential candidate Rodrigo Duterte surged in the polls in early 2016[1]. President Benigno Aquino III, who was unable to run again for office, had provided a predictable, comparatively transparent platform under which the Philippines enjoyed continued economic growth and above-average inflows of foreign investment.[2]

Duterte presented an antithesis to Aquino, with his drastic proposals for engaging in a large-scale war on illegal drugs, holding peace talks with Communist rebels, and re-examining the country's historically close alliance with the United States.

After receiving more than 16 million votes, President Duterte has been given a strong public mandate to follow through on his campaign promises. His party coalition has amajority in the House of Representatives, partly as a result of defectors from Aquino's Liberal Party. The administration also enjoys a majority in the Senate and is due to appoint a record number of justices to the Supreme Court by the year 2022, when Duterte's term finishes.[3] Unlike any president in modern Filipino history, Duterte has the power to chart a new course for the country. His first six months in office have indicated what this course could be.

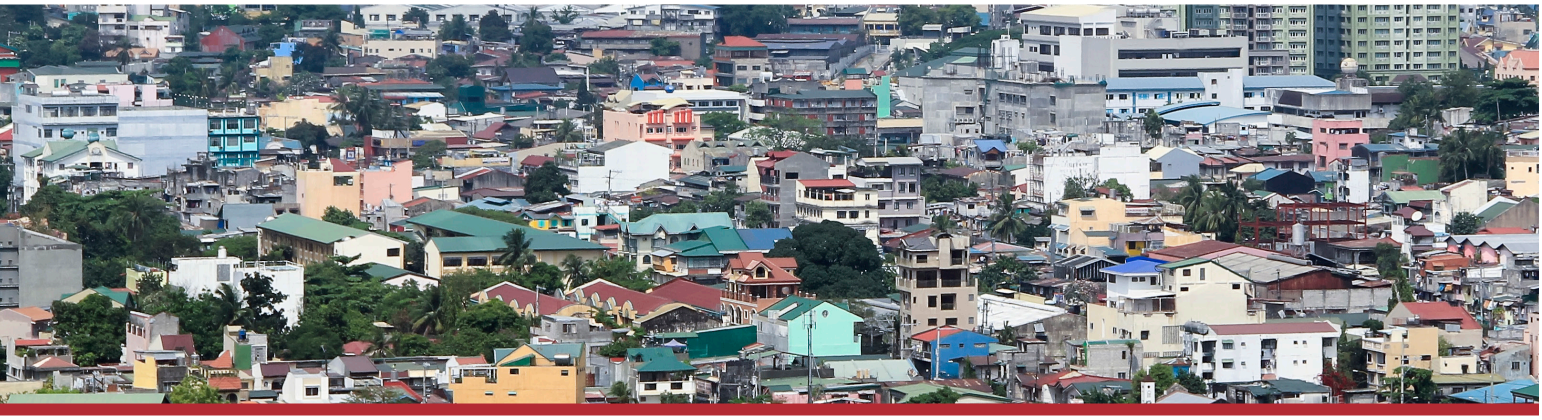
## Controversial war on drugs

As he repeatedly promised during the election campaign, Duterte has begun an escalation in the war against illegal drugs. This has proven to be the single most controversial item on the administration's agenda.

The Philippine National Police ("PNP"), as part of Operations Plan ("OPLAN") "Tokhang"[4], commenced an unprecedented, large-scale search for both drug users and drug traffickers. Critically, Duterte urged the PNP as well as ordinary citizens to kill those involved in drugs trafficking.[5]

OPLAN Tokhang arguably did result in a disruption of the narcotics industry in the Philippines. From July to August 2016, more than 500,000 drug addicts had registered with the authorities and the PNP has made a number of high-profile arrests, including government officials allegedly involved in the narcotics trade.[6] Figures released by the PNP claim that more than 5,900 individuals have been killed during the first six months of OPLAN Tokhang, either as a result of police operations or by unknown vigilantes in extrajudicial circumstances.[7]

While Duterte's tough stance on drugs has done nothing to diminish his continually high domestic approval ratings, human rights groups have criticized the administration's approach.[8] An investigation by Amnesty International claims that OPLAN Tokhang primarily targeted the country's poor and further claims that evidence against suspects was in some cases allegedly fabricated by police. It also alleges that some police officers unofficially received monetary incentives from "headquarters" for killing suspects.[9] Duterte has publicly denied the latter allegation.[10]



There have been indications that the drug war is spiraling out of control. The kidnapping-for-ransom and murder of a Korean businessman by PNP officers under the guise of an anti-drug operation in October 2016 sparked a new debate about whether the drug war has given rise to a culture of impunity in law enforcement.[11] This forced Duterte to call an end to the PNP's involvement in Operation Tokhang, stating that he would instead continue the war with the military and the country's drug enforcement agency.[12]

Duterte has on several occasions alluded to his intention to declare martial law. He has also previously announced that he would revive the Philippine Constabulary, a paramilitary force under the control of the President that was abolished after the end of the Marcos years following widespread human rights violations.[13] Both the public relations aspect of extrajudicial killings as well as their potential implications for rule of law do not raise the Philippines' attractiveness as a destination for foreign investment.

## Shift in foreign policy

Duterte has also delivered on his other promise to "re-balance" the foreign policy space. Relations with the United States, the Philippines' former colonial master and a key ally since its independence, have become strained. Duterte publicly humiliated both the United States Ambassador to the Philippines as well as President Obama, accusing the United States of interference in the Philippines' domestic affairs.[14]

The Duterte administration has made it clear that it favors stronger political and economic relationships with Russia and China. Whether this will result in strategic rather than tactical partnerships remains to be seen, however high-profile meetings with China's President Xi Jinping and Russia's President Vladimir Putin resulted in a range of bilateral deals and agreements to increase trade and defense cooperation.[15] For example, in early January 2017, Russian warships docked in the Philippines for the purpose of conducting joint drills for the first time with the Philippine Navy.[16]

Additionally, Duterte abandoned the strategy of his predecessor to seek a multilateral solution to the Philippines‘ territorial disputes with China in the Western Philippine Sea. He chose to disregard a ruling of an international panel of judges which found China's claims to be in violation of international law.[17] Duterte's preference for bilateral negotiations with China runs contrary to the approach favored by the United States as well as countries engaged in similar disputes with China, including Vietnam and Japan.

Nevertheless, Japan's Prime Minister Shinzo Abe received a warm welcome to the Philippines in January 2017. In a typical show of Japanese checkbook diplomacy, Abe pledged up to USD 8.7 billion in Japanese Official Development Assistance as well as private sector investments in the Philippines over a period of five years. These come in addition to grants for the purchase of equipment to shore up the Philippine Coast Guard, an indication that Japan is concerned about the Philippines' new foreign policy stance.[18]

The undiplomatic and seemingly impromptu way in which the Duterte administration has been executing its foreign policy shift has tarnished the Philippines' brand in the West and may result in an accompanying shift in foreign direct investment inflows. Asian investors, in particular China and Japan, may benefit on the back of closer political relations. It is yet to be seen whether relations between the United States and the Philippines will improve under President Trump, whose statements indicate that he takes a narrower view of multilateralism and human rights than his predecessor.[19]

## Political economy and destinations for investment

The Japanese delegation's visit to the Philippines highlighted another repercussion of the Duterte administration: a domestic shift in economic and political power from Manila to the country's provinces. The persisting inequitable distribution of wealth in the Philippines, including the perceived domination of the country's development agenda by Manila-based elites to the detriment of the rest of the country, was a key point that contributed to Duterte's election.

Prime Minister Abe was the first foreign head of state to visit Davao, a city of 1.6 million on the southern island of Mindanao. Duterte, who served as Mayor of Davao for decades, has made the city the country's second capital and put it on the map as an investment destination. Mindanaoan businessmen can be expected to benefit under the new administration. Several have been the President's biggest campaign donors and some have been rewarded with high-profile cabinet posts.[20]

Meanwhile, domestic and international conglomerates have been eager to prove their commitment to the country's economic reform process by pledging investments in the provinces, especially in the Visayas and Mindanao ("VISMIN") region in the south of the Philippines.[21,22] Duterte's policy of a more "equitable development" of the country's provinces should be welcome as it can be expected to lead to continued demand for investments in the infrastructure and energy sectors, where demand already outstrips supply on a nationwide scale.

## Sectors to watch

Partly due to a continuously low public investment rate,[23] the Philippines have fallen behind other Southeast Asian nations in terms of transportation infrastructure quality.[24] Recognizing the constraints upon public finances, the Aquino administration revived the Public Private Partnership ("PPP") program, which taps the private sector in the development, maintenance, and operation of infrastructure projects. While the award of projects has been perceived as transparent, the PPP program under Aquino suffered from weak implementation capacity. Only four out of 55 PPP projects in the pipeline are operational so far.[25]

The Duterte administration vowed to expand the PPP program and to expedite the award of projects.[26] Projects outside metro Manila with a focus on rural development would be prioritized. In November 2016, the administration's National Economic Development Authority ("NEDA") approved eight projects at a combined cost of USD 7.8 billion.[27] In addition to private sector funding, Duterte will also increasingly rely on bilateral grants to finance infrastructure tickets. NEDA approved guidelines on processing China-assisted projects that would make the agency's Investment Coordination Committee[28] responsible for the screening of potential Chinese investors.[29]

In this environment, some industries have become subject to heightened risk. Duterte's objective to broker peace agreements with various rebel groups operating in the country's provinces resulted in his appointment of several leftist figures as cabinet members. Among them are Gina Lopez, a prominent environmentalist, as Secretary of the Department of the Environment and Natural Resources ("DENR"). Lopez is a known proponent of sustainable mineral resources development and since taking office has conducted an audit of mining firms that resulted in the suspension of several firms' operations.

Another sector to watch is agri-business. Duterte has appointed Rafael Mariano, the former leader of a militant peasants' organization, as head of the Department of Agrarian Reform ("DAR"). One of Mariano's stated key objectives is to bring about "genuine" land reform. In a country where landed families have for centuries defended their control of vast tracts of agricultural land, a change to the status quo could in the short-term result in clashes between private security firms defending the current owners' interests and politicized peasants' organizations asserting their membership's rights.

## Volatility calls for entering markets carefully

Whether in foreign or domestic policy, the Philippines will be more volatile under Duterte. In terms of the more controversial initiatives undertaken by Duterte – drugs and foreign policy – he has acted often unilaterally, on his own, perhaps out of personal experience and conviction, and consistent with the way a city mayor would interpret his mandate. But the informed Philippine public is increasingly calling into question his authority and wisdom in taking the country in these directions absent prior consultation with other relevant authority.

In terms of economic policy, the country's demand for infrastructure and energy projects remains unchanged and will likely receive increased priority under the Duterte administration. Other sectors, in particular mining and those impacted by land reform, are under heightened scrutiny. Policy direction vis-à-vis these sectors should be monitored closely. In order to capitalize on the opportunities presented by the new administration, foreign investors would do well to plan their market entry carefully.

*This article continues Michael's analysis of the political and risk landscape in the Philippines; his first article on the subject was published in June 2016 in Asia House, which you can read here.*

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