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ScienceDirect
Policy and Society 33 (2014) 39–52
policy and society
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The political economy of foreign direct investment—Evidence from the Philippines☆

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Abstract

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

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

☆ This research was supported by a sub-agreement from the Johns Hopkins Bloomberg School of Public Health with funds provided by the Bloomberg Initiative to Reduce Tobacco Use. Its contents are solely the responsibility of the authors and do not necessarily represent the official views of the Bloomberg Philanthropies or the Johns Hopkins Bloomberg School of Public Health.
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http://dx.doi.org/10.1016/j.polsoc.2014.03.002
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and regulation. The firm ultimately succeeded in increasing its market share dramatically in large part through massive investments and a strategic joint venture, but perhaps somewhat counter-intuitively, its success in securing favorable policy has been mixed, and even limited in one key area, taxation.[1]

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

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

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

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

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

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

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

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

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

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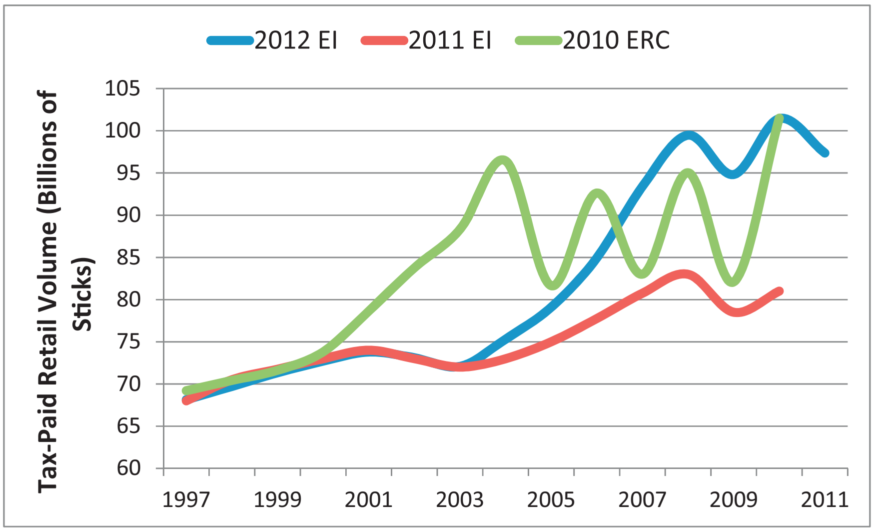
Table 1
Philippines cigarette sales, 1997–2011.



it was the strongest tobacco lobby in the region (Hemisphere-Leo Burnett, 1994). Key informants from both health-focused civil society organizations and government ministries confirm that the tobacco industry remains powerful economically and politically, though the latter claim is difficult to evaluate (this research will shed some light on this assertion). Second, the economic stakes of the tobacco tax policy reforms were and are enormous – though not necessarily existential, the potential loss to the industry is in the hundreds of millions of dollars stemming from both changes in tax rates and the overall structure (Tobacco Reporter, 2013). Table 1 below demonstrates not only the sheer size of the industry – most estimates place recent cigarette sales at more than 100 billion sticks per year – but also the consistent and dramatic growth. Third, the tax policy reforms in question had significant implications for the private interests of foreign and domestic tobacco and alcohol firms operating in the Philippines. In the tobacco industry, for example, a joint venture between a large foreign tobacco multinational corporation, Philip Morris, and a domestic tobacco firm, Fortune Tobacco Company, has recently dominated the marketplace. Fourth, most political observers view the Philippines as institutionally weak (Hutchcroft, 2008; Hutchcroft & Rocamora, 2003) and often corrupt (Azfar & Gurgur, 2008; Kang, 2002). Thus, private firms' abilities and motivation to seek preferential policy are almost certainly large. If significant FDI does in fact deeply shape or re-shape policy, we would expect to observe it in a case like this one.

To evaluate these competing narratives, we systematically evaluate a range of complementary data sources, including: tobacco-related economic data (investment, production, imports, exports, etc.); key documents (public documents; minutes from relevant congressional meetings; published reports; international and domestic tobacco-related policies; and international investment and trade agreements and corresponding domestic policies); and particularly, key informant interviews with 33 individuals across a range of official institutions (the legislature, the executive, ministries, agencies, etc.), civil society and international organizations. The interviews took place between November 2012 and October 2013 (inclusive). We interviewed several key informants more than once, both before and after the reform. Because many of the officials that we interviewed remain in government service and were fearful of reprisal, we agreed that all interviews would be non-attributable. In other words, we would not use names or precise titles in the research, though most subjects permitted us to use the name of their organization or official institution and the level of their position (see Appendix A for a list). In the interviews, which typically lasted two hours, we recorded where permitted; a small number of subjects refused recording, but allowed note-taking. Accordingly, we do not use verbatim quotes in the research. In the cases where we utilize information from only interview notes, we improved our recall accuracy by systematic comparison of team members' notes in order to reach agreement amongst the research team on the material (multiple authors of this research were at all interviews). Moreover, the objective was primarily to identify common themes in the interview data that we could cross-reference among subjects and with the other data sources mentioned above, and non-audio-recorded interviews did not pose a problem for this task.

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In brief, we find that PMI's significant investments in the Philippines consistently did not yield the desired tax policy outcomes, leading to policies that affected profitability strongly and negatively. In particular, in January 2013, despite efforts on the part of PMI and powerful domestic allies, including many legislators and tobacco grower organizations, the Philippines government enacted one of the most significant tobacco tax structure reforms and implemented one of, if not the, largest tobacco tax rate increase (proportionally) in any LMIC. At face value, this outcome suggests that PMI as a foreign investor partnered with a domestic firm wielded less political influence than purely domestic firms wielded in earlier rounds of tax reform.

2. Previous literature

The political economy literature rarely attempts to make an explicit connection between FDI and political influence. Rather, most scholars tend to focus on how FDI has some direct or indirect effect on a set of policies, usually related to regulation or macroeconomic policy. But the implicit suggestion of these studies tends to be a positive relationship between FDI and political influence: greater amounts of FDI and the mobility of a foreign investor's capital enhance an investor's ability to influence political processes to reach their policy preferences. The actual mechanisms of influence, however, tend to be murky.

One common approach in the political economy of FDI literature focuses on the pre-investment phase and posits an indirect relationship: the so-called ''race-to-the-bottom'' (or RTB) hypothesis posits that countries in an effort to attract investment are likely to adjust sharply their policy frameworks by dismantling regulations across multiple key policy areas (e.g. education, environment, health, labor, social welfare, etc.) (Mehmet & Tavakoli, 2003; Notermans, 1993; Xing & Kolstad, 2002) or converge on macroeconomic policies that many observers perceive to be beneficial to foreign investors (e.g. capital controls, fiscal policies) (Andrews, 1994; Cohen, 1996; Goodman & Pauly, 1993). Of course, one of the key subtle, underlying assumptions of this approach – typically with a large implicit normative component – is that MNCs naturally prefer less regulation and/or that there is a narrow set of policies that all or most businesses prefer (e.g. certain kinds of capital controls, exchange rate regimes, etc.). Empirical evidence of these relationships from a vast literature is mixed at best.

Several important counter-literatures have developed. One literature suggests that the positive relationship between FDI and regulatory decline and/or macroeconomic policy convergence either does not exist (e.g. Plümper, Troeger, & Winner, 2009) or is much more nuanced (e.g. Biglaiser & DeRouen, 2006). For example, some scholars argue that under certain conditions, firms seeking to invest are actually attracted to stable or even more stringent regulatory frameworks (Potoski, 2001; Vogel, 1996). Taking a slightly different focus, Vogel (1995, 1997) examines U.S. states and argues that some heightened health and environmental standards in certain jurisdictions actually change firms' orientation to sell products elsewhere that meet the higher benchmarks. Thus, government policies can actually push firms into an apparent ''race-to-the-top''.

In related research, Basinger and Hallerberg (2004) examine the competition for capital in OECD countries and argue that two types of costs actually mitigate a race to the bottom. First, they argue that changing legislation to dismantle regulation is politically costly because it requires convincing multiple veto holders. Second, they suggest that there are tangible constituency costs: policymakers face genuine and often large pressures to make policies preferred by voters, and voters are not necessarily supportive of less regulation.

In their finding that globalization, which includes investment, can affect collective labor rights positively, Mosley and Uno (2007) argue that actors' desire to adhere to international norms that privilege workers' rights can play a key role in making labor policy. In another norms-related finding, Wheeler and David (2001) argues that MNCs face significant public pressure to adopt developed world standards in developing countries, again contributing to the notion that a RTB scenario is not inevitable.

In the tobacco control literature, however, scholars have typically argued, often forcefully, that FDI leads to negative health-related outcomes both in terms of aggregate and individual behavior (i.e. increased consumption), and regulation. In terms of individual behavior, in their analysis of tobacco-related FDI in former Soviet states, Gilmore and McKee (2005) find that consumption rates increased after large tobacco company investment. In this case, the causal mechanisms are not clear as the research also highlights enormous changes in political circumstances and trade flows, which realistically might affect consumption, as well as failing to control for changes in regulation and individual-level income.

Some scholars have explored evidence that multinational tobacco firms conceptualize FDI as a strategy for affecting the political process in a country. For example, Szilágyi (2004) examines PMI's major investment in Hungary

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and their effort to affect the regulatory framework, but does not identify conclusively how the two relate. In fact, notably, in this instance, PMI's efforts to undermine stricter controls on tobacco advertising failed. In related research, Szilágyi (2006) uses tobacco industry documents to demonstrate that tobacco firms conceptualized investment as a foothold toward affecting relevant policy more effectively. MacKenzie (2004) finds a similar expectation with British American Tobacco's investment in Cambodia in the 1990s. However, the research has yet to link the firm's intention to influence the politics of the host country and actual influence more systematically.

In other tobacco-related research, scholars make the link between FDI and political lobbying more explicit. In a review of tobacco sector privatization, Gilmore, Fooks and McKee (2011) argue that privatization – used more or less synonymously with FDI – provides both a foothold and additional impetus for tobacco MNCs to counter tobacco control policies. In a study of tobacco sector investment in Uzbekistan, Gilmore, Collin, and Townsend (2007) examine BAT's efforts to affect tax policy. While the study focuses on lobbying efforts, it is not clear if investment was an underlying force, or at least a force stronger than an alternative economic scenario, such as importing. In earlier research, Gilmore (2005) is more precise about the causal mechanisms of influence, arguing that tobacco MNCs invest after a period of building trust with government officials by providing advice, particularly on privatization and regulation. These connections form an important foundation for subsequent interactions about regulation after the investment. In closely-related work, Gilmore and McKee (2004) posit that increased FDI in the tobacco sector incentivizes firms to lobby more vigorously to stymie attempts to regulate tobacco. They point out, however, the confounding role of a well-organized civil society – in this case, in the Baltic states – that can prevail in promoting more health-based tobacco regulations and measures.

In another related strand of the tobacco control literature, scholars have examined the effects of increased marketing by multinational tobacco firms in new markets. Researchers have focused particularly on market openings in East Asia and how aggressive marketing contributed to consumption increases (Chaloupka & Laixuthai, 1996; Lee et al., 2009; Lee, Lee, & Holden, 2012; Wen et al., 2005). It is important to note that these changes, mostly in the 1990s and early 2000s, did not necessarily happen within the context of major FDI, but these discussions nevertheless help to elucidate one key possible mechanism of changes in patterns of consumption.

3. Tobacco taxation as a public health instrument

In order to understand why recent tax reform in the Philippines is a critical case, it is important to establish tobacco taxation as not only a viable public health tool, but one that is contrary to the interests of the tobacco industry as a whole. There is near consensus amongst scholars, international health organizations and policymakers that effective taxation of tobacco products is arguably the best tool to reduce the prevalence of tobacco consumption (Chaloupka et al., 2000; Chaloupka, Straif, & Leon, 2011; Holford, Meza, & Warner, 2014; Jha & Peto, 2014; WHO, 2010). For example, South Africa and France were able to reduce tobacco consumption by half in less than 15 years primarily through increased and appropriately-structured tobacco taxation (Hill, 2013; Jha, 2009; Van Walbeek, 2006). More than any other single common intervention, effective tobacco taxation is thought to affect consumption in ways that produce the largest positive public health outcomes. In brief, taxes that tobacco producers pass on to consumers affect price and/or the affordability of tobacco products, and thereby consumption: higher taxes typically lead to higher prices, making tobacco products less affordable, which then leads to lower consumption. As a bonus, in many circumstances, even with decreased consumption of tobacco products, a tobacco tax increase still generates more revenue for government than before the increase. As a result of its consistent effectiveness, tobacco firms for decades have consistently opposed increased tobacco taxation and certain tax structures that counter firms' specific economic interests (Chaloupka, Yurekli, & Fong, 2012; Heiser & Begay, 1997; Smith, Savell, & Gilmore, 2013; Traynor & Glantz, 1996).

Tax structures dictate how governments tax goods and/or services. Generally, governments use excise taxes as a tax on consumption or use. Often, revenue agencies around the world employ excise taxes to tax products with larger externalities, such as tobacco, alcohol and fuel/energy. Some countries use ad valorem excise taxes, which are assessed on the declared value of the product (frequently using wholesale prices), while other countries utilize specific excise taxes that are assessed to a particular quantity or size of a product (e.g. 1000 sticks of cigarettes or per kilogram, etc.); still other countries employ a more complex system that assesses both types of taxes simultaneously on the same product. Each type of excise tax has its advantages, but in the case of tobacco products in LMICs, the World Health Organization (WHO, 2010) typically recommends specific excise taxes because they are easier to administer and more

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difficult for producers to manipulate. With ad valorem taxes, producers can deeply affect government revenues by adjusting declared values. It is also typically easier for consumers to shift to a cheaper brand under an ad valorem system. There are other important elements of structure that are often components of tax reform, including: indexation of rates to account for inflation and/or changes in income; minimum tax burdens (i.e. the proportion of price that is tax); and rate floors and/or ceilings.

In addition to the shared interest tobacco firms have with respect to taxes that affect the prevalence of consumption, firms have diverging private interests because tax structure affects the conditions under which they compete. In other words, under certain circumstances, firms might pursue a structure that ensures that the rules of the marketplace are more equitable, but might not seem in their obvious interest in terms of actual tax rates. This is evident in the history of tobacco taxation in the Philippines. For decades, specific elements of the tax structure favored incumbent domestic firms, and foreign investors, including PMI for many years, fought for a more equitable structure. It was only after PMI secured the same favorable treatment through a joint venture with a large domestic producer that it actively fought to preserve the status quo.

4. Tobacco excise tax reform in the Philippines

For many years in the Philippines, neither the tobacco tax structure nor the corresponding rates were favorable to public health outcomes, particularly consumption. For decades, Section 142 of the Internal Revenue Code assessed an ad valorem tax that due to low wholesale prices seldom exceeded a few pesos. As a result, cigarette prices in the Philippines have traditionally been amongst the lowest in the world and have remained relatively affordable even in the face of significant poverty (SITT, various years). The tax was also discriminatory, assessing lower rates on domestic brands compared to both foreign brands produced domestically and imports (with imports facing the highest rates).

In the mid-1990s, the Philippines Department of Finance (DOF) sought to reform the tobacco excise tax structure. According to a former high-ranking DOF official, many in the department, including at the highest levels, were strongly in favor of reforming the tax structure during this time period, particularly in order to generate more revenue (interview, November 2012). The largest domestic cigarette producer, Fortune, owned by billionaire Filipino industrialist, Lucio Tan, fought the reform vigorously. Eventually, the discussion centered around the inclusion of product price tiers that would be taxed at different rates, with lower taxes for lower-priced cigarettes. Moreover, Fortune lobbied for a permanent ‘‘freeze’’ in what the Bureau of Internal Revenue (BIR) would consider the price for each brand for excise tax purposes. Not surprisingly, considering the implications of a complex and inflexible tax law, there were many opponents to the bill, including some in the DOF.

Notably, during this fight, according to the same high-level DOF official, in its quest for a more level playing field in the marketplace, PMI publicly supported a tobacco tax structure without price tiers and without a price freeze. PMI criticized the proposed reform because it would create a clear advantage for the incumbent firm, Fortune, which owned the country’s most popular brand, at that time priced in the lowest tier. As Table 2 illustrates, in the mid-1990s, PMI had scarcely 20% of the cigarette market and was actively seeking ways to break the strong grip of Fortune, which at the time also had a licensing agreement with Japan Tobacco International to sell that firm’s brands in the Philippines (SITT various years). Finally, the official noted that the U.S. economic attaché actively and publicly supported PMI’s position.

In 1997, the Philippines Congress passed legislation (RA 8424) that amended the existing tobacco excise tax regime. After considerable debate, the final legislation was very close to the Fortune-backed proposal. The law included four cigarette price tiers, each with a different tax rate.[3] Moreover, the legislation locked in late-1996 prices in perpetuity – or at least until new relevant legislation – that the BIR would consider when determining a product’s tier placement. This component of the law had the effect of enshrining the lowest tax rate for the vast preponderance of Fortune’s product line, even if the value of the products increased over time. For example, the price of their best-selling brand, ‘‘Fortune’’, soon thereafter increased well into the next price tier, but its tax rate remained at the lower rate until early 2013, amounting to hundreds of millions of pesos more in profits as compared to what would have otherwise been due in excise tax payments.

Undaunted by the loss with the tax legislation, in 2000, PMI invested $300 million (USD) in a new cigarette manufacturing plant in Tanauan in Batangas province. Previously, PMI had a licensing agreement with local

[3] The four retail price (per pack in pesos) tiers with per pack tax rates: P5 (tax P2.72); P5-P6.50 (P7.56); P6.50-P10 (P12); and >P10 (P28.30).

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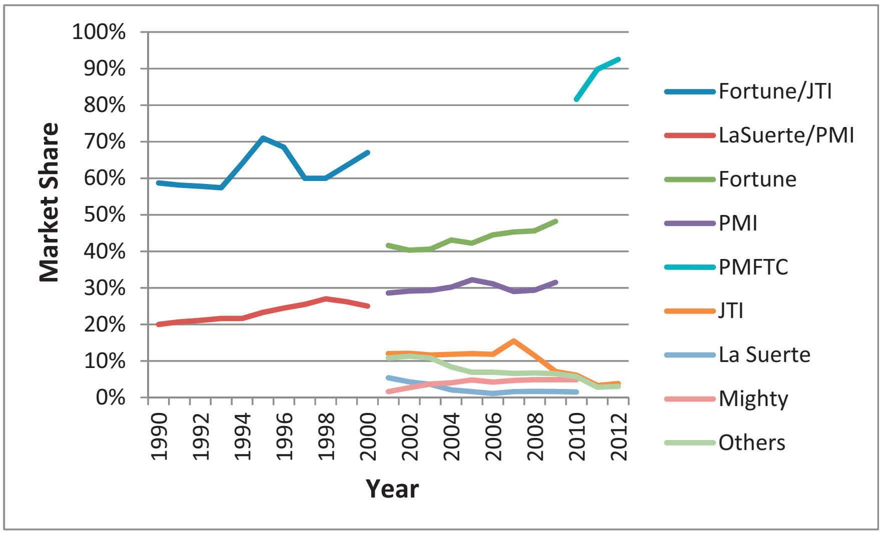
Table 2
Cigarette market share.



manufacturer, La Suerte Tobacco, to manufacture its brands. But if one of the goals of this large investment was to increase political influence, observers close to the political process suggest that it mostly worked out otherwise. In personal interviews, highly-placed officials from both the legislature and key ministries (DOF, Department of Trade and Industry (DTI), Department of Agriculture (DA) and Department of Health (DOH), interviews in April 2013) consistently observed that in spite of PMI's increased and vigorous economic activity in the country in the 2000s, the real political lobbying power continued to reside with Fortune. Several elected and unelected high-ranking officials stated categorically that Fortune directly funded campaign efforts of preferred candidates (interviews April 2013 and October 2013). Unfortunately, because of the lack of transparency in election and political contribution laws, we were unable to verify these claims directly. However, multiple sources in different parts of government, including the legislature and the executive branch, civil society and international financial institutions made the same independent observations.

In 2003–2004, reform of the so-called ''sin tax'' (alcohol and tobacco) reappeared on the legislative agenda. Reportedly, in another attempt to dislodge Fortune, its main competitor, PMI actively supported the elimination of the price tiers and the price-freeze designations (Philip Morris, 2003). Though there were very modest rate increases in the specific taxes in the eventual 2004–2005 reform, the tiered structure and the price designation freeze remained intact. Once again, PMI failed to secure tax legislation favorable to its business goals.

Despite this additional legislative setback, in 2007, PMI invested another $20 million (USD) in a tobacco storage facility north of the capital, Manila, indicating that exporting from the Philippines was also an emerging priority. Notably, sources at the DTI and the DA suggest that PMI did not receive overt incentives to invest (interviews, April 2013). Responding to our formal information requests, DTI's main investment agency, the Board on Investments (BOI), and the Philippine Export Zone Authority (PEZA) both reported that PMI did not request special investment treatment – even fairly standard requests such as tax holidays, import duty exemptions and tax credits – and none were granted. We also inquired directly with provincial and local governments and were unable to identify specific economic incentives that might have been provided to PMI to invest. Of course, it is possible that the firm received other less transparent incentives, but we did not uncover such evidence.

No doubt aware of their continuing political challenges, and an enduring effort to dominate the highly lucrative Philippine cigarette market, PMI tried a new strategy in 2010: PMI's Philippines subsidiary and Fortune announced that they would form an official joint venture, Philip Morris-Fortune Tobacco Company (PMFTC), though Fortune would keep some small assets separate from the new entity. In one of the largest joint ventures in Philippines history, Philip Morris would have a slight majority share, while Lucio Tan, the principal owner of Fortune, would be chair of the board. The new corporation at first dominated the cigarette market in the Philippines with a consistent 80–90% share through the end of 2012. In 2013, its market share fell as a previously small domestic firm, Mighty Corporation,

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gained significant market share by selling cigarettes at prices scarcely above the new excise tax rates. In late 2013, BIR initiated an investigation into the firm's pricing (Gonzalez, 2013).

It did not take long before the political power of the new joint venture was tested directly. In 2012, the issue of tobacco taxation once again came to the top of the legislative agenda in the Philippines. The European Union had challenged the Philippines in formal dispute settlement (case DS396) in the World Trade Organization (WTO) concerning the Philippines' liquor tax structure that favored specific domestic distilled spirits. The panel at the WTO's Dispute Settlement Body ruled that the structure violated GATT III:2 because the lower flat tax on distilled spirits made from designated locally-abundant materials (including sugar cane) discriminated against imported products typically manufactured from non-designated materials. After the WTO Appellate Body upheld the decision in December 2012, the Philippines had to address the decision in a timely manner or risk economic retaliation from the EU. In effect, the decision actually created a broader impetus to revisit tax reform across alcoholic beverages and tobacco, another so-called "sin tax" package. The Philippine president, Benigno Aquino III, was enthusiastic to pursue this tax reform aggressively for both health and revenue reasons.

There was tremendous controversy around the bill. PMFTC moved immediately to oppose the reform, objecting vehemently to the proposed changes in both structure and rates, and lobbying for a package that mostly preserved the status quo. Growers – supported by PMFTC – also mobilized vocally against the tax reform, staging many open protests in front of the Philippines Congress and elsewhere. Health organizations in civil society on the other side mobilized a large coalition to support vigorous reform. Domestic liquor firms also lobbied the government, seeking to preserve a tax structure that would offer a competitive advantage for domestic distilled spirits as compared to their imported competitors.

The final bill, RA 10351, markedly reformed key components from the earlier excise tax laws. First, the price tiers for cigarettes were immediately collapsed from four to two, which would then after two years, decrease to one. The legislation also completely eliminates the price freeze component, which Fortune sought so vigorously in 1997, protected aggressively in the mid-2000s, and which turned out to be a boon financially for years. Finally, the legislation formally includes indexation so that rates increase incrementally each year to address inflation and changes in income, thereby directly affecting affordability of cigarettes in the future. The government did increase alcohol taxes though the de facto rate change was relatively small. Per the WTO demand, there are no longer different tax rates for liquor manufactured from different source materials.

Political contestation of the proposal was vigorous within Congress. On one side, PMFTC, smaller Philippine domestic tobacco manufacturers, tobacco growers and other allies lobbied vigorously for a version of the bill that preserved much of the existing structure (including price tiers and freezes), generated only a modest increase in revenue (~P20 million) and shared the burden relatively equally among tobacco, liquor and beer. On the other end, many health proponents lobbied for a bill that generated over P60 billion in revenue, with a significantly larger burden on the tobacco sector. Members of the House Ways and Means Committee reported that discussion amongst members was vigorous, including during myriad hearings and private meetings in which both sides presented their preferences. After significant contestation in discussions and forceful shepherding of the bill by the committee chair, a member of the President's Liberal Party, the committee voted to approve the proposal, which was followed by a definitive vote in favor in the full House (see Philippines House of Representatives Journal 52, June 6, 2012: pp. 15–28). In the Senate, the vote was much closer. The eventual vote was 10–9 in favor of the ratification of the bicameral committee report, with 4 senators who had committed verbally to supporting the bill conspicuously absent on the day of the vote (see Philippines Senate Journal 42, December 11, 2012: pp. 1197–2016). The final bill was a compromise in that the estimated increase in revenue was most likely to fall in the P40-50 billion range, with approximately a 60% burden falling on the tobacco sector (this is not, however, enshrined in the legislation explicitly), but the structural changes were much closer to what health proponents sought. The bill also explicitly earmarked the preponderance of revenue to health. The tobacco industry and market analysts agreed that this reform was a tremendous blow to the manufactured tobacco products sector as a whole (Trefis, 2013a, 2013b).

5. Underlying conditions

The description of major events surrounding excise tax reform above suggests that the narrative of limited influence for the foreign investor, PMI, is a more accurate and realistic characterization in this complex scenario. The final tax reform was almost directly counter to the economic interests, including the broader competitiveness, of PMFTC,

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which had been benefiting from the structure since the creation of the joint venture. In this section, we examine some of the potential underlying conditions that help to explain this outcome.

In many ways, it is likely that PMI was partly the victim of bad timing, which was partly symptomatic of globalization more broadly. As described above, because of the WTO ruling on the Philippines' discriminatory liquor taxes, the impetus to develop a new ''sin tax'' arose rapidly. Here, the narrative becomes significantly complicated by issues of ownership. Lucio Tan, the owner of Fortune, who made the decision to merge in 2010 with his long-time tobacco rival, PMI, also continues to have major holdings in the alcoholic beverages sector, including Asia Brewery, the Philippines' second largest brewer, and Tanduay Holdings, a major global rum producer. According to accounts from high-ranking officials in the DOF, the alcoholic beverages sector lobbied vigorously – and ultimately successfully – to have their sector's taxes comprise a much smaller proportion of the total sin tax revenue total (interview, November 2012). So, in effect, it appears that Tan and/or his allies may well have actively lobbied against his new tobacco partner, an industry from which he was openly and aggressively divesting. A key informant from civil society and another from the tobacco industry speculated separately that tobacco's legislative loss reflected Tan's recent waning political influence, though this claim is extremely difficult to evaluate considering that his significant alcohol interests fared quite well in the eventual legislation (interviews, April 2013).

The overlap with alcohol ownership is also relevant through another dynamic in the congressional debate. According to sources in the House Ways and Means Committee and the DOF, a group of 10 representatives from the Nationalist People's Coalition (NPC) were early supporters of the major reform of the tax structure and rates in committee meetings (interviews, April 2013). The founder and chair of the NPC, Eduardo Cojuangco, Jr., is also the chairman of the San Miguel Group, the country's largest manufacturer of alcoholic beverages.

It is also apparent that a confluence of specific, critical individuals who did not respond to tobacco industry lobbying (legal or otherwise), played central roles in pushing the reform and ensuring that it was not diluted. First and foremost, President Aquino strongly and publicly backed the tax reform, and according to sources in the House Ways and Means Committee, indicated to the chair that this was a major policy priority (interviews, April 2013 and October 2013). Moreover, by most accounts, the president is not corrupt and as a result is not beholden to many of the business interests that supported earlier presidents. Both government and civil society interviewees noted a shift in norms in Philippines away from government corrupt practices (interviews, April 2013 and October 2013). Although they also noted, anecdotally, that widespread corruption continues to exist. The BIR Commissioner, Kim Henares, was and remains a vocal proponent of the reformed excise tax structure and corresponding rates. In the House, the Chair of the House Ways and Means Committee, Isidro Ungab, was known to push the legislation quietly but firmly through his committee. He reportedly would not give up the chair's gavel during negotiations for fear that the committee would remove it from the agenda if another member were to take the chair's position temporarily. Later, Ungab played a very public role in the House and Senate reconciliation process for the two versions of the proposed bill: he would publicly report each day exactly what had transpired in the hearings, thereby generating remarkable transparency for the public and civil society. In the Senate, once the seemingly pro-tobacco chair of the Finance committee, Ralph Recto, resigned, the subsequent chair, Franklin Drilon, was a firm and unwavering supporter of the tobacco tax reform initiative. Finally, according to a high-ranking official in the DOF privy to internal discussions and from representatives of two major medical organizations (interviews, April 2013), the DOF from the very top of the organization (i.e. secretary and under-secretaries) gave firm and overt public support and backed the reform in terms of providing the necessary technical assistance.

There is considerable evidence that PMFTC likely overplayed its position in negotiations with the government about tax reform in early 2012. Several key informants from both civil society and government contended that PMFTC likely assessed its own influence at the levels that Fortune enjoyed before the merger (interview, DOF, November 2012; interviews with civil society, April 2013). According to an official at the DOF, when broader discussions on the sin tax began, the DOF invited high-level representatives from the liquor, beer and tobacco industries to negotiate. But, the tobacco industry chose not to attend these meetings reportedly because it was confident that it could quash any effort, and instead spent its time and energy developing an alternative version of the bill (which was remarkably similar to the one initially presented by Senator Recto in the Senate Finance committee). According to DOF sources, it was only after the House Ways and Means committee passed the bill that the tobacco industry returned to the negotiations. By that time, however, the DOF had a much stronger position and offered a package that was less favorable to the tobacco sector.

Institutional structure played key indirect roles in undermining PMI's attempts to thwart the proposal. As both a high-ranking DOF official and a member of the House Ways and Means Committee suggested, the parts of the proposal that earmarked significant funds from cigarette excise tax revenues for the government's Phil Health program

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(∼68%) and health infrastructure improvement (∼17%) were very attractive to many members of both congressional houses (interviews, April and October, 2013). The Phil Health earmark allocated funds to ensure that individuals in the lowest income quintile would receive universal health coverage, with any remaining funds allocated to the next income quintile. Particularly for the 80% of House representatives elected by district, the direct positive effects of the reform were considered useful for demonstrating to a large number of constituents that they were doing their jobs effectively. In comparison to previous excise tax regimes that mostly allocated revenues back to the tobacco-growing areas, the most recent tax reform promised to provide resources to a much larger number of legislative districts.

Additionally, like earlier tobacco excise tax legislation, the eventual bill allocated a tranche of tobacco excise tax revenue for the districts that grow tobacco. The organizations of tobacco growers were among the most vocal opponents of the reform and, according to representatives of civil society organizations, a high-level official in the National Tobacco Administration (NTA) and a member of the House Ways and Means Committee, had significant sympathy amongst some politicians and many in the general public (interviews, April 2013). According to the House member, the substantial earmark for the growers, however, was reportedly another variable that convinced legislators that the legislation would account for costs to these specific regions from the reform.

The structure of the Philippine Senate was also likely consequential in mitigating PMI's leverage, but in a manner different from the House. In the Philippines, all senatorial elections are ''at-large'', so resources and name recognition are significant determinants of successful candidates (Rivera, 2011). During the time under scrutiny, the industry and PMI appeared to lack a critical mass of at least overt support within the Senate. It is well documented that Senator Recto from the state, Batangas, where PMI's largest operation is located, put forward a proposal that closely mirrored the industry's as the chair of the Senate Finance committee when the initiative first came to the committee's agenda. Ultimately, both colleagues and the public dismissed Recto's proposal for being so egregiously in favor of his major constituent, PMFTC, that he stepped down from this powerful legislative position.

Several high-ranking officials in the DOF and the NTA speculated that domestic businesses play by different rules than transnational corporations: domestic businesses still largely play by the ''old'' rules in which bribing legislators is common, while MNCs are either more accountable to international norms and/or simply less able to engage in such behaviors (interviews, April 2013). Though PMI is no longer technically a U.S. company, and PMFTC is a registered corporation in the Philippines, several informants speculated that they do pay attention to the norms promoted by the U.S. Foreign Corrupt Practices Act.

However, many key informants, in civil society, the DOH and the legislature all indicated a strong belief that pay-offs were present in the sin tax campaign (interviews, April and October, 2013). Two interviewees even offered the specific ''price'' for a vote (P20,000) and for a legislator to take a vocal stand in legislative debates (P30,000). It is noteworthy that many of the interviewees who suspected that PMI had achieved or attempted to achieve capture could not provide examples that disentangled PMI from Fortune, and further stated that Fortune had been much more overt in its efforts to influence policy. It was further speculated that PMI merged with Fortune in part to benefit from the political relationships that Fortune had established over the years; however, this remains speculation.

Notably, like PMI in the mid-1990s and mid-2000s, British American Tobacco (BAT) lobbied openly and aggressively in favor of the 2013 tobacco tax reform. In personal interviews (November 2012 and April 2013), two high-level industry executives reported that reform of the tax structure was the only effective way to ''level the playing field'' with PMFTC. The interviewees also reported that BAT was even willing to support large increases in the tax rates if the government changed the structure. Notably, BAT promised to invest heavily in the Philippines if the tax reform was successful. In legislative debates and public discussion around tax reform, BAT held out the prospect of direct investment if reform were to create a level playing field. More specifically, BAT indicated that it was willing to invest $200 million over a five-year period, including the possibility of building a manufacturing facility (Gonzalez, 2012). BAT has also invested in the purchase of tobacco leaf from tobacco growing areas in the Philippines, partly to assuage political concerns about the impact of tax reform on tobacco growers (Manila Bulletin, 2013). It is impossible to disentangle how much of a role BAT involvement played in the regulatory outcome, but it is worth noting the somewhat counter-intuitive conclusion that a tobacco MNC supported tax reform that is likely to lower the prevalence of tobacco consumption over time. This support highlights that BAT and other tobacco firms had a private interest in tax reform that would level the conditions of competition and that this, rather than the ultimate level of the tax, was BAT's primary concern.

The narrative and analysis above points to the complexity of a world of increasing trans-border capital flows, but it also suggests that the worst-case scenarios for public health measures may not necessarily develop. In this case of a very powerful tobacco industry in the Philippines, enormous amounts of capital did not appear to help the foreign

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investor reach its goals in its most important policy confrontation with the government. This analysis suggests that the simple equation of FDI leading to political capture does not reflect the ways in which regulation was developed, argued for and implemented in this case. We have introduced a number of major underlying conditions that presented obstacles to PMI's goal of regulatory capture.

One particularly salient and yet counterintuitive feature of this case is that the capital pull from the Philippine government for FDI, rather than resulting in yielding to the preferences of PMI, was actually combined with a measure that will have a negative effect on the investor. The regulatory context may have been such that the cost of regulating was outweighed by the government's need to generate revenue. It is noteworthy that this case highlights a fiscal reform whereby it can be assumed that government benefits are much more immediate and tangible when compared to other cases of tobacco regulation such as product regulation where the burden of enforcement is not followed by such direct monetary gains. More abstractly, the target of the regulation may be a moderating factor when it comes to measuring the relationship between FDI and political capture. In fact, the tobacco industry informants who supported tobacco tax reform also explicitly rejected graphic warning labels, plain packaging and many smoke-free provisions (interviews, April 2013).

On a similar note, it is worth considering the important notion that there are undoubtedly different types of FDI and the nature of these investments is likely to affect how governments react to demands from these investors (Hecock & Jepsen, 2014). In the case of tobacco in the Philippines, it is clear that foreign firms were and remain particularly interested in gaining a stronger place in the domestic market. In such a scenario, the Philippines government is likely to have considerably more leverage with the investor, particularly compared to a dynamic such as an export-processing zone or some extractive industries in which the government is likely competing with other countries to attract investors who care little about the domestic market and are instead seeking cheap labor and/or less regulation.

Our analysis also reflects a truism from private interest theories of regulation that interests are often many and conflicting or as Croley (1998) notes "groups face competition from rival groups with incompatible regulatory preferences". One element of this particular case that resulted in the marginalizing of PMI's preferences was the combination of a group of actors from the private sector (including PMI's partner in Fortune), different government institutions and a vociferous civil society in support of a reform that aligned with both tobacco control objectives and government fiscal policy. Another set of factors existed at the level of political and historical context.

The transnational factors that seemed to contribute to a context favorable to tax reform that ran contrary to PMI preferences included a WTO dispute panel decision that obligated the Philippine government to establish a non-discriminatory tax structure governing alcoholic beverages. This pressure in a sense was neutral with respect to different public and private interests in the tobacco sector, however it is clear that the result was the marginalization of PMI preferences. International trends to establish universal health insurance schemes across the world also occupied a significant part of the response from interviewees. This norm has gathered strong support from different intergovernmental organizations, including the World Bank and the World Health Organization over the past decade (Evans & Etienne, 2010).

6. Conclusions and broader implications

The ultimate outcome of tobacco tax reform in the Philippines was contrary to PMI's interests both in terms of the potential reduction in prevalence of tobacco consumption and loss of a competitive advantage. This outcome is contrary to the narrative that the foreign character of an investor gives it special influence over generally applicable policy and regulation. On the contrary, the outcome of reform adheres more closely to the opposite view, which is that domestic regulation after the establishment of an investment is likely to favor the private interests of domestic firms at the expense of foreign investors. As was recognized above, the conditions under which this outcome occurred are numerous and many of those conditions may be specific to the Philippines or the case at hand.

The outcome of tax reform might also be said to have three other theoretical implications that merit further investigation. First, the outcome might suggest that the opening of a tobacco market may under some conditions be favorable – or at least not contrary – to regulation such as tobacco taxation. As detailed above, the existing public health literature focuses on the risks to health associated with FDI in the tobacco sector, without identifying conditions under which FDI may alter the political economy in favor of tobacco control.

Second, the outcome also suggests that trade agreements can offer governments political cover in the face of lobbying by groups with special interests. The outcome of the WTO dispute in *Philippines – Distilled Spirits* was one

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factor prompting tax reform that leveled the playing field between competing firms and ultimately provided a political opportunity to achieve public health goals. Further examination of this issue could help highlight the conditions under which trade agreements may enhance regulation in the public interest.

Third, the outcome might suggest that linking issues such as alcohol and tobacco control may increase the likelihood of strong tobacco control being implemented. This question of issue linkage is relevant not only to the domestic political strategies adopted by different actors, but also to how governments and inter-governmental organizations organize reform that seeks to reduce different risk factors for non-communicable diseases.

The case study here does not suggest that large amounts of FDI cannot seriously affect a country's political economy. Rather, this example demonstrates that under a particular set of circumstances, the outcome can challenge the conventional wisdom. In short, a number of key variables can potentially act as serious counter-weights to strong private interests. In many ways, though it is far too early to tell definitively, this might be a harbinger of the mature democracy into which the Philippines appears to be developing. In this case, strong private interests sought aggressively to overwhelm a major welfare-maximizing policy reform and lost. This outcome hews more closely to the theoretical framework posited by Basinger and Hallerberg (2004) – genuine veto points in the ''new'' Philippine democracy were a successful foil to attempts to preserve a tax policy status quo that was bad for public health and good for a narrow but powerful economic interest. Furthermore, public support appeared to mostly favor more taxation, not less. Not too far in the past, there is strong evidence that the tobacco industry typically won such battles.

This case does not suggest that the tobacco industry is not economically and politically powerful in the Philippines or elsewhere. As the literature review above suggests, the tobacco industry has successfully wielded its political influence in many places. However, this case demonstrates neatly that a simple conceptualization that posits negative effects of FDI on legislation and regulation may be woefully inaccurate. Understanding better the political economic implications of different forms of FDI under varying circumstances should help policymakers as they seek to balance the needs for foreign capital and domestic regulatory autonomy.

Appendix A. List of key informants by organization

All interviews were conducted between November 2012 and October 2013.

A.1. Government

Department of Finance – two high-ranking officials from two different presidential administrations.

Department of Trade and Industry – one former under-secretary and three director-level officials. All have been involved in WTO negotiations in various capacities. Three had been involved in FCTC negotiations. We interviewed an additional two officials who are involved directly in the Inter-Agency Committee-Tobacco.

Department of Agriculture – two high-ranking officials, one legal expert and the other who specializes in multilateral trade negotiations.

Department of Health – one high-ranking official who was involved in FCTC negotiations; two director-level officials in health promotion; one program-level official; and one legal advisor.

Department of Foreign Affairs – director-level official who works directly with trade negotiations.

National Tobacco Administration – high-ranking official.

Legislature – ranking member of the House Ways and Means Committee and one House member's chief-of-staff who was involved in the negotiations.

A.2. Civil society

Health NGOs – two high-level officers from a health-focused NGO and two directors at another more general NGO that has worked extensively on tobacco-related issues.

Medical organizations – two high-level officers of two major medical organizations that have been active in tobacco control efforts.

Trade union – former high-ranking official of a major tobacco workers union.

Tobacco industry – two high-level executives and one former executive from two major tobacco MNCs.

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A.3. International organizations

World Bank – two senior officials who have worked extensively on tobacco issues in the Philippines.
World Trade Organization – two high-level officials who work on tobacco-related issues at the WTO

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