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Maharlika Investment Fund: Still beyond repair

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Maharlika Investment Fund: Still Beyond Repair¹

by

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¹ This paper reflects the views of the authors and does not necessarily represent the official views of the UP School of Economics or the University of the Philippines.

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Maharlika Investment Fund: Still Beyond Repair¹

6 June 2023

By Ma. Joy V. Abrenica, PhD; Luzeta C. Adorna, PhD; Patricia T. Coseteng; Emmanuel S. de Dios, PhD; Marian S. de los Angeles, PhD; Noel B. Del Castillo; Benjamin A. Endriga; Laarni C. Escresa, PhD; Jonna P. Estudillo, PhD; Maria Socorro Gochoco-Bautista, PhD; Aleli D. Kraft, PhD; Alice A. Lee; Adrian R. Mendoza, PhD; Ernesto M. Pernia, PhD; Jan Carlo B. Punongbayan, PhD; Renato E. Reside Jr., PhD; Anthony G. Sabarillo, PhD; Orville Jose C. Solon, PhD; Gerard P. Suanes; Elizabeth Tan; Atty. Mariel Jances Nhayin P. Yamashita

Abstract

The administration of President Ferdinand Marcos Jr. is pushing for the creation of the Maharlika Investment Fund (MIF). Originally proposed as a sovereign wealth fund, the MIF later on morphed into what can be called a sovereign investment fund (SIF): a state-owned investment fund that aims to reap returns from financial investments as well as economic returns from developmental projects like infrastructure. We find that the MIF violates fundamental principles of economics and finance and poses serious risks to the economy and the public sector — notwithstanding its proponents’ good intentions. First, the *raison d’être* of the MIF remains unclear even as it has already hurdled both houses of Congress. Second, due to its confused goals, the MIF bill does not adequately articulate and take account of several implications of the fund’s dual-bottom line objective. Third, the manner of funding the MIF poses huge risks to our already strained public coffers and is vulnerable to moral hazard. Fourth, red flags abound in the MIF’s governance structure. Fifth, with elevated global economic headwinds and uncertainties, it is unlikely that MIF will be able to “crowd-in” investments and eke out returns that are large enough for the fund to grow substantially to finance development projects. Sixth, the preoccupation with this defective proposal has diverted attention from more vital and urgent national agenda that the administration itself has rightly identified, notably the need to reform the retirement and pension system for military and uniformed personnel. In view of the foregoing, we call upon President

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Marcos to seriously reconsider the final approval of the MIF bill, and present before the public a clear and solid rationale for setting it up in the first place. We also call on our former and present colleagues who are now part of the Marcos economic team to reconsider their position on the MIF and advise the President accordingly, in line with their best appreciation of their discipline and the reservations expressed by the rest of the economics profession of the country.

Keywords: strategic investment fund, Philippines, economic development

JEL codes: G23, G32, H50, H54, H63

Maharlika Investment Fund: Still Beyond Repair

6 June 2023

We, the undersigned faculty members of the U.P. School of Economics, in our autonomous personal capacities, wish to voice our grave concerns over the Maharlika Investment Fund (MIF) bill, which was recently passed by both houses of Congress and, as of this writing, is just awaiting the signature of President Ferdinand Marcos Jr.

In our view, the MIF violates fundamental principles of economics and finance and poses serious risks to the economy and the public sector — notwithstanding its proponents' good intentions.¹

Our reservations are as follows:

I. First, the raison d'être of the Maharlika Investment Fund remains unclear even as it has already hurdled both houses of Congress.

The MIF was originally pitched as a sovereign wealth fund (SWF), a state-owned investment fund never before seen in the Philippines.

If there is any argument in favor of an SWF, it is the flexibility for making global investments that might yield higher returns than those locally available for the same risk profile. Largely because of this, SWFs have grown in popularity in recent decades. In 1990, assets of SWFs worldwide totaled about USD 500 billion (Bernstein, Lerner, and Schoar 2013). As of end-2022, there were about 175 SWFs worldwide with total assets of USD 11.36 trillion (Megginson et al. 2023). Many countries have also leveraged SWFs as a way to spur investments and economic activity in the wake of the COVID-19 pandemic (Divakaran et al. 2022).

¹ A number of us joined other economists and experts in an earlier statement prepared by the Action for Economic Reforms. See Filomeno Sta. Ana III et al., "Statement on the Maharlika Wealth Fund," 7 December 2022, <https://aer.ph/statement-on-the-maharlika-wealth-fund/>.

The literature classifies SWFs into two broad categories. First and more common are “commodity SWFs,” which arise from surplus revenues drawn from natural resources such as oil. The Kuwait Investment Board, widely considered the first SWF², was set up as early as 1953 “to manage its booming oil receipts and insulate its economy from the erratic changes in commodity prices” (Garg and Shukla 2021).

Other countries have since used their oil windfalls for SWFs, but focused less on the need to stabilize their finances and more to accumulate wealth. For example, the world’s largest SWF today is the Norway Government Pension Fund Global, which was set up in 1990 from oil and natural gas windfalls. Now it has total assets in excess of USD 1.3 trillion as of January 2023, and is used not just as a fiscal buffer but also for intergenerational equity (i.e., to benefit future generations of Norwegians).

The second type is called “non-commodity SWFs.” Singapore’s Temasek Holdings, for example, was set up in 1974 not from oil receipts but instead from the Singaporean government’s current account surpluses, fiscal surpluses, foreign exchange reserves, and privatization proceeds.

Under non-commodity SFWs, a subset called “sovereign development funds” (SDFs) or “strategic investment funds” (SIFs) has emerged in recent decades (Santiso 2009; Divakaran et al. 2022). These are essentially SWFs in emerging economies that lack both natural resource windfalls and government surpluses, and are imbued with distinct developmental goals in mind. SDFs and SIFs are also more inward-looking; i.e., investments are made toward local projects like infrastructure.

The most recent example of this is the Indonesia Investment Authority (INA), set up in 2021 by the Indonesian government which, unlike the usual government with an SWF, has seen chronic fiscal and current account deficits in past years.³

With the Philippines similarly lacking windfalls from natural resources and other types of surpluses, the MIF reasonably falls under the category of a non-commodity SWF.

² Although this fact is contested; see López (2023).

³ James. Guild, “What Did the INA, Indonesia’s Sovereign Wealth Fund, Do in 2022?” *The Diplomat*, 18 April 2023, <https://thediplomat.com/2023/04/what-did-the-ina-indonesias-sovereign-wealth-fund-do-in-2022/>.

Specifically, it may also be considered an SDF or SIF given the increasing emphasis on developmental goals as the bill passed through the legislative mill.

Article III, Section 12 of the MIF bill says that “The Fund shall be used to invest on a strategic and commercial basis in a manner designed to promote fiscal stability for economic development, and strengthen the top-performing GFIs through additional investment platforms that will help attain the National Government’s priority plans.”

Moreover, Article III, Section 13 states that: “The objective of MIF is to promote socio-economic development. This will be achieved by making strategic and profitable investments in key sectors to preserve and enhance long-term value of the Fund; to obtain the optimal absolute return and achieve financial gains on its investments; and to satisfy the requirements of liquidity, safety/security, and yield in order to ensure profitability...”

In short, while the MIF will invest in financial instruments in a bid to earn commercial returns, it will also invest huge portions of its funds in local development projects in a bid to earn economic returns. In the literature, this is also called the “double-bottom line objective” (OECD 2016; Divakaran et al. 2022).

The MIF’s lack of a clear focus at the outset has led to confusion even among MIF’s proponents and supporters. On 29 May 2023, as the Senate was deliberating its own MIF bill, Bangko Sentral Governor (BSP) Felipe Medalla was quoted as saying “[the MIF is] no longer a sovereign wealth fund. It’s more of a national development, investment fund. I don’t know what it will be used for. But the way it’s evolving now, it will be very targeted, and it will have many good governance principles.”⁴ Whether the MIF is an SWF or SDF or SIF, it should be stated clearly in the bill.

Clarity of goals is essential for any new SWF. Article II, Section 4 of the MIF bill says that the Maharlika Investment Corporation “shall adhere to the Santiago Principles,” a set of 24 Generally Accepted Principles and Practices developed by the International

⁴ Keisha B. Ta-asan, “No Issues with Maharlika Investment Fund — Medalla,” BusinessWorld, 30 May 2023, <https://www.bworldonline.com/top-stories/2023/05/30/525600/no-issues-with-maharlika-investment-fund-medalla/>. Notably, BSP Governor Medalla aired valid reservations shortly after the MIF bill was first submitted in the House of Representatives; he has since walked back on those reservations.

Forum on Sovereign Wealth Funds (IFSWF) “to promote good governance, accountability, transparency and prudent investment practices.”⁵

The MIF’s failure to state a clear goal potentially violates Principle No. 2 of the Santiago Principles, which states that, “The policy purpose of the SWF should be clearly defined and publicly disclosed.”

López (2023) elaborates the importance of clear goals: “A clear definition of the sources and uses of funds (fiscal rule) and of the mandate of the fund is the most important factor of success when establishing a SWF.” Clear goals serve to delimit an SWF’s allowable investments and activities and lay down reasonable expectations and metrics of success. The IFSWF further says, “A clearly defined policy purpose facilitates formulation of appropriate investment strategies based on economic and financial objectives... The pursuit of any other types of objectives should be narrowly defined and mandated explicitly. A clearly defined policy purpose will also ensure that the operational management of the SWF will conduct itself professionally and ensure that the SWF undertakes investments without any intention or obligation to fulfill, directly or indirectly, any geopolitical agenda of the government.”

Even inward-looking and developmental SDFs and SIFs have relatively clear-cut goals. INA, for example, not only aims to promote growth in a broad sense, but specifically aims to “attract private investments into the government’s infrastructure projects”⁶ and develop (or “re-energise”) “state-owned entities” in line with the Indonesian government’s overall development plan.⁷

⁵ Santiago Principles, International Working Group of Sovereign Wealth Funds, October 2008, <https://www.ifswf.org/santiago-principles>.

⁶ Manggi Habir, “Indonesia’s First Sovereign Wealth Fund (INA): Opportunities and Challenges,” ISEAS Yusof Ishak Institute, 5 May 2021, <https://www.iseas.edu.sg/articles-commentaries/iseas-perspective/2021-63-indonesias-first-sovereign-wealth-fund-ina-opportunities-and-challenges-by-manggi-taruna-habir/>.

⁷ Kyunghoon Kim, “How to Make Indonesia’s Sovereign Wealth Fund Work,” Lowy Institute, July 2022, <https://www.loyyinstitute.org/sites/default/files/2022-08/KIM%2C%20Indonesia%20SWF%2C%20PDF%2C%20v4.pdf>.

II. *Second, due to its confused goals, the MIF bill does not adequately articulate and take account of several implications of the fund’s dual-bottom line objective.*

More and more countries are setting up SIFs with the dual-bottom line objective, and there is nothing inherently wrong with pursuing this. However, the MIF bill does not clearly articulate and take into account the complexities and nuances associated with the MIF’s double-bottom line objective.

a) The MIF is not aligned with the Philippine Development Plan nor the Medium-Term Fiscal Framework.

First and foremost, the MIF has amorphous developmental goals and speaks of development only in the broadest possible terms. It does not even make any reference to the Philippine Development Plan (PDP) 2023-2028 published in December 2022.

The MIF’s macroeconomic implications (on, say, inflation and the deficit) have also not been explored and articulated by its proponents. This, even if SIFs should ideally aim for “macroeconomic coherence” by aligning it with the government’s overall development plan, including, for example, its fiscal program. One way of doing this is by conducting a “macroeconomic modeling exercise that helps determine the optimal size and relative allocations [of investments] by sector” (Divakaran et al. 2022). As far as we know, no such analysis emanated from any of the economic agencies in support of the MIF.

Without anchoring the MIF on specific long-term development objectives, the MIF (especially if it is large enough) may pose macroeconomic risks and become prone to exhaustion when the political environment is unstable or incumbent officials prioritize short-term goals (Di Bonaventura Altuve 2023).

b) The additionality of the MIF has thus far not been proven by its proponents.

With the MIF now leaning more toward funding development projects, how exactly does it differ from other existing government agencies pursuing developmental goals? What does it bring to the table?

The literature points to a concept called “additionality” as a crucial prerequisite in setting up SDFs and SIFs: that is, an SDF or SIF must spur investments or economic activity over and above those that would happen without it (OECD 2016; Divakaran et al. 2022).

Additionality implies that any new SIF must “produce economic, environmental, and social returns equivalent to what the government could otherwise execute through its budget process or other agencies.” At the same time, an SIF should “[serve] the sovereign’s policy purpose better than through budget expenditure and that the SIF has no overlapping mandates with existing state agencies” (Divakaran et al. 2022). This is because growth and equity objectives may be better achieved if the government were to spend directly on providing public goods today rather than pour resources into an SIF.

MIF’s proponents should have asked: What is the opportunity cost of using the MIF to invest in projects versus direct government spending on public goods today? Is there an efficiency gain here that can be cited *a priori*? Will the undertaking and completion of infrastructure projects be any faster and less costly?

On this score, the MIF fails on at least three counts. First, it may render redundant the National Development Corporation (NDC), which is tasked “to pursue commercial, industrial, agricultural or mining ventures in order to give the necessary impetus to national economic development.”⁸ Second, the LBP and DBP themselves are involved in investments aimed at spurring development, and this function may overlap with the goals of the MIF. Third, the MIF may overstep the functions of the NEDA Board, which scrutinizes and approves infrastructure projects in line with the PDP. (While the NEDA Secretary is part of the MIF, he is just one of three members of its Advisory Body, and this fact alone is no assurance that the MIF will align with the PDP.)

In case the MIF bill will be signed or will lapse into law, crafters of its IRR must ensure the additionality of the MIF. They will do well to ask the following: Are there infrastructure projects — besides those identified in PDP or the Public Investment

⁸ Corporate Profile, National Development Corporation, <https://www.ndc.gov.ph/corporate-profile> This is not to say the NDC has been a paragon of wise government-led investment decisions. Indeed its past record under the Marcos I regime holds negative lessons regarding political influence over investment choices. Yet this model is potentially what Maharlika wants to replicate and expand multiple times over.

Program (PIP) — that require funding via the MIF? If there are indeed such projects that lack funding, are they more important than those already identified in the PDP/PIP? If no such projects exist — which should be the case since the PDP/PIP should already contain all priority projects with funding sources identified and M&E indicators defined — then the MIF would be used for projects that could be dispensed with without affecting economic growth and development envisioned by the PDP/PIP? If the MIF were meant to substitute for the sources already identified in the PDP/PIP, what advantages, if any, does it have over other funding sources? Specifically, is the cost of money lower using the MIF than, say, ODA or other concessionary loans?

c) The bill is vague about MIF's expected financial and economic returns.

What is the nature of financial and economic returns that the MIF is expected to generate? This is not threshed out in the MIF bill.

This point is crucial since aiming for both financial and economic returns is far more complicated than aiming for just financial returns. Financial returns are easier to measure and therefore afford greater accountability in terms of performance. By contrast, returns to development projects, though at times even higher, are softer, more amorphous, harder to measure, and sometimes even non-monetary in nature (e.g., projects with distinct positive or negative externalities).

The literature points to two ways of going about this double-bottom line objective (Divakaran et al. 2022). First, an SIF may require proof that each and every investment has the potential for both financial and economic returns (a transaction-by-transaction basis). Alternatively, the SIF may lay down a specified return for the entire investment portfolio, but allow lower returns for projects aimed at economic development.

Beyond stating the MIF's double-bottom line objective, the bill does not define what kinds of returns the MIF is expected to yield. Returns are referred to only in a general sense, and the concepts of financial and economic returns are conflated — thus betraying the lack of clear goals of the MIF.

For instance, Article III, Section 13 of the bill says that the MIF aims “to obtain the optimal absolute return and achieve financial gains on its investments....” But what level of returns and financial gains, exactly?

Meanwhile, Article IV, Section 17(k) of the bill says that “In the formulation of its investment policies, the Board of Directors shall be guided by the principle that priority must be given to investing in government infrastructure and other developmental projects which would yield the highest return on investment coupled with the developmental impact of lower cost of living and lower cost of basic commodities, as well as in those investments that incorporate environments, social and governance (ESG) considerations and sustainable practices.” When they cited “return on investment,” how does it relate to the returns on financial investments? Which is the priority? This is not at all clarified in the bill.

The MIF should be able to clearly demonstrate that it can earn higher financial returns than its sources of finance, apart from earning higher economic returns, vis-à-vis existing development institutions. At minimum, for example, it should be able to explain why it can be expected to earn better returns than the Land Bank of the Philippines (LBP), the Development Bank of the Philippines (DBP), etc. Otherwise, the Board should be held accountable.

By effectively adopting a double-bottom line objective, the MIF can pour money into a wide range of financial investments (such as “cash, foreign currencies, metals, and other tradeable commodities,” “fixed income instruments,” “domestic and corporate bonds”) and economic investments (such as “road and infrastructure projects,” “programs and projects on health, education, research, and innovation”). However, the bill includes as allowable investments “mergers and acquisitions” and “loans and guarantees,” which are not investment vehicles per se.

Moreover, in other countries, the high-level investment policy of an SIF is included in the establishing legislation, and there are clear parameters that define allowable investments beyond merely listing them down. For instance, while waiting to reap returns from infrastructure investments, the Nigeria Infrastructure Fund “can make short- and medium-term fixed-income investments with unspent funds.” However, “It

can purchase only investment grade instruments with a maximum tenor of three years (board approval required for tenors of more than one year)” (Divakaran et al. 2022).

To ensure the MIC’s commitment to accountability, it would be preferable if lawmakers had placed the MIF’s investment policies in the bill itself, and did not simply leave it to the Board to formulate (Article IV, Section 17).

d) By having unclear financial and developmental goals, the MIF threatens to encroach upon the budget process.

If the government wishes to set up the MIF primarily to invest in projects that yield economic or social externalities, such goals may be better achieved through the normal budget process, not an SIF.

In fact, there is a very good reason for doing so, since it may prove difficult to hold accountable the SIF on the basis of economic returns, which are more amorphous and difficult to measure than financial returns.

Gelp et al. (2014) recommended that any SWF ought to “create a clear separation between the government as promoter of investments and as owner of the SWF,” and that “domestic investment by the SWF should not be used to finance public expenditure bypassing budgetary controls.”

The MIF bill fails to define the relative share or importance of financial and economic investments. In the event it focuses more on domestic investments — and gets to finance sufficiently many development projects like toll roads or dams — will the MIF also risk bypassing the normal budget process, thereby diminishing Congress’ power of the purse? Will this possibly violate Article VI, Section 24 of the 1987 Constitution, which states that “All appropriation, revenue or tariff bills, bills authorizing increase of the public debt, bills of local application, and private bills shall originate exclusively in the House of Representatives...”?

Until the passage of the bill, its proponents have not sufficiently taken into account the possibility of the MIF encroaching on the government’s budgetary process.

III. *Third, the manner of funding the Maharlika Investment Fund poses huge risks to our already strained public coffers and is vulnerable to moral hazard.*

Another major defect of the MIF is that the proposed ways of financing it stand to erode the fiscal situation of the country, beleaguered as it already is.

As a first principle, any SIF should first “maintain coherence with the overall fiscal policy of the government” (Divakaran et al. 2022). An SIF that exacerbates rather than abates a country’s fiscal deficits, for example, may prove counterproductive in achieving the country’s medium- and long-term fiscal goals.

In 2022, the Philippines’ current account deficit widened and reached its highest level in nearly two decades, at least since the earliest comparable data in 2005. This implies that the country is a net borrower from the rest of the world, and increasingly so, betraying the fact that we have neither fiscal or external surpluses to spare and invest in a sovereign wealth fund—especially one with an authorized capital of ₱500 billion (as stated in Article 2, Section 6 of the MIF bill). Meanwhile, the Philippine government’s budget deficit exceeded ₱1.6 trillion in 2022.

Chronic budget and current account deficits mean that the MIF might worsen rather than abate the country’s fiscal situation. NEDA Secretary Arsenio Balisacan made assurances that Maharlika will not balloon the public debt: “We have a Medium-Term Fiscal Framework to address the issue of debt, deficits, macroeconomy, and the economy so I’m not too worried about it [debt].”⁹ However, with ₱50 billion of Maharlika’s seed fund coming from taxpayers’ money, this will surely feed into the deficit and contribute to debt. The deficit — specifically the consolidated public sector deficit, of which the national government’s debt is only a subset — may also rise in the event of future losses incurred by Maharlika, contributing to even more debt. Ideally, adherence of MIF to the government’s Medium-Term Fiscal Framework should have been explicitly stated in the bill.

⁹ Ted Cordero, “NEDA’s Balisacan: Maharlika fund won’t increase PH debt,” GMA Integrated News, 31 May 2023, <https://www.gmanetwork.com/news/money/economy/871656/neda-s-balisacan-maharlika-fund-won-t-increase-ph-debt/story/>.

Divakaran et al. (2022) recommend that “sovereigns with high levels of debt and costly debt repayment must consider the opportunity cost of setting up a SIF versus paying down debt.” In our context, MIF’s proponents should have asked: At the margin, is it worth the risk to set up an SWF or SIF that could further increase the national debt, which is already at a record high? Will the MIF make it more or less difficult for the Marcos administration to reach its medium-term goal of reducing the debt-to-GDP ratio to 52.8% by 2028?

At the very least, MIF’s proponents should have put in place provisions that align the MIF’s funding and investments with the country’s fiscal objectives. The law establishing Ireland’s SWF, for example, provides that the fund must “ensure that investments do not have a negative impact on the net borrowing of the general government of the State for any year.” Nigeria’s SWF, meanwhile, “can be funded only with hydrocarbon revenues that are in excess of Nigeria’s budgetary requirements.” The more MIF is disciplined to adhere to fiscal goals, the better.

The lack of any surpluses necessarily forces the MIF to scour money from other agencies and corporations of government, posing risks on, say, state-run banks and even the BSP. But lodging state assets into the MIF poses several fiscal risks. The fund can “absorb uncertain and potentially large liabilities,” while the SIF itself can “create fiscal risks for the government (through debt or contingent liabilities) through its own transactions, for example, if the SIF can borrow or issue bonds” (Divakaran et al. 2022). MIF’s losses could, in the end, very well be shouldered by the public coffers — thus harming taxpayers, depositors of state-owned banks, and the BSP (among other sectors and institutions).

Draining capital from state banks like the LBP and the DBP risks destabilizing these institutions and compromises their ability to meet BSP’s capitalization requirements. This is contrary to the funding of the Indonesia Investment Authority, which as of 2022 *obtained shares* in profitable state-owned banks, namely the Bank Mandiri (IDR 37 trillion or USD 2.5 billion) and Bank Rakyat Indonesia (IDR 27 trillion or USD 1.8 billion).¹⁰

¹⁰ James Guild, “What did the INA, Indonesia’s sovereign wealth fund, do in 2022?” *The Diplomat*, 18 April 2023, <https://thediplomat.com/2023/04/what-did-the-ina-indonesias-sovereign-wealth-fund-do-in-2022/>.

Meanwhile, tapping into the BSP's net profits or declared dividends will also invariably delay the BSP's own capital-raising activities, as mandated in its amended charter.

Based on Republic Act No. 7653, as amended by Republic Act No. 11211, "The capital of the Bangko Sentral shall be Two hundred billion pesos...." By contrast, the MIF's authorized capital is 2.5 times this amount. During the Senate hearings on the MIF, BSP Deputy Governor Francisco Dakila Jr. said that if the BSP were to remit all its dividends to the MIF for the fund's first two years, and 50% of dividends after that, it would take them 14 years to raise capital and reach their ₱200 billion target — twice the length of time it would take if BSP's dividends were not placed in the MIF.¹¹

The House version of the MIF bill initially stipulated that initial capitalization will partly come from social security systems, namely the Government Service Insurance System (GSIS) and the Social Security System (SSS). This provision was removed after strong public backlash. To try to allay fears further, the Senate included a provision removing the GSIS and SSS, as well as other government social welfare entities, as sources of seed capital for Maharlika.

Specifically, Article II, Section 6 provides that "The government agencies and GOCCs providing for the social security and public health insurance of government employees, private sector workers and employees, and other sectors and subsectors, such as but not limited to the SSS, GSIS, PhilHealth, Pag-IBIG Fund, OWWA, and PVAO Pension Fund shall be absolutely prohibited, whether mandatory or voluntary, to contribute to the capitalization of the MIC."

Furthermore, Article III, Sec. 12 provides that "government agencies and GOCCs providing for the social security and public health insurance of government employees, private sector workers and employees, and other sectors and subsectors, such as but not limited to the SSS, GSIS, PhilHealth, Pag-IBIG Fund, OWWA, and PVAO Pension Fund shall be absolutely prohibited, whether mandatory or voluntary, to invest in the MIF."

¹¹ Ralf Rivas, "Maharlika fund to delay Bangko Sentral's P200-billion capital goal," Rappler, 15 February 2023, <https://www.rappler.com/business/maharlika-investment-fund-delay-bangko-sentral-pilipinas-capital-goal/>.

However, it remains to be seen if the GSIS and SSS pensions funds are truly scot-free. On 31 May 2023, after the Senate passed its MIF bill, the President himself floated the idea that the state's social security systems, GSIS and SSS, could still choose to engage with Maharlika if they want to. He said, "If the pension fund decides the Maharlika Fund is a good investment, it's up to them if they want to invest in it."¹² Meanwhile, on 30 May 2023, Finance Secretary Benjamin Diokno also broached such a possibility: "Why would you prohibit [GSIS, SSS from investing]? It's the decision of the board. While they are presidential appointees, they act in the best interest of the company."¹³ Later, Diokno clarified that GSIS and SSS can still "subscribe" to individual MIF projects.¹⁴

Already, confusion about Maharlika's implications on GSIS and SSS is causing some apprehensions among depositors of LBP. In response to this, the National Treasurer reasoned that the investible funds of LBP, amounting to ₱1.3 trillion as of February 2023, so that the ₱50 billion LBP will commit to Maharlika will be "less than 3%" of total investible funds. She also said this "will not affect the prudential ratios imposed by the BSP."¹⁵

More accurately, the ₱50 billion LBP commitment to Maharlika is 3.846% of LBP's total investible funds as of February 2023. As rightly pointed out by UP Los Baños senior lecturer Enrico Patiga Villanueva, prudential ratios set by the BSP are not based on the share of investible funds.¹⁶ As it is, Fitch has already flagged risks to LBP's capitalization. Sure, LBP's capital ratios "are likely to improve modestly on better internal capital generation and as unrealised losses on its investment securities portfolio partially reverse." But on the other hand, Fitch also said that LBP's "common

¹² Bea Cupin, "Marcos: Up to pension funds if they want to invest in Maharlika," Rappler, 31 May 2023, <https://www.rappler.com/nation/marcos-jr-up-to-pension-funds-invest-maharlika/>.

¹³ Bea Cupin, "Marcos: Up to Pension Funds If They Want to Invest in Maharlika," Rappler, 31 May 2023, <https://www.rappler.com/nation/marcos-jr-up-to-pension-funds-invest-maharlika/>.

¹⁴ Ted Cordero, "Diokno: GSIS, SSS can still 'subscribe' to Maharlika's projects, but not equity," GMA Integrated News, 5 June 2023, <https://www.gmanetwork.com/news/money/economy/872028/diokno-gsis-sss-can-still-subscribe-to-maharlika-s-projects-but-not-equity/story/>.

¹⁵ Job Manahan, "Don't close Landbank accounts amid Maharlika fund fears: Treasury, DBM," ABS-CBN News, 3 June 2023, <https://news.abs-cbn.com/business/06/03/23/dont-close-landbank-accounts-amid-maharlika-fund-fears-treasury>.

¹⁶ Enrico Patiga Villanueva (@EnricoPatiga), Twitter, 4 June 2023, 3:53 p.m., <https://twitter.com/EnricoPatiga/status/1665265473246859265?s=20>.

equity Tier 1 (CET1) ratio (end-2022: 13.9%) could drop materially if its capital contribution to MIC proceeds. This reduces its loss-absorption buffers despite any regulatory forbearance that may be provided to the bank, which led us to revise the outlook on the capitalisation and leverage score of ‘bb’ to negative from stable, pending clarity on the terms and structure of LBP’s involvement in MIC.” Rather than a Treasury official, it would also be ideal for LBP management itself to clarify exactly how they will be exposed to the MIF.

Transferring state-owned assets into the MIF also poses “moral hazard” risks. Moral hazard is a concept in economics where one party is willing to take on more risk because it believes another party will bear the burden of those risks.

In the context of an SWF, the fund managers may undertake riskier investments than they normally would, because they know that the state, ultimately, stands behind them. Should audit and other checks on MIF be tight enough, the MIF’s Board and fund managers may be incentivized to take on riskier investments in pursuit of higher returns.

This means that the public, through their taxes or pensions, could end up bearing the risk of poor investment decisions, while the rewards (if the risky investments succeed) may accrue to a limited group of people, such as those in power and their associates or the managers of the fund. The SWFs can also be manipulated and politicized by whoever is in power or those connected to them, enriching themselves or consolidating their political and economic clout, thereby misusing funds that are meant for the public’s benefit.

Note that there are no safeguards that penalize MIF’s managers should heavy losses be incurred due to poor or overly risky investment decisions. As it is, the bill does not spell out parameters that distinguish between poor fund management and general market downturns if the MIF doesn’t meet expected returns. In other words, it does not say how to determine whether a bad year for the MIF is due to mistakes made by those managing it or just because the local or global economy overall is performing poorly.

Another potential source of moral hazard is the fact that the MIF can issue debt and incur contingent liabilities. Using borrowed money to invest can theoretically increase potential returns, but it also raises the risk of moral hazard and financial losses.

In the Senate bill, there were efforts to ensure that the state will not guarantee debt issued by the MIF. For instance, in Article II, Section 10, the following provision was inserted by the Senate: “In no instance shall the Philippine government guarantee any bonds issued by the MIC.” However, Article IV, Section 18 states that “No guarantee involving financial liability arising from any action of the MIC shall be binding upon the Philippine government without obtaining the written authority of the proper authorities under existing laws.” This could still allow the MIF to rope in public funds in the event of losses.

It is quite telling that the MIF bill contains no provisions regarding bankruptcy and resolution. This might mean that, implicitly, the Philippine government will still shoulder in the end any liabilities or losses that may arise from the MIF. As warned by Divakaran et al. (2022): “A SIF that does not have defined procedures for bankruptcy and resolution may be assumed to have its liabilities implicitly backed by the government budget. Such an implicit state guarantee would likely generate perverse incentives with respect to risk management. In addition, if the state guarantees a share of the fund’s contingent liabilities, then this guarantee should be accounted for in the government budget (even if implicit).”

If the MIF’s investments fail to yield returns greater than the cost of the debt plus administrative costs, the fund can face significant losses, and the government may find itself needing to bail out those who invest in MIF’s bonds. This could have serious implications on our deficits and debt. It could also impair our credit ratings.

Implicit sovereign guarantees on the MIF’s debts may also bring about so-called “fiscal dominance” (Sargent and Wallace 1981), in which the central bank is forced by fiscal constraints or fiscal losses to finance deficits by printing money, thereby monetizing these and effectively ceding its mandate of inflation control to fiscal authorities. This may end up threatening both the institutional and instrument independence of the BSP.

For example, consider the case where the BSP wants to lower its policy rate to spur economic activity, but at the same time the MIF issues debt to finance investments or cover losses. Interest rates could rise and this could undermine what the BSP is trying to do with interest rates and monetary policy. Stabilizing the economy or business cycles will be more difficult, and the MIF could severely impair the conduct of countercyclical monetary policy.

Aside from worrying about maintaining interest rate differentials vis-à-vis the US, the BSP will then have to contend with contrary pressures on interest rates arising from the actions of the MIF. In addition, if there is a threat of default on MIF bonds, Philippine treasury bonds will be subject to higher risk premiums and default risks as well. Would Philippine bonds then be so attractive to an investor, including foreign ones? This could also adversely affect our sovereign credit rating and, ultimately, the country's debt sustainability.

Moreover, what kind of split in the capital structure between debt and equity will likely arise? We know from theory that equity investment flows are preferred to debt flows as the former allows for greater risk sharing. If there are implicit government guarantees on MIF-issued debt, and none on equity investments, this may induce investors to favor debt-financed investments. This preference could be stronger if weak laws and institutions make it easy for the government to take over the MIF's assets if its investments go bad.¹⁷

IV. Fourth, red flags abound in the MIC's governance structure.

With a lack of initial funds and with financing schemes that pose moral hazard risks, it is all the more imperative that the Maharlika Investment Corporation — which will manage the MIF — should have a top-notch governance structure and sufficient checks and balances in order to run smoothly, avoid politicization, and establish legitimacy.

However, the MIF bill provides for a poorly designed governance structure that opens the floodgates for political interference, mismanagement, and corruption.

¹⁷ To prevent or reduce the negative externalities arising from debt financing, there would need to be a carefully designed system of so-called Pigouvian taxes. But identifying and measuring externalities is difficult, and designing such a system of Pigouvian taxes would be near impossible.

Best practice dictates that for any SWF or SIF, “the board should be chaired by an independent director and most board members should be independent (unaffiliated with the government sponsor or owners).” Also, “to protect the SIF’s commercial orientation, government representatives must not be on the fund’s investment committee” (Divakaran et al. 2022).

Here, the MIF already fails. All members of the MIC’s board, as well as its Advisory Body, are presidential appointees, including “independent” directors. This is troubling since in Article V, Section 21, the Board is empowered to “direct the management and operations, and administration of the MIC,” “approve and implement the Investment and Risk Management Guidelines,” and “oversee the investment processes which may include asset allocation, portfolio construction, monitoring, and risk management” (among many other key functions). These provisions will effectively allow presidential appointees to exert significant influence on the everyday operations of the Maharlika, potentially paving the way for politicization and boding ill for the MIC’s operational independence — a key determinant of the success of any SWF.

The lack of adequate safeguards for political independence among the MIF’s operators also contravenes Principle No. 6 of the Santiago Principles, which states that “The governance framework for the SWF should be sound and establish a clear and effective division of roles and responsibilities in order to facilitate accountability and operational independence in the management of the SWF to pursue its objectives.” Principle No. 9, meanwhile, says that “The operational management of the SWF should implement the SWF’s strategies in an independent manner and in accordance with clearly defined responsibilities.”

The composition of the MIF’s Board is also crucial since it will likely dictate which types of investments MIF pursues. For instance, Bernstein, Lerner, and Schoar (2013) showed that funds were more likely to be invested domestically in SWFs with heavy involvement of political leaders. The hiring of external managers, meanwhile, is “associated with fewer domestic investments.”

We also observe that the proposal for a risk management unit, as outlined in the MIF bill, lacks sufficient independence from the Board. This could potentially compromise

the effective risk management of the MIF. For instance, Article V, Section 21 says that the Board shall “approve and implement the Investment and Risk Management Guidelines...” and “oversee the investment processes which may include asset allocation, portfolio construction, monitoring, and risk management...” The risk management unit also comprises three presidential appointees on the board (an independent director, an ex-officio member of the Board, and a regular director), as well as a senior executive of the MIC and the risk management officer. Ideally, there should be a chief risk officer who is independently appointed, in order to properly flag risks to MIF.¹⁸ The lack of independence of the risk management unit is, in itself, another source of risk for the MIF.

Notwithstanding INA’s imperfections, its governance structure actually provides a model that MIF’s proponents could have simply adopted, as rightly pointed out by Villanueva [2023].¹⁹ INA has a two-tier governance structure. The Board of Directors consists of 7 independent professionals from various fields. Meanwhile, the Board members are appointed and overseen by another body called the Supervisory Board (which, in turn, consists of the Minister of Finance, the Minister of State-Owned Enterprise, and three private sector professionals, all reporting to the President).²⁰ The Supervisory Board is authorized to supervise the management activities of the Board of Directors, which adds a layer of oversight to scrutinize the decisions of the Board. As well, it is ultimately the Board of Directors that oversees the INA’s day-to-day operations, not the presidential appointees in the Supervisory Board. This adds a layer of independence that may prevent (or at least minimize) instances of politicization.

Without sufficient guardrails in place, and absent sufficient independence on the part of the MIC board and Advisory Body, the MIF may suffer the fate of similar funds like Malaysia’s SWF called 1MDB (1Malaysia Development Berhad), from which billions of dollars were embezzled precisely due to weak governance structure and lack of oversight. Coincidentally, 1MDB was also motivated by developmental goals: when it was established in 2009, it was “tasked with driving the sustainable long-term

¹⁸ E.P. Villanueva (@EnricoPatiga), Twitter, 25 May 2023, 11:58 p.m., <https://twitter.com/EnricoPatiga/status/1661761263259762689?s=20>.

¹⁹ E.P. Villanueva (@EnricoPatiga), Twitter, 31 May 2023, 1:54 p.m., <https://twitter.com/EnricoPatiga/status/1663786111100141568?s=20>.

²⁰ Manggi Habir, “Indonesia’s First Sovereign Wealth Fund (INA): Opportunities and Challenges.”

economic development of Malaysia.”²¹ Malaysia’s experience shows that such good intentions can be totally undone by poor governance.

V. Fifth, with elevated global economic headwinds and uncertainties, it is unlikely that MIF will be able to “crowd-in” investments and eke out returns that are large enough for the fund to grow substantially to finance development projects.

One more crucial precondition for a new SIF is that it should “crowd-in” private investments as much as possible. That is, greater spending of public funds should spur greater private investments (Aschauer 1989). But several factors could hamper crowding-in. For example, uncertainty about the future of the economy can deter private investments. If the government’s establishment of an SWF is viewed as a risky move or creates economic instability, it could discourage private firms from investing in such a fund.

Crowding-in investments is also made more difficult by the current global economic environment. In his letter to the Senate certifying the MIF bill as urgent, the President cited the following conditions: “the downgrade of the global growth projection this year on account of debilitating inflation, fluctuating and unstable prices of crude oil and other fuels due to the protracted conflict between Ukraine and Russia, and continuing interest rate hikes in the international financial sector...” But in fact these are factors that could pose significant risks, limit crowding-in private investments, and therefore argue against the creation of any new SWF at this time. Also, amid this global economic backdrop, the proposed MIF will likely generate returns that are too little to finance the government’s development projects such as infrastructure and social programs.

The current high (and rising) interest rate environment here and globally is a particularly important factor that could hamper crowding-in and erode the viability of the MIF. If, for example, the MIF issues bonds at higher interest costs, and the government has to borrow to implicitly bail out the MIF, this could threaten the

²¹ “1MDB Frequently Asked Questions,” New Straits Times, 23 December 2014, <https://www.nst.com.my/news/2015/09/1mdb-frequently-asked-questions>

financial viability of bank and non-bank institutions that choose to hold MIF-issued bonds. To the extent that these institutions hold bonds, they will suffer capital losses when interest rates rise due to, say, heightened risk and uncertainty, or central banks' uncoordinated monetary tightening to contain inflation. The feasibility of having profitable investments is also lower since the present value of future streams of income from long-gestating investments falls when interest rates go up. Some investments may become economically unviable, and so will not be undertaken at all.

SWFs worldwide have suffered huge losses of late. In early 2023, it was reported that Norway's SWF (The Government Pension Fund Global) incurred losses to the tune of USD 164.4 billion, owing to "multiple different emergencies and crises at the same time" like the "war in Europe, broader geopolitical tensions, rising inflation, rising interest rates, high energy prices and increased economic uncertainty."²² Many other SWFs experienced massive losses, so much so that the assets of SWFs and public pension funds worldwide dropped by USD 2.2 trillion in 2022 alone.²³

It is notable that INA itself — often claimed as an inspiration for the MIF — is facing difficulties at this time. When it was set up in 2021, INA received an initial cash injection of USD 5 billion. But as of 2022, no foreign investors had yet come in to reinforce INA's seed money²⁴, and by January 2023 it had only grown to USD 27 billion.²⁵ When asked by Bloomberg about investing amid global economic headwinds, INA's CEO Ridha Wirakusumah said, "Sometimes I'd like to think I'm a contrarian... I'd beg to differ..."²⁶ Although they have allegedly secured USD 27 billion in co-investments (in toll roads, e-commerce, geothermal, etc.), INA is far from reaching its target fund size of USD 200 billion by April 2024.

²² "Norway's Wealth Fund Posts Record Loss Of \$164 Bn," Agence France-Press, 31 January 2023, <https://www.barrons.com/news/norway-s-sovereign-wealth-fund-loses-164-bn-in-2022-01675153209>.

²³ "Market misery deals sovereign wealth funds historic setback in 2022: Study," Reuters, 1 January 2023, <https://www.cnbc.com/2023/01/01/market-misery-deals-sovereign-wealth-funds-historic-setback-in-2022-study.html>.

²⁴ James Guild, "What did the INA, Indonesia's sovereign wealth fund, do in 2022?"

²⁵ Claire Jiao and Yvonne Man, "Indonesia Wealth Fund Wants to Hit \$200 Billion Investment Goal by 2024," Bloomberg, <https://www.bloomberg.com/news/articles/2023-01-11/indonesia-wealth-fund-keen-to-ramp-up-investment-on-upbeat-2023>.

²⁶ Claire Jiao and Yvonne Man, "Indonesia Wealth Fund Wants to Hit \$200 Billion Investment Goal by 2024."

VI. *Sixth, the preoccupation with this defective proposal has diverted attention from more vital and urgent national agenda that the administration itself has rightly identified, notably the need to reform the retirement and pension system for military and uniformed personnel.*

Finance Secretary Benjamin Diokno himself flagged the looming fiscal crisis that will arise from the ballooning pensions for military and uniformed personnel (MUP). A GSIS study in 2019 said that the national government will need to pay ₱848 billion annually in the next two decades just for the MUP pension system.²⁷ Unfunded MUP pensions are also as large as half of GDP.²⁸ And in 2022 alone, MUP pensions cost ₱164 billion, already 31% larger than maintenance and operating expenses, as well as capital outlays, for the military and police. Pension payments only stand to balloon in coming decades, and this needs urgent fixing.

However, by choosing to pour their energies into the MIF, lawmakers and the economic team are only adding to — and not abating — the nation’s fiscal strain. In addition, by committing ₱50 billion from the national government, the MIF takes away precious funds from the public coffers — funds that could be spent instead on myriad developmental projects with surer or more tangible returns, like conditional cash transfers, nutrition programs, universal health insurance, or active transportation projects.

To conclude, we call upon President Marcos to seriously reconsider the final approval of the Maharlika Investment Fund bill, and present before the public a clear and solid rationale for setting it up in the first place.

Here are some questions to consider:

²⁷ Anna Leah Gonzales, “Discussions start rolling to reform 'unsustainable' MUP pension,” Philippine News Agency, 7 May 2023, <https://www.pna.gov.ph/articles/1200913>.

²⁸ Ted Cordero, “Unfunded liabilities under MUP pension system half of PH GDP, says Diokno,” GMA Integrated News, 22 May 2023, <https://www.gmanetwork.com/news/topstories/nation/870717/unfunded-liabilities-under-mup-pension-system-half-of-ph-gdp-says-diokno/story/>.

- What is/are the opportunity cost(s) of going the MIF route versus direct government spending on necessary public goods today?
- Is it really more efficient to conduct fiscal policy (and even development policy) via the MIF?
- Will the MIF make infrastructure and other projects move any faster or be completed more cheaply?
- What infrastructure projects identified in the Philippine Development Plan (or, more specifically, the Public Investment Program) lack funding sources and would require MIF?
- What advantages, if any, does the MIF have over other funding sources? Specifically, is the cost of money lower using MIF than, say, ODA or other concessionary loans?
- Will the MIF enable government to earn returns enough to improve its capacity to fund projects?
- Will the MIF enable government to better manage its budget?
- Can the MIF serve as a catalyst to attract FDI and capital inflows to these development projects?
- How does the MIF address the market failure(s) that prevents/prevent the private sector from investing in agriculture, infrastructure, energy, and other sectors?
- What parameters will be used to distinguish agency failure from sheer market outcome when the MIF fails to produce the expected returns?

We also call on our former and present colleagues who are now part of the Marcos economic team to reconsider their position on Maharlika and advise the President accordingly, in line with their best appreciation of their discipline and the reservations expressed by the rest of the economics profession of the country.

We are not unmindful of the political stakes and reputational face-saving that have led to the hasty passage of this law. Short of asking Congress to rescind the bill or the President not signing it — both unlikely scenarios — some hope still exists for reducing the harm and risks this law might bring to the economy.

To hold leaders to account and allay the public's legitimate fears, we call on the NEDA to explain to the public in concrete terms the supposed indispensability of MIF to the

success of the Philippine Development Plan. We call on the DOF and DBM to explain in detail how the MIF will possibly affect the Medium-Term Fiscal Framework, and explain specific and extra measures they would adopt to safeguard public interest in the fund. We also call on our legislators to give more detailed explanations on their positions on the MIF, and explain how and why they were persuaded by the arguments used by the President to justify the urgency of passing the legislation.

We further ask the economic managers and lawmakers to make public clarifications that respond to the specific issues and questions we have raised (e.g., categorical statements about the exact purpose of the MIF), as well as address these concerns in the formulation of the IRR. Further, we ask that the formulation of the IRR be as transparent and inclusive as possible to allow public comments and scrutiny.

We must prioritize fiscal and financial stability, transparency, and prudence over speculative gains and uncertain financial experiments. Let us pursue programs and policies that will lead to robust and equitable growth without compromising the integrity and sustainability of our public finances. Proper management of the public coffers is an indispensable component of robust and equitable growth.

-End-

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