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## **Industrial Policies and Government-Business Relations in the Philippines**

**Nina Rodmann**  
**Goethe University Frankfurt am Main**  
**Faculty of Social Sciences**  
**rodmann@soz.uni-frankfurt.de**

### **Abstract**

The industrial sector of the Philippines is still significantly lagging behind regional standards. This is mostly due to the lack of effective industrial policies and political economy factors such as pervasive corruption, rent-seeking and the continued dominance of the landed elite. In order to explore the Philippine development dilemma and its underlying problems of implementing developmentally oriented industrial policies, this paper studies respective strategies of industrial policies in the Philippines, based on distinct government-business relations and patterns of social embeddedness. In so doing, the paper contributes to the analysis of the political economy of Philippine development and provides insights on the prospects and limits of industrial policy in the Southeast Asian context.

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## **1. Introduction**

In contrast to its high performing Northeast Asian neighbors, the Philippines has not been able to partake in the “Asian Economic Miracle”. In short, the Philippines does not classify as a “developmental state” which exercises strategic industrial policies as traced in Japan and the “dragon economies” South Korea, Taiwan and Singapore. In fact, even its Southeast Asian neighbors Malaysia, Thailand and Indonesia had economically outdone the Philippines by the 1980s even though their prospects were much worse than those of the Philippines in the 1950s. And while the economy has been experiencing a slight upsurge in the past decade, Philippine industry is still significantly lagging behind regional standards. This is mostly due to the mere lack of industrial policy and political economy factors such as pervasive corruption, rent-seeking and the continued dominance of the landed elite. In order to explore the Philippine development dilemma and its underlying problems of implementing developmentally oriented industrial policies, this paper studies two of the country’s main export industries—electronics and textile/garments— regarding the respective strategies of industrial policies, based on distinct government–business relations and patterns of social embeddedness. In so doing, the paper contributes to the analysis of the political economy of economic development in the Philippines and provides insights on the prospects and limits of industrial policy in the Southeast Asian context. Section 2 of the paper elaborates on the theoretical background, i.e. the concept of the “developmental state”. Section 3 then delineates the varieties of industrial policies and government–business relations in North- and Southeast Asia, while section 4 analyzes these matters in the Philippines in greater detail. Section 5 concludes and points out future research opportunities.

## **2. Developmental States and Industrial Policy**

As mentioned above, in explaining the success of the high performing Northeast Asian countries<sup>1</sup>, the concept of the “developmental state” is highly relevant. It originated in Japan where, in addition to fulfilling a regulatory role, the state took on a developmental role by employing industrial policy concerned with fostering that industry structure which promised the

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<sup>1</sup> Although not geographically located in Northeast Asia, Singapore is included in the term “Northeast Asia” whenever used in this paper for economic reasons. Consequently, “Southeast Asia” excludes Singapore for the same reason.

greatest international competitiveness (Johnson 1982: 19). With the aim of enabling learning and, by that, furthering industrialization, the state in South Korea, for example, intentionally distorted market outcomes by setting “wrong” prices which resulted in enhanced investments in strategic industries (Amsden 1992: 3n, 13n). Apart from investment, international competition is particularly important in achieving economic development and the state’s role is to “govern the market” in order to generate such development (Wade 1990: 26n). In order for industrial policy to be successful, however, it needs to be implemented by well-educated bureaucratic agents largely independent from interest groups (Johnson 1982: 315n). In other words, the “developmental state” partly depends on a specific type of government–business relations. By being a “strong central authority”, the South Korean state, for example, was capable of penalizing unsuccessful businesses while rewarding successful ones—with performance measures primarily related to export sales (Amsden 1992: 15n, 18n). Potential problems of industrial policy might also stem from government failure in selecting the “right” strategic industries to be promoted or the exploitation of public power (Wade 1990: 333n). Japan, South Korea and Taiwan, however, have largely been able to circumvent these dangers by, for example, considering technology trends and possessing the societal foundation necessary for independent bureaucrats (ibid.: 333n). “Governed interdependence”, i.e. a mixture of “insulation” and “connectedness” between government and business, then grants the state the transformative capacity necessary for economic development (Weiss 1998: 38n and 7). To sum up, the three characteristics typical for “developmental states” employing industrial policy to spur economic development are: (1) transformative goals directed at productivity growth and technological catch-up, (2) a respective pilot agency run by mostly independent elite bureaucrats and (3) institutionalized government–business cooperation (Weiss 2000: 23). Accordingly, the question is not only which industrial policy a government adopts but also— and maybe even more importantly—if the respective government is capable of successfully implementing it (Haggard 2004: 70). The “developmental state” achieves this by precisely enjoying a certain degree of autonomy while, at the same time, being embedded in enabling societal relations—this is what Evans (1995: 12) calls “embedded autonomy”. In contrast to “developmental states”, “predatory states” are those which “extract at the expense of society” and, by that, undermine economic development (Evans 1995: 12). In other words, “predatory states” do not enjoy autonomy from elite interests but rather take advantage of autonomy from societal interests (Evans 1989: 571). The states situated between these two ideal types can then be classified as intermediate cases (Evans 1995: 45).

The current debate concerning “developmental states” revolves around the model’s applicability in the 21st century. While critics do not cease to argue otherwise, Rodrik (2004: 38) points out that “[t]here is plenty of scope for industrial policies in the present international economic environment” and Weiss (2003a: 267) even asserts the state an increasingly important part as globalization advances. However, as countries such as South Korea and Taiwan are reaching the technological frontier, the nature of the “developmental state” is shifting away from merely absorbing technological advances towards actively creating them (Ebner 2013: 8n). Ebner (2009) then speaks of an “entrepreneurial state”. This shift in focus is reflected in cluster policies increasingly replacing firm- or sector-specific industrial policy which was traditionally employed by “developmental states” (Ebner 2013: 15n). This policy orientation, however, still requires an efficient bureaucracy and effective government–business relations (Evans 2008: 18). In other words, the “developmental state” debate continues to be particularly relevant for countries such as the Philippines which still struggle with completing the phases of industrialization that other countries, e.g. South Korea and Taiwan, have long passed. In this context, Usui (2011: 21) stresses the importance of not “leapfrogging” industrialization in favor of the services industry, but rather building on both pillars—industry and services—when seeking further development. In this manner, industrialization and industrial policies still matter.

### 3. Varieties of Industrial Policies and Government–Business Relations in North- and Southeast Asia

Since the 1960s, Japan and the so-called “dragon economies”—South Korea, Taiwan and Singapore—have been able to achieve substantial economic growth which led to the notion of an “Asian Economic Miracle” (World Bank 1993: 1). Structural change and the leading role of exports caused a decrease in inequality and poverty (ibid.: 27n). Currently, these Northeast Asian countries are increasingly shifting into the setting of a knowledge-based economy (Ebner 2014: 141n). While the Northeast Asian high performers shared a similar vision, their respective approach to achieving rapid economic growth differed from each other. Japan and South Korea featured large diversified business groups—keiretsus and chaebols, respectively—, Taiwan relied on large state-owned firms and small- and medium-sized enterprises (SMEs) at the same time and, in Singapore, foreign direct investment (FDI) played a major role in generating economic growth (Kasahara 2013: 6). Moreover, all of these countries except Japan were at least temporarily ruled by an authoritarian regime while experiencing rapid economic development, although the causal connection between these aspects is discussed controversially (Hayashi 2010: 56n). The same applies to the question in how far the use of “industrial policy” influenced economic growth (see, e.g., Stiglitz 2001: 517n). “Industrial policy”, in this context, means “policies that stimulate specific economic activities and promote structural change” (Rodrik 2007: 3). Arguments in favor of industrial policy include the necessity to correct market failures due to imperfections and externalities, while critics emphasize the possibility of government failure in carrying out this sensitive task (Haggard 2004: 64n). In Northeast Asia, capable bureaucracies might have contributed to overcoming this obstacle (Kasahara 2013: 5). In fact, there is a strong notion of the state’s significant role in promoting economic development through industrial policy—not only in East Asia (see, e.g., Wade 1990: 345 or Rodrik 2007: 2). As Evans (1995: 5) puts it: “states have become responsible for economic transformation”. This notion is also reflected in the concept of the “developmental state” (see section 2). However, while Japan, South Korea, Taiwan and Singapore have been able to achieve significant economic growth, others in the region have not—or, at least, not to the same degree (Jomo 2001: 465). This group includes the Southeast Asian countries Indonesia, Malaysia, the Philippines and Thailand. In contrast to their Northeast Asian neighbors, they heavily relied on natural resources, i.e. agro-based sectors, in their respective development—resulting in lesser degrees of industrialization (Kasahara 2013: 6; Jomo 2001: 466). In terms of industrial development, foreign direct investment (FDI) played a more important role in Southeast than in Northeast Asia where the focus was mainly on local firms (Hobday 2013: 136). Southeast Asian countries have, however, not succeeded in moving on to more sophisticated business functions as of now (Wade 2012: 232). Generally, governments in Southeast Asia employed far less industrial policy than their counterparts in Northeast Asia and—if they did—were influenced by political, military and ethnic issues or simply tended to particularistic interests (Hayashi 2010: 53; Jomo 2001: 473). Essentially, government–business relations are considerably more problematic with regard to their developmental impact in Southeast than in Northeast Asia (Kasahara 2013: 7). In general, Southeast Asian countries are much more heterogeneous internally than their high performing neighbors. This refers to ethnic and religious cleavages as well as inequalities in land ownership—due to a lack of agrarian reforms—and income (Tipton 2009: 401; Jomo 2001: 472, 466). In this context, the dominance of the Chinese minority in the economy throughout Southeast Asia cannot be stressed enough—in part as it adds to the “complex class structures” (Tipton 2009: 409n; Kasahara 2013: 6). To sum up, Southeast Asian countries feature inherently different development trajectories than their Northeast Asian neighbors. However, while they certainly do not correspond very closely with the above mentioned “developmental state”, they still exhibit certain developmental aspects and cannot be placed on the same level with “predatory states” such as Zaire and Nigeria (Hayashi 2010: 56).

#### **4. The Philippines: Development Performance, Industrial Policies and Government–Business Relations**

With regard to underperformance in comparison with Japan and the “dragon economies”, particularly the Philippines stands out as it went from having brighter economic prospects than even South Korea and Taiwan in the 1950s to having been outdone not only by them but also by its Southeast Asian neighbors Malaysia, Thailand and Indonesia by the 1980s (Hutchcroft 1994: 218). And even though the Philippine economy has been picking up especially since 2000, in 2013, its gross domestic product (GDP) per capita at purchasing power parity (PPP) still only amounted to 6,600 current international dollars compared to 23,118 in Malaysia, 15,519 in Thailand and 9,599 in Indonesia—still more than a five per cent increase from the previous year however (Bird and Hill 2009: 267; ADB 2014b: 172, 180). Above all, the manufacturing sector of the Philippines has not been significantly contributing to either output or employment and, thereby, could not propel the rest of the economy—this stands in sharp contrast to its Northeast Asian neighbors’ development paths (Intal et al. 2008: 16n). In fact, the stagnation of economic growth in the Philippines was even accompanied by the country’s de-industrialization (King 2007: 295). 11.2 per cent of GDP in 2013 were generated by the agricultural sector, while the industrial and service sectors contributed 31.1 and 57.7 per cent, respectively (ADB 2014b: 174). Out of a total labor force of about 41 million workers, 31 per cent were employed in agriculture, 8.9 per cent in industry and 60 per cent in services (ADB 2014c: 1; ADB 2014b: 152). The discrepancy between the percentage of workers employed in the agricultural sector—31 per cent—and the sector’s contribution to total GDP—11.2 per cent—points towards high levels of unproductive labor in the agricultural sector. The total unemployment rate in the Philippines was 7.1 per cent in 2013 (ADB 2014b: 150n). However, the underemployment rate was 19.5 per cent and almost 40 per cent of the labor force were either in the informal sector or in vulnerable employment (ADB 2014a: 219). This precarious situation on the labor market then also causes the “export” of labor which is actually actively supported by the state (Kondo 2014: 179n). In 2013, exports of goods and services accounted for 27.9 per cent of the Philippine GDP (ADB 2014b: 177). This percentage is significantly lower than the exports to GDP ratios of Malaysia and Thailand—82.9 and 71.4<sup>2</sup> per cent, respectively—but still somewhat higher than Indonesia’s export ratio which was at 23.7 per cent in 2013 (ibid.; ADB 2013: 217). This is particularly relevant since the export sector has been crucial for the development of, for instance, South Korea and Taiwan (World Bank 1993: 22n). In fact, the electronics and textile/garments<sup>3</sup> industries, for example, are amongst the Philippines’ main manufactured exports but have so far failed to generate advantageous trajectories (NSO 2013; Rasiah 2009: 123n; Frederick and Staritz 2012: 67) This stands in sharp contrast to their equivalents in neighboring countries where they have been and continue to be the main drivers of economic development (World Bank 1993: 304; Sturgeon and Kawakami 2010: 3; Gereffi and Frederick 2010: 7). Instead, in the Philippines, both sectors are characterized by low local value-added and weak backward ties to the local economy (Aldaba 2013: 2). While having been the Philippines’ main exporting industry since the 1990s with direct employment of around 500,000 workers in 2010, the country’s electronics industry has remained at the lower end of the global value chain and continues to mostly engage only in assembly and testing as opposed to taking on more sophisticated tasks (Austria 2006: 1; TESDA 2011: 9). This is mostly due to comparatively low levels of skills and research and development when contrasted with, for example, South Korea and Taiwan (Rasiah 2009: 134). After having expanded quickly under the protection of the

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<sup>2</sup> Data from 2011.

<sup>3</sup> According to the classification scheme of the United Nations (2008: 95n), the production of “textile” and “wearing apparel” are two separate categories. They are, however, interconnected as the textile industry provides the major inputs for manufacturing clothing items (Nordås 2004: 1). This paper uses the term “garments” instead of “wearing apparel” or “clothing” as it is used by the Department of Trade and Industry of the Philippines (DTI 2014).

Multi-Fiber Agreement (MFA) from 1976 on, the Philippine garments industry has increasingly been losing out to its competitors—above all China—since 1995 when the quota regime started to be phased out and the pressures from the emerging global competition set in (Ofreneo 2012: 85; Frederick and Staritz 2012: 66n). Accordingly, the workforce of the garments industry shrank from one million workers in the 1990s to a mere 100,000 in 2012 (Ofreneo 2012: 85). The decline of the textile industry had started even earlier due to, amongst others, “the amazing absence of productive linkages between the home-oriented textile industry and the export-oriented garments industry” (ibid.: 86). In addition to foreign competition, the current challenges faced by both the electronics and the textile/garments sectors include increasing wages and poor infrastructure including high energy costs (U 2005: 20; Habaradas 2008: 61). The poor performance of both the electronics and the textile/garments industry can be seen as exemplary for the general failure of Philippine industries to induce sustainable economic development. Due to its comparative lack of economic development, the Philippines has frequently been coined Asia’s “sick man” (Kind 2000; Noland 2000: 401) and also has been described as “Anti-Development State” (Bello et al. 2004). The latter hints at political economy aspects as being crucial for the country’s lack of development and alludes to the contrast to the aforementioned Northeast Asian countries which are oftentimes characterized as “developmental states” (see, e.g., Moon and Prasad 1998: 9). However, when trying to identify reasons for the weak performance of the Philippine economy, the literature discusses factors from different realms. While some scholars blame exogenous influences such as the Spanish colonization or the American occupation, others stress low productivity levels due to missing technological and innovative capabilities and, more generally, sluggish industrialization (Nelson 2007: 3; King 2007: 303; Usui 2011: 20). Another angle on the subject stresses the prolonged phase of import-substitution industrialization as causal for the lack of economic development in the Philippines (see, e.g., Kind 2000: 6 or Bautista and Tecson 2003: 157). In this context, Yap (2009: 23n) points out the absence of “policy coherence” in the Philippines which is usually needed for economic development. Again, this implicates political economy factors as decisive for the problems of the Philippine economy. Indeed, the Philippines does not classify as a “developmental state” as of now. Instead, it exhibits a lack of a coherent industrial policy, a weak bureaucracy and ineffective government–business relations (Yap 2009: 10n; Hutchcroft 1994: 225; Quimpo 2009: 350). With regard to the electronics and textile/garments industry in the Philippines, adequately supportive industrial policies have been scarce, even though Philippine policy-makers have recently explicitly included the above mentioned cluster promotion strategies into their agenda for promoting sustainable economic growth as it is part of the Philippine Development Plan 2011–2016 (NEDA 2011: 83, 97n). In the case of the electronics industry, Rasiah (2009: 126) characterizes the current style of public support as “laissez faire”, whereas the same industrial sector was in fact created intentionally—and successfully so—by policy means in South Korea and Taiwan (Rasiah 2009: 126; Mathews and Cho 2000: 31). Also the set of industrial policies with regard to the Philippine textile/garments industry has been labeled as “laissez faire” and both the export-oriented strategies adopted in the 1970s and the recent ambitions of establishing a sector-specific free-trade agreement with the United States—the “Save Our Industry” Act or SAVE Act—seem to be symptomatic of a missing sound industrial policy (Ofreneo 2009: 545; Ofreneo 2012: 89n). In fact, Ofreneo (ibid.: 97) speaks of “a poignant story of industrial blindness” when it comes to the lack of development of the textile/garments industry in the Philippines. Due to their export-orientation and often foreign ownership, most electronics and textile/garments manufacturers in the Philippines are located in so-called export processing or economic zones where they enjoy certain benefits such as tax and duty exemptions (U 2005: 19; Antonio and Rodolfo 2006: 35; Manasan 2013: 3). An example is the Mactan Economic Zone 1 in Lapu-Lapu City in the Province of Cebu. Having taken up operations in 1986 and home to almost 200 mostly foreign-owned companies primarily engaged in the production of electronics as of 2014, it has so far

failed to establish potent backward linkages and increase local value-added (van Helvoirt 2009: 86 and 171; PEZA 2014; Manasan 2013: 5n). And a study comparing the costs and benefits of different export processing zones across Asia finds that only in the case of the Bataan Export Processing Zone<sup>4</sup> in Mariveles in the Province of Bataan—the first such zone in the Philippines and now, amongst others, home to several garments manufacturers—costs exceed benefits (Jayanthakurmaran 2003: 61n; Manasan 2013: 2; FAB 2014). This stands in contrast to export processing zones in, for example, South Korea and Taiwan where the respective local economies have been able to significantly benefit from their existence (Milberg and Amengual 2008: 21n). As operator of the public special economic zones in the Philippines and encouraging the development of similar but privately run zones, the Philippine Economic Zone Authority (PEZA) is one of the institutions engaged with both the electronics and textile/garments industry. Others include the Department of Trade and Industry of the Philippines (DTI) with its Board of Investments (BOI) and its Bureau of Export Trade Promotion (BETP) and nongovernment organizations such as the Philippine Exporters Confederation, Inc. (PHILEXPORT) and the Philippine Chamber of Commerce and Industry (PCCI). Supporting institutions specific to the respective industry are, amongst others, the Semiconductor and Electronics Industries in the Philippines Foundation, Inc. (SEIPI) and DTI's Garments and Textile Industry Development Office (GTIDO).

One political economy aspect frequently mentioned in the literature as partly responsible for the Philippine development dilemma is corruption. Corruption can be defined as the “use of public office for private gains, where an official (the agent) entrusted with carrying out a task by the public (the principal) engages in some sort of malfeasance for private enrichment” (Bardhan 1997: 1321) and generally has negative effects on efficiency, investment and growth (ibid.: 1327). In the Philippines, corruption is widespread and, in fact, continues to worsen, whereas the situation has been improving in other Asian countries (Brillantes and Fernandez 2010: 87n). While there are numerous reasons for corruption in the Philippines, insufficient political will to thoroughly fight corruption is mostly responsible for the failure of the array of anti-corruption measures which have been in place since as early as the 1930s (Quah 2010: 26; Brillantes and Fernandez 2010: 91). In short, in the Philippines, “corruption is a way of life” (Quah 2010: 33) which is practiced not only on all levels of the bureaucracy, but also in the private sector and the media (Brillantes and Fernandez 2010: 88n). In addition to corruption and, in fact, closely related to it, rent-seeking is one of the major factors obstructing economic development in the Philippines. Rent-seeking means “resource-wasting activities of individuals and groups seeking wealth transfers” (Pasour 1987: 123) and is intensely practiced by the Philippine elite (McCoy 2009a: 10n). Rents are mostly being captured in sectors such as, for example, agriculture, transport and mining and can turn state institutions into mere vehicles for amassing wealth (Magnoli Bocchi 2008: 14; de Dios 2008: 27). As Cruz (2014: 80) puts it, “elites [can] do whatever they want”. The Philippine elite consists of kinship networks which are respectively tied by blood, marriage and ritual (McCoy 2009a: 10). The family as social unit is extraordinarily important in the Philippines as the state oftentimes fails to deliver in terms of social services (ibid.: 7). As family loyalty extends to kinship ties, cultural values such as the “debt of gratitude” principle<sup>5</sup> dictating the reciprocity of favors reach very far and not seldom up to the highest offices (ibid.: 8n; Quah 2010: 15). A major contributor to making the Philippine elite so powerful—and, by that, setting apart the Philippines from other countries in the region—is the fact that the Philippine elite is landed (de Dios and Hutchcroft 2003: 46n).<sup>6</sup> The latest agrarian reform implemented in 1988 and ending in 2014—the Comprehensive Agrarian Reform Program (CARP)—has largely been unsuccessful in changing this situation and enhancing the

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<sup>4</sup> Now “Freeport Area of Bataan”.

<sup>5</sup> “Utang na loob”.

<sup>6</sup> In this context, some authors stress the similarities of the Philippines and Latin American countries due to their shared colonial history and resulting structures such as large landholdings (see, e.g., Nelson 2007).

(economic) well-being of its beneficiaries (Fabella 2014: 1n). This is due to its failure to establish more stable property rights and general shortcomings regarding its design and implementation (ibid.: 5n). In contrast, land reforms have been successful in both South Korea and Taiwan where they gave rise to improved agrarian efficiency and subsequently contributed to industrialization (Kay 2002: 1079n). While access to land is deemed essential for development, land reforms bear the problem of requiring structural and institutional transformations as a condition which they can only install themselves in the first place (Deininger 2003: 1n; Borras 2001: 531). Additionally, it is usually not in the interest of the governing elite to pursue institutional reforms because the current circumstances are often beneficial to said elite (Robinson 2012: 47). This then also explains the lack of developmentally oriented industrial policy (see also Acemoglu und Robinson 2013: 107 or Robinson 1999). However, while political economy factors tend to inhibit economic development in the Philippines, the Philippines still does not exhibit the features of a “predatory state” as described above. Therefore, in trying to capture the country’s persistent underdevelopment and the incapacity of the state in the design and implementation of effective industrial policies that would be set to push for a developmental agenda of industrialization and economic growth, the Philippines might best be described as one of the above mentioned intermediate cases introduced by Evans (1995: 45).

## **5. Conclusion**

While Japan, South Korea, Taiwan and Singapore have been able to achieve significant and equitable economic growth over the past decades, most Southeast Asian countries have not been able to do so—or, at least, not to the same degree. This is due to the lack of industrial policy and highly collusive and therefore ineffective government–business relations. The example of the Philippines clearly illustrates the complexity and durability of such problematic government–business relations and their social embeddedness. In order to explore this dilemma in more detail, the concept of government–business relations deserves further operationalization. In this context, te Velde (2013: 20n), for example, suggests four proxies in order to assess the relations between the public and the private sector—(1) the way the private sector is organized towards the public sector, (2) the way the public sector is organized towards the private sector, (3) the practice and institutionalization of these relations and (4) the avoidance of harmful collusive behavior—and then further operationalizes these proxies. Against this background and additionally drawing on the theoretical framework of institutionalist political economy (see, e.g., Ebner 2008), more detailed comparative sectoral studies—on levels reaching from regional to national to international spheres—will then be able to shed further light on the respective institutional specificities and, thereby, provide further insights on the prospects and limits of industrial policy in the Southeast Asian context.

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