Issues, Views, Action

Institutional Issues Concerning Industrial Policy for the Philippines: Learning from Other Countries

Dr. Joseph Anthony Lim
Professor, Economics Department, Ateneo De Manila University and
Trustee, Action for Economic Reforms

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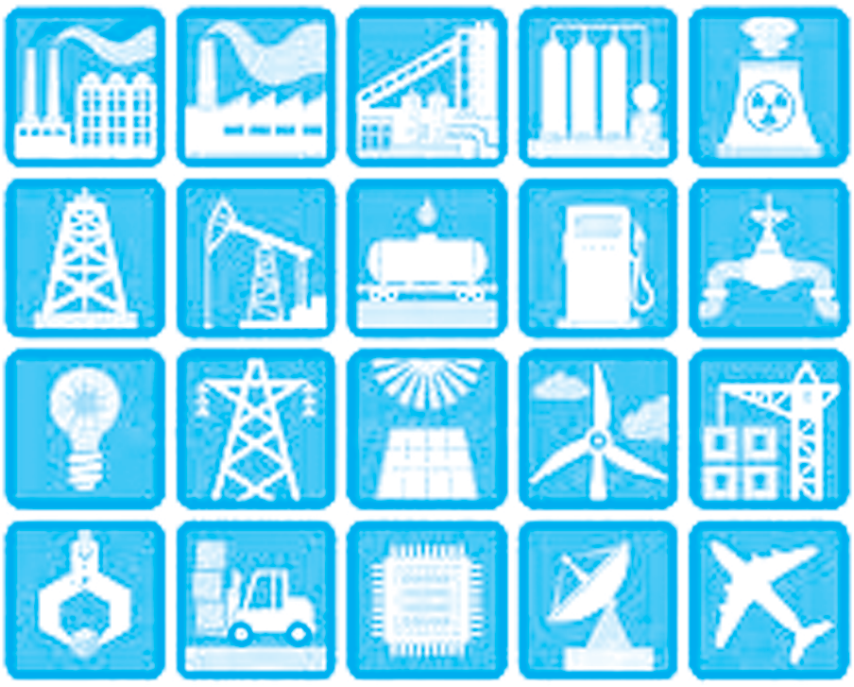

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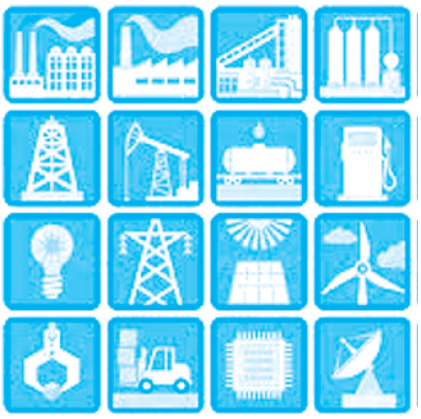

The World Bank (WB, 1993) book The East Asian Miracles: Economic Growth and Public Policies acknowledged that High Performing Asian Economies (HPAEs) – Hong Kong, Indonesia, Japan, Malaysia, the Republic of Korea, Singapore, Taiwan, and Thailand – in the period before the Asian crisis, undertook not just market reforms but industrial policy and strong unorthodox government interventions to achieve success in both growth and equity. The WB however called the whole economic strategy of these countries 'market friendly' and claimed that the more sophisticated political and intellectual institutions in these countries are unique and make their interventionist policies practically impossible to replicate by other developing countries.

But growth literature in the 1990s till the present – endogenous growth theories, multiple equilibrium theories, first mover problems, coordination failures – points to market failures that lead to the necessity of sector-specific interventions by the government and the need to stimulate technological upgrading through government interventions. Thus, developing countries, if they want to industrialize and develop economically, will have to undertake some form of industrial policy. This should include changes in industrial programs, institutions and governance regulating and guiding industrial policy, and a change in the mindset and ideology of the state concerning markets and government interventions.

Mainstream economics had emphasized the need for macroeconomic stability, good governance (in general) and good investment climate (in general) to achieve economic development. This is precisely the strategy of the current administration in the Philippines in achieving its current high growth rate and investment upgrading. There is a roadmap being developed for the manufacturing sector financed by the Department of Trade and Industry (DTI) and being developed jointly by the Philippine Institute for Development Studies (PIDS) and the Federation of Philippine Industries (FPI). But this roadmap is taking a low profile in the government's economic agenda. How to achieve productivity growth and technological upgrading is not clear in the vision and thrust as the government relies more on the markets, the private sector and public-private-partnership (PPP) investments and projects for its main economic programs.

Review of the Shift in the Mainstream Development Paradigm: From Interventions to Free Markets and Trade

In the 1950s and 1960s, most developing countries were trying to industrialize and achieve economic development through development economics theories that favor strong state planning and interventions to stimulate industrialization and growth sectors. Some of these theories are:

- Neoclassical (Solow) Growth model that says that developing countries must increase their capital labor ratios – i.e. industrialize
- Big Push models point to the need to promote key important industries (such as basic industries and technologically strong industries) to give push to economy
- Balanced Growth models: Several key and connected industries and investments should be undertaken up simultaneously for overall industrialization and development
- Unbalanced Growth models: A few key industries should be set up that will spur growth in the economy – particularly key import substitution industries – again basic sectors and technologically strong sectors
- Infant industry arguments. Basic and technological sectors have to be protected from imports from more developed and advanced countries. For the successful industries, the protection and subsidies may last decades to succeed (e.g. auto industry in Japan, Nokia)

The Philippines' golden age of industrialization was during the import substitution period of 1950s, when the manufacturing sector began to grow and prosper. This gave rise to strong supporters of import substitution and protection of industries, such as Alejandro Lichauco and Larry Henares.

In the late 1950s, the Philippines faced a balance of payment problem as it ran out of dollars due to the import dependence of the import substitution industries (mainly assembly of imported inputs using imported machinery). This led to RP turning to the IMF for money in 1962 and an IMF program was instituted, which slowed down our import substitution development, and shifted our economic strategy to a more market-oriented, private sector-based approach.

In the 1970s and 1980s, the developed countries and multilateral agencies (WB, IMF, ADB, etc.) insisted that the economy be ruled by markets and the private sector. The government should no longer protect or subsidize industries. This will just distort the market prices, lead to inefficiencies and lead to rent seeking and corruption. This perception was heightened with the rise of Monetarism and the political emergence of Reagan in the US and Thatcher in the UK.

At that time, most developing countries had not developed and industrialized except for the East Asian tigers (Japan, Korea, Taiwan, HK, Singapore) and later on Chile. Thailand and Malaysia later joined them as Japanese investments poured into their countries in the late 1980s, accompanied by good development planning and policies. The lack of industrialization of developing countries was ascribed by the conservative economists to market distortions, rent seeking, and government inefficiencies.

Marcos reinforced Philippine mainstream economists' belief that government interventions and rent-seeking are synonymous. These were proclaimed as government failures. Thus, trade liberalization (initially, removal of import quota restrictions), financial liberalization, privatization of state enterprises and deregulation were undertaken unilaterally in the post-Marcos governments of Aquino and Ramos.

The specter of rent-seeking and associating protecting monopolies with industrial policy (government failures) remains a very strong belief

of mainstream economists in the Philippines today.

The creation of WTO and the entry of all countries into the organization made it more difficult for industrial policy to be achieved due to:

- Abolition of import quotas and significant tariff reductions
- Prohibition of subsidies to exports and tradeable goods
- The bigger power given to developed countries in its decision making (the Green Room) and developed countries' continued use of protection while developing countries are forced to 'deprotect'.
- At the same time, developed countries use the anti-dumping rule against developing countries
- The rules concerning intellectual property rights (IPRs) – the TRIPS – no longer allowed developing countries to access sophisticated technologies developed in the developed countries (Japan, Korea and Taiwan had access to these frontier technologies before WTO since they were early-comers).

In the 1990s, many economists – including the WB – started analyzing the Asian Miracles and concluded that they used both market-friendly policies and government promotion of key sectors (i.e. picking winners)

Direct subsidies, credit subsidies, government corporations, tax incentives were some of the government interventions use to promote successful development of their industries and exports. The important thing is that the industries have to perform well (e.g. export penetration of world markets or a certain level of scale production and sales after a period of time).

New theories arose that point to market failures rather than government failures. Market failures occur because if things are just left to the market and the private sector, there will be inefficiencies and lack of development. Some of these theories are embodied in the endogenous growth theories:

- Sectors with positive externalities have multiplier beneficial effects in economy. These need state support and promotion since the firms undertaking these (if any) do not reap all the benefits of the sector.
- There is a need to develop human capital, quality education geared to industries, develop specific specialized skills, R&D and technologies for key industries with positive externalities

Rodrik and Hausmann (2006) further provide the reasons for market failures

- First Mover Problem
  - A beneficial sector will not be developed by innovative entrepreneurs if first movers don't move because of possible losses (uncertainties on their success), or if they succeed, imitators will just cut into their markets. Government has to give them subsidies or tax incentives and general support.
- Coordination Problem
  - A beneficial sector will not develop unless the right infrastructure, legal governance, quality inputs, institutions for standards and quality, etc are in place. These requirements may be sector-specific so that the government will have to provide assistance to achieve these.

Thus, growth theories have moved back towards the theories of the original development economics of the 1950s and 1950s. But the international context – WTO and various free trade agreements as well as competition among many newcomers -- have made it more difficult for developing countries to achieve success.

Most developing economies had moved towards a more open economy in trade and capital/ financial accounts. They are now more prone to volatilities and contagion from global crises originating more and more from the developed world. The global financial crash has led to the call for both capital controls and 'rebalancing' the economy towards more domestic demand. This is after

developing countries were forced to open up to free trade and shift to export production.

Ha-Joon Chang (2009)_criticized economists' penchant of dichotomizing export promotion and import substitution. An industrial policy includes a decision on the right mix of free trade (no interventions), export promotion (with interventions) and domestic industry promotion (including import substitution and protection of infant industries). It is not an 'either or' strategy.

The most heated debate now among economists is:

- Should the state just provide support – e.g. help in the coordination problem – or give actual subsidies or tax incentives to particular industries or firms

- Another debate is should the picking of 'winning' sectors come from the government – with a long-run view and plan (roadmap?) for industrialization (creating new industries) – or should the government just base its decision on the best performing sectors seen as the comparative advantage of the country (facilitating winners)?

The debate between Justin Lin and Ha-Joon Chang (2009) highlights this debate. But the active role of the state is now accepted more and more among the academics.

Institutions and Industrial Policy of Successful Countries

The theoretical and empirical justification for industrial policy within the academe is clear. But the institutional and organizational mechanisms to undertake industrial policy had not been explored more thoroughly.

Definitely, there is no one-size-fits-all set of political and social institutions and governance framework for industrial policy. In fact there is no one-size-fit-all for the type of industrial policy itself.

Ohno (2009) shows how different East Asian 'Miracles' undertook different industrial policies under different organizational and institutional arrangements. It is important that the industrial policies undertaken be suited to the organizational institutions and political power relations in the country. The industrial policy must of course be in tune with the human skills and education and potential capabilities of the economy. In fact the planning of industrial policy and the institutions and relationships that are involved in industrial policy are actually one and the same set of processes. The following lifts heavily from Ohno (2009) in the cases of Japan, Korea, Malaysia and Thailand.

Japan and Korea

Japan's and Korea's strategy of high government profiles in industrial policy and licensing privileges for large domestic firms (employing the infant industry arguments) differ much from Taiwan's reliance on technology licensing and linking large multinationals to efficient small and medium domestic firms for technology transfer.

Japan and Korea shared some similarities in having super-ministries in charge of industry, giving licensing to large conglomerates (zaibatsus, chaebols) for special privileges in return for fulfilling strong performance indicators, and relying on imitating foreign advanced technologies instead of relying on multinationals and foreign direct investments. They differ in the fact that Japan relied on its super-ministry for organizational leadership whereas Korea was more dependent on a personal leadership of Park Chung Hee and his promotion of the Economic Planning Board under a Deputy Prime Minister hand-picked by President Park. They, however, use similar protective devices such as credit subsidies, export subsidies, technological support and promotion and infant industry protection.

Japan's institutional capacity for industrial policy from the late 1950s to the 1970s consisted of a super-ministry, the Ministry of International Trade and Industry (MITI), that implemented the medium and long term plans formulated in cooperation

with the Prime Minister's Office. The role and functions of the MITI consisted of:

a) Inter-ministry coordination of industrial policies especially with the Ministry of Finance and the agencies under the Prime Minister's Office: the Economic Planning Agency, the Land Agency, etc.

b) Deliberation councils where the MITI and industries agree on an industrial vision, discuss industrial policies including finance and technology, generates cooperation among firms and industries on common strategies, share information build and consensus, negotiate and sometimes provide the venue where MITI flexes muscles with the private sector firms.

c) Business officials, government officials, academia and the media are active in the deliberation councils to generate best results and overall societal support for the strategies.

Korea's political institutional structure for industrial policy consisted of:

a) The Economic Planning Board (EPB) is the super-ministry for industrial policy in charge of development, investment and budget planning, aid management, and monitoring. It is headed by a Deputy Prime Minister directly reporting to the President.

b) The President is the real power behind economic planning using the Deputy Prime Minister as titular head of the Economic Ministers' Council, and the State Council.

c) These councils are, in effect deliberation councils that consist of strong cooperation and collaboration between the state and the big business sector (the chaebols) especially in export promotion, economic briefs, promotion of critical industries and the like. The President was actually very active in these deliberation councils.

d) The Korean Development Institute (KDI) was very active in providing academic support and ideas to the medium and long term economic plans, industrial policies and policy analyses. It was critically linked to the entire state planning and industrial policy structure.

e) More so than Japan, Korea's initial industrial policy, despite reports of widespread corruption, was performance-based with good performing industries and firms given further rewards, and those not performing given penalties and withdrawal of privileges.

Malaysia

Similar to Korea, Malaysia had a strong personal leadership of promoting industrial policy under Prime Minister Mahathir. In the 1980s, Mahathir developed industrial visions with the 'Look East Policy' in the 1980s and the Industrial Vision 2020 announced to the Malaysian Business Council in the early 1990s. The industrial policy involved multi-layered inter-ministerial coordination:

a) The Industrial Coordination Council (ICC) -- chaired by Minister of International Trade and Industry (MITI) with members from seven other ministries including the Economic Planning Unit (EPU), the Department of Finance, the Central Bank, 15 business representatives from the Chambers of Commerce, industry associations – coordinates the activities of industrial policy.

b) The Industrial Policy and Incentive Committee (IPIC) made up of the 8 ministries plan and operationalize incentive schemes.

c) The public-private cooperation works through the Public-Private Cluster Working Groups and the Strategic Thrust and Initiative Task Force (STITF). The focus is on 18 industrial clusters and cross-cutting issues.

Unlike Korea and Japan, Malaysia involved multinational firms in technologically driven industries such as electronics. Unlike the Philippines, Malaysia had gone up the technological ladder in electronics – going into micro-chips and more sophisticated products. Malaysia's strategy included consultations with Malay, Chinese and Indian political parties and communities and included regional development in the cluster-corridor strategy of development.

Taiwan

Taiwan's industrial policy followed a quite different approach and concentrated on technological licensing and the participation of hi-tech multinational corporations. The strategy consisted mainly of building the capacities and efficiencies of cost-competitive small and medium firms to act as suppliers to the hi-tech multinational firms (Fuller (2002)). The strategy included building the necessary infrastructure and R&D requirements to achieve technological upgrading and linking Taiwanese firms to strategic customers. The outsourcing of MNC input requirements became a major source of technological learning of Taiwanese firms. Through time the small and medium firms were able to learn sophisticated technologies from the MNCs and became major exporters themselves. Taiwan's strategy was complemented by promoting the education of engineers and scientists schooled abroad.

The Taiwanese bureaucracy had the special feature of including strong state technology institutions in the state industrial policy planning and implementation. The Industrial Technological Research Institute (ITRI), and under it, the Research Service Organization (ERSO), played a key role. The Science and Technology Advisory (STAG) also played a crucial role in industrial policy.

It must be pointed out that engineers, scientists and lawyers played very important roles in the industrial planning and policy bureaucracy of Taiwan and Korea (Ha-Joon Chang (2009)).

Thailand

Finally, we look at the case of Thailand. Thailand does not have a strong state structure for industrial planning and industrial policy. But in the 1980s, industrial policy was achieved in the form of regional development of the country. The regional development strategy consisted of:

a) large scale infrastructure building and setting up of industrial zones;

b) the Eastern Seaboard Development Program (ESDP), which created the most dynamic region in Thailand where high value goods and Japanese multinationals (automobiles, electronics) and other high-tech export firms moved to;

c) the setting up of the Joint Public-Private Consultative Committee where government and business collaborated and strongly participated in,

d) the Rural Development Committee.

In the 1980s, the Thai Prime Minister himself chaired the committees and the committees were managed by the National Economic and Social Development Board (NESDB). Within the NESDB, the Secretariat of the Eastern Seaboard Development Program was formed. Subcommittees chaired by ministers of key agencies were formed that planned and implemented the regional development of the Eastern Seaboard and the promotion of the chemical fertilizer and petrochemical industries and educational and social programs.

It must be pointed out that firms and industries that had been protected or given special privileges must have a time horizon for such benefits. In the East Asian success countries, once state-supported firms and industries became viable and successful, they are left to themselves to improve their performance, their products and undertake their own innovations and technological upgrading. That is why the East Asian countries were able to join WTO and the free trade era of the 1990s and 2000s and adhere to less government interventions in the private sector.

Conclusion

The Philippines have the technical capabilities, potential institutional structure and knowhow to undertake selected and well-thought out industrial policy for critical and progressive industries. It is in the political will and mindset of the government and private sector and society in general that change is needed in order that industrial policy can be effective and successful in the Philippines. This is from a mindset of achieving macro stability, having a good investment climate through better governance and openness to foreign investments to one where industries have to be strongly supported to achieve technological upgrading and competitiveness.

It also depends on the insulation of government to strong lobbies of powerful groups and blocks.

In a way there has to be a political, social and economic transformation of the Philippine society. But this doesn't mean that one should not proceed with 'roadmaps' and industrial policy planning. Industrial policy is a 'learning by doing' process and, as long the political will is there, the process may generate its own institutional and organizational mechanisms based on the necessities of the program.

A concern of course is the free trade agreements that we have signed. But there are always policies that are not included in the free trade agreements, as well as vague interpretations of the agreements. That is why, just like Korea and Taiwan, international lawyers, engineers and scientists would be some of the critical people needed in the bureaucracy.

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Action for Economic Reforms

Unit 1403 West Trade Center
132 West Avenue, Quezon City,
Philippines 1104
Phone/Fax: (+63 2) 426 5626
Website: www.aer.ph • www.ifoi.ph