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Institutional Constraints on Philippine Growth

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Institutional Constraints on Philippine Growth

Emmanuel S. de Dios*

1. Introduction

It is difficult in principle to controvert the simple statement that institutions play a role in explaining growth. An *institution*, after all, is “a system of rules, beliefs, norms, and organizations that together generate a regularity of (social) behaviour”¹ (Greif 2006:30). Viewed at this fundamental level, institutions are pervasive, and therefore, affect all behaviour manifesting any semblance of regularity, including behaviour by politicians, bureaucrats, and of the citizenry itself. In particular, to the extent that formal rules, informal norms, beliefs and convergent expectations, and organisations are implicated in the acquisition and exercise of political authority, then *governance* itself – understood as “the manner in which public officials and institutions acquire and exercise the authority to shape public policy and provide public goods and services” (World Bank 2007:i) – must be understood as being themselves institutional outcomes. This is straightforward, since the institutional elements just mentioned directly affect political behaviour. At the most formal and superficial level, constitutions and statutes place obvious limits to the mode of acquiring and exercising authority (e.g., elections, executive-legislative relations, etc.). In many instances, of course, behaviour will appear to deviate from or spill over the limits imposed by formal laws – a problem endemic to many developing countries – such as, when clientist or patriarchal relations swamp outwardly democratic processes. Closer analysis, however, will typically reveal that such behaviour² actually accords with some *other* (perhaps competing) set of *de facto* institutions that operate alongside or in lieu of *de jure* institutions. In the event, institutions of one form or another are implicated.

The term *political economy* is taken here to mean the analysis of the effects of political constraints on economic policies and economic outcomes (Drazen 2000:7): “Political constraints”

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¹ This definition by Greif amplifies the more cursive definition provided originally by Douglass North (1990) of institutions as constraints on behaviour, or as “rules of the game”, and of organisations as players in the game. The distinction highlights the point that for people to be guided by rules, they must be motivated by beliefs, while rules must often be sanctioned or implemented by organisations, notably those involved in the political and legal system. In more recent work, North (2005:48ff) has himself acknowledged the crucial importance of beliefs.

² That is, to the extent it is *regularly observed* behaviour. In another paper [de Dios 2008], I apply this observation to local political relationships in the Philippines.

itself is shorthand for conflicting or heterogeneous interests, since upon closer consideration, complete homogeneity of interests would imply an almost axiomatic absence of conflict. Viewed from this aspect, the content of policies themselves assumes second-order importance, since whether or not policies are taken and the degree to which they are implemented become matters that are endogenous to prevailing institutions and political economy. But although definitions of institutions and their pervasiveness appear unexceptionable, it is less clear exactly what kinds of institutions *do* matter for economic performance, how their effects are transmitted, and how they may be changed.

The immediately following section briefly recapitulates what is known both conceptually and empirically regarding the role institutions play in development. Section 3 changes tack by sifting through evidence to suggest that economic growth in the Philippines has indeed been hobbled by issues relating to institutional outcomes or the performance of institutions. Section 4 applies a framework based on new institutional economics for understanding the historical roots of the problem. Section 5 concludes with some implications for policy.

2. Institutions and development – the argument

The crucial importance to economic development of the rule of law, the enforcement of contracts, and the protection of property rights stems from Douglass North's earliest observations [1990, 1981, and 1973 (with Thomas)] of how such institutional outcomes appear to have been historical pre-conditions for the support of anonymous exchange and long-term contracting, especially for credit, venture capital, and technological innovation. Absent these, the risks and costs associated with consummating market transactions beyond spot-exchange and local markets would have been prohibitively high, and technological innovation likely stifled. North distinguishes between contracts that are self-enforcing between parties, e.g., those based on credible commitments (hostage-exchange, collateral), repeat-transactions, and, on the other hand, those that rely on third-party enforcement. Institutions of the former type are frequently supported by customs and norms in the context of a "dense social network where people have an intimate understanding of each other" (North 1990:39) such as those prevailing in small and closely-knit communities. But for transactions that are more complex, entail larger amounts, are spread out over time and space, and involve larger jurisdictions, self-enforcing contracts become increasingly difficult to write and to enforce. Instead there is increasing resort to sanctions by third parties, which point to the rise of impersonal legal systems and specialised institutions to enforce them. These outcomes were historically achieved in the now-developed economies in conjunction with the rise a legal

and penal system and a bureaucratic state in the sense of Weber.³ Even Adam Smith's vision of *laissez faire* was underpinned by a state that performed a night-watchman's role of enforcing the law, providing defence, and providing a number of public goods.

Coercive force and revenues must be conceded to the state for it to fulfil its functions of property-rights protection, contract-enforcement, and defence. The problem has perennially arisen, however, of constraining state power. Rules and organisations have had to evolve to exact accountability from rulers, who could otherwise use their powers for expropriation and abuse. In one sense, therefore, the institutional design required for growth entails a careful balance between vesting the state with sufficient power to enforce, yet not so far as to make it oblivious to its citizens' interests and allow it act with impunity. In much of the history of Western Europe and North America, these constraints on the powers of the state were imposed by the emergence of electoral democracy, checks and balances between branches of government, a professional bureaucracy, and the guarantee of civil rights and liberties (North and Thomas 1978; North 1980). On the other hand, it remains a festering question in development whether and how the transplantation or emulation of such institutions will also work for developing countries.

Econometric tests of the above hypotheses from Barro (1991) onwards have for the most part consisted of cross-country data⁴ that repeatedly display significant influences on the long-run growth (or investment) record of different variables representing institutions or their outcomes. But attempts to measure variations in economic performance across explicit types of institutions (e.g., forms of constitution and types of electoral rules, as found in the important work of Persson and Tabellini (2003) are impaired in principle and in fact by divergences between the formal specification of institutions and actual conditions on the ground. For instance, while presidential systems of government on paper represent relatively more constraints on the executive compared to parliamentary systems, they can (and do) mask a great deal of unilateral executive power in some real instances, e.g., *caudillismo* in Latin America and the strong presidency (as will be discussed below) in the Philippines.

³ This historical account is not entirely unchallenged, of course. Greif (2006) for one contends that the impersonal state did not *per se* guarantee long-distance trade, credit, and impersonal exchange and instead cites the role of corporate bodies or associations, such as merchant groups (e.g., those of the Maghribi traders, or the German Hansa), town-communes bound by community-responsibility systems, and finally joint-stock corporations. These same observations tie in with similar work on *guanxi* networks in Chinese society that also originally facilitated trade. On the latter, see a recent paper by Fabella (2007).

⁴ Subsequent work includes Barro and Sala-I-Martin (1995), Mauro (1993), Keefer and Knack (1995), La Porta et al. (1998), Kaufmann, Kraay, and Zoido-Lobaton (1999), Rodrik, Subramanian, and Trebbi (2002), and Easterly (2006).

Such difficulties have led alternatively to attempts at measuring the impact of institutions, rather than specifying them directly. Barro's original work, for example, found significant influence of variables that measure the "rule of law" and political stability. Since then, the list of institutional variables that plausibly appear to affect growth positively has come to include the degree of protection of property rights; civil liberties; political rights and democracy; measures of social cooperation, such as trust, religion, and clubs and associations (see, e.g., the survey by Aron , 2000).

One difficulty with the interpretation of such results, however, is that they represent at best only an indirect test of the hypothesis, since the variables included are not institutions *per se* but rather outcomes of institutions or their performance (Shirley 2005). Such reservations apply even to the most comprehensive collection of such variables currently available for a large number of countries [Kaufmann, Kraay, and Mastruzzi (KKM) 2007]. KKM assemble data representing institutional quality or institutional performance from a wide array of sources and define indices delineating five aspects of institutional quality for various years (since 1998 and annually beginning 2002), namely: voice and accountability; political stability; government effectiveness; regulatory quality; rule of law; and control of corruption. Here, it will be noted that indices of "political instability", for example, measure not institutions *per se* but rather the results of the weakness or lack of legitimacy of institutions. Likewise, the scope of corruption (typically measured through subjective-expert or public opinion) is not by itself an institution but rather the signal of institutional weakness, in the sense that widespread corruption reflects the extent to which rules either do not exist, are badly designed, go unheeded, or are vendible. As a result, even as the econometric evidence suggesting the importance of institutions continues to mount, it is quite another thing to determine exactly which institutions matter, why, and how.

An early attempt to address such questions was the significant work of La Porta, Lopez-de Silanes, Shleifer, and Vishny (1998), which used cross-section data to explain how a series of institutional outcomes or indicators of institutional performance – such as respect for property, corruption, bureaucratic efficiency, political rights among others – could be related to prevailing legal systems, geography, social or ethnic heterogeneity, and belief-systems. Their findings suggest that even controlling for per-capita incomes, countries with (a) legal systems derived from civil-code traditions (ultimately of French or Spanish origins) rather than common-law, (b) which have predominantly Muslim or Catholic religious backgrounds, (c) which are ethnically fragmented, and (d) which are geographically close to the equator, generally perform poorly on most indices of governance-outcomes.

Important exceptions and qualifications can, of course, be made with respect to any of these conjectures. Notable counterexamples are some of the major Western industrialized countries themselves: France, Spain, Belgium, Portugal, and Italy, after all, maintained their unhelpful civil-code and predominantly Catholic traditions yet managed to join the ranks of the wealthiest nations, even if this is nuanced by the fact that within Europe itself, civil-code, Catholic countries were often relative laggards or latecomers (e.g., relative to England and the Netherlands) (North and Thomas 1973). Be this as it may, the historical experience of these countries shows that the mechanisms of causation can be further modified by such factors as the external pressures of intra-European rivalries and competition among fragmented states (Diamond 1997); the remarkable cross-fertilisation of ideas among the European intellectual (particularly its scientific) elite (Mokyr 2004); and the peculiar history of violent religious wars those countries underwent. The rise of a secular state in France and Germany, for example, cannot be understood separately from the struggle against temporal claims of the papacy and the need to preserve national unity amidst violent internal strife between Catholics and Protestants. Ultimately, even institutional economists concede that they “know very little about the mechanisms through which the rules implemented by these institutions diffuse to governance structures and contribute to the shaping of how transactions are organized. Therefore, we know very little about comparative costs of different institutional schemes (e.g. the cost of running different kinds of judiciary systems for implementing contractual laws)” Ménard (2001:86-87).

The problem is rendered more complex when one recognises the significant differences in the development of institutions in the present developed western countries, on the one hand, and the post-colonial developing countries, on the other. It is scarcely possible to appreciate the costs of operating institutions in today’s developing countries without understanding the historical processes that moulded them. North himself (North, Wallis, and Weingast 2006) has drawn the important but somewhat heretical point that institutions proven to work in the current industrialised countries – such as democratic rules for selection of leaders, non-kin-based organisations, impersonal third-party enforcement, and prices as the primary means of resource-allocation – will not necessarily represent an improvement when simply imported (and imposed from without) in today’s poorer countries, one of the most important reason being that this may simply disrupt a pre-existing social order without installing a feasible replacement. The difficulties encountered by the US in introducing the formal institutions of western democracy in its recent forays into Afghanistan and Iraq should serve as sufficient food for thought.

Two historical factors complicate the understanding of institutions in developing countries, namely, a country's *colonial heritage* and the pre-existing degree of *social or national cohesion* (Shirley 2005), or its opposite, the degree of social heterogeneity. The effect of the former is partly reflected in the differences between various legal traditions and religious beliefs which, as already been noted, created a measurable impact on the relative growth trajectories of the Western industrial countries. The hierarchical and authoritarian structures of traditional Catholicism render its less accessible to the masses and more the preserve of initiates and trained specialists. Such a "scholastic" or prescriptive tradition contrasts with the "pietism" of many Protestant sects, many of whose observances emanated from the communities of the faithful themselves.⁵ A similar contrast presents itself in a comparison of the common-law and civil-code traditions. The common-law tradition presumes a greater openness to the community's evolving customs rather than (as in the civil code) the delineation of right by an interpretation and application of a fixed code by learned individuals. This is partly evident, for instance, in the practice of judgement by jury in most common-law systems, rather than by specialist judges and magistrates as under the civil code tradition. It is reasonable to conclude, therefore, that common-law traditions are *ceteris paribus* more accessible to communities than the civil code.

More important, however, is the fact that such institutions (whether common law or civil code) have been transplanted and imposed (largely through conquest and coercion) by colonisers. This raises the real cost to the indigenous peoples of utilising or accessing any of them. This is an alternative way to view the findings (notably by Acemoglu, Robinson, and Johnson, 2001) that persuasively relate subsequent growth to the density of the external settlers relative to the native population. Where the areas colonised by outsiders were densely populated to begin with (e.g., South and Central America, sub-Saharan Africa, and parts of Asia), a greater cost was obviously involved before borrowed or imposed institutions could gain legitimacy or be internalised among the majority of the inhabitants. By contrast, where new settlers themselves constituted the larger proportion or a majority of the population, such as in Australia or North America, the cost of establishing functioning institutions was lower, since this largely entailed the transplantation of forms of rules and traditions that were in many respects already familiar to and accepted by the colonists.

⁵ I owe these terms to Nelson (2004:474), who uses *scholastic* to describe the situation where "a church hierarchy interprets the ways of God to the faithful", as exemplified by the Roman Catholic Church, and *pietistic* to describe "a more direct relationship between the individual and God", a notion more closely associated with the tendencies of early Protestantism. Nelson cites the theologian Paul Tillich for these assessments.

The degree of social or national cohesion is another factor potentially affecting the subsequent hold of formal institutions in developing countries. Greater ethnic, cultural, or economic homogeneity – itself an outcome of common history or experience – is more likely to facilitate convergent beliefs and an appreciation for a common set of rules. Today's developing countries, on the other hand, are handicapped in this respect by their more recent national experience and by the almost capricious partitioning and assignment of territory among the new nation-states by the quondam colonial powers. Applied to the Philippines, for example, it cannot be denied that Mindanao and its Muslim populations were decisively incorporated into the republic only after the sultanates were subdued by superior US military power. But this problem is even more pronounced in other parts of the world, i.e., most of Africa, the Middle East, Central Europe, and the Indian subcontinent, where multi-ethnic states have been the residue of the post-colonial experience.

This observation regarding the cost of using institutions may also explain the earlier-mentioned findings of La Porta et al. (1998) that associate ethnic fragmentation with poor governance outcomes. From the viewpoint of access and the cost of internalising and trusting institutions, there is a greater likelihood that a heterogeneous population will encounter difficulties in reconciling their pre-existing traditions, beliefs, and aspirations with rules that have been crafted and imposed from outside. More recently, Easterly, Ritzen, and Woolcock (2006) have also pointed to the significance of social equality and the size of the middle class as determinants of subsequent growth. Interestingly, colonial heritage and economic geography may again be partly implicated, since certain economic formations in colonial times were more conducive to the persistence of highly unequal distributions of political power and economic wealth. In an attempt to elaborate earlier work by Engermann and Sokoloff (2000), Easterly et al. (2006) hypothesise that geography and factor endowments encouraged certain types of settlement and colonial economic exploitation that strongly influenced subsequent social structures. In particular, factors conducive to wheat-farming encouraged small farms and a more equitable asset-distribution in North America; by contrast, the massive labour requirements and large scale of operations entailed by sugar plantations produced slavery and social inequity in the Caribbean, Central and South America, and the southern United States.

From the viewpoint represented here, such factors as have been alluded to in the literature, therefore, (e.g., colonial heritage, social cohesion, and even geography) matter primarily because they affect the *ease of access* by the majority of the population to those formal or codified institutions that were ultimately able to support anonymous exchange, long-term investment, and

technological innovation in the manner described by North. The analytical upshot of this, however, is that an assessment of institutional performance cannot simply consist of an *a priori* specification of what are “good” and “bad” institutions, per se: rather, one must additionally consider the degree to which the greater population grant credibility and are able to gain access to existing institutions to guide their behaviour, given their current beliefs, historical experience, proximate expectations and interests. It then follows that mismatch or conflict between prevailing institutions – particularly of the formal kind – and the latter can be expected to result in cognitive dissonance at the societal level, at the very least, and social strife and collapse, at the worst. The succeeding sections proceed to document how such a framework may provide part of the explanation for the long-run record of Philippine economic performance.

3. Current evidence

In applying such a framework to the Philippines, we initially seek to establish whether and to what extent institutions – as expressed through governance-outcomes –*currently* represent first-order causes hindering investment and economic growth. A further pursuit of the argument becomes important, after all, only if institutional factors or outcomes can be shown to express themselves as significant hindrances to current performance.

Towards this end, various indicators for governance outcomes for recent various years constructed by Kaufmann, Kraay, and Matruzzi (2007) are assembled to determine whether the Philippines fares significantly better or worse than other countries. As already described, these indicators pertain to five dimensions, namely: voice and accountability, political stability, government effectiveness, regulatory quality, the rule of law, and control of corruption. As a further control, however, Philippine scores on each dimension are compared to those of other countries based on a regression controlling for levels of per-capita income. The details of this comparison are summarised in Table 1. Negative (respectively, positive) entries indicate that in that particular year, the Philippines score is comparatively worse (respectively, better) on that particular governance-outcome indicator than countries with a similar level of income per capita.

Table 1: Governance indicators for the Philippines
cross section and for selected years

Governance indicator	1996	1998	2002	2003	2004	2005	2006
Voice and accountability	+	+	+	+	+	+	
Political stability	–	+	–	–	–	–	–
Government effectiveness	+					+	+
Regulatory quality	+	+	+	+		+	+
Rule of law	+	+	–	–	–	–	–
Control of corruption	–	–	–	–	–	–	–

Legend: (+), [respectively, (–)], denotes a governance score for the Philippines that is significantly better [respectively, worse] at the five-percent level or less, when compared to countries with similar GDP per capita for the period.

Empty cells indicate scores that are within the predicted range.

Source: Author's computations using data from Kaufmann, Kraay, and Mastruzzi (2007)

For all years reported except the last, the Philippines rated above the norm in “voice and accountability”. This largely reflects the country’s long-established democratic traditions and the formal guarantees of civil liberties, a free media, regular elections, and checks and balances as prescribed in the country’s current constitution (in force since 1987). The deterioration in the most recent period coincides with government restrictions of civil liberties and extraordinary assertions of executive power in response to corruption scandals and threats to stability. It also corresponds to a marked rise in extra-judicial killings and disappearances suspected to have been carried out by the military – directed mostly against Left activists– that has been significant enough to attract international concern and comment.⁶

The other dimension in which the Philippines appears to rate fairly well has been “regulatory quality”, referring to the ability to formulate and implement policy that encourages private enterprise. Political vagaries notwithstanding, all administrations since 1986 have invariably committed to a formal policy of promoting private enterprise and reducing government involvement in business. The more substantive aspects have included the sustained efforts at privatisation, deregulation, and trade liberalisation in various industries. The quality and qualifications of the bureaucracy are also vindicated by ratings of “government effectiveness” that are broadly in line with what is typical for the Philippines’ level of income.

By contrast, the country falls consistently below the norm in political stability and the absence of violence; the control of corruption; and the rule of law. Unlike other aspects previously

⁶ These killings were the subject of at least one special government commission (the Melo Commission) and a mission by the special rapporteur appointed by the United Nations, J. Alston.

mentioned, it is significant that the latter pertain less to formal policies and declarations of principle and relate more to *de-facto* performance. While regulatory policy may be liberal with respect to the private sector, for example, the actual assignment of economic rights and concessions may be biased and subject to elite-capture. As a result, above-average ratings in the quality of regulatory policy may be diluted – as in this case – by below-average scores in the control of corruption. Likewise, although civil liberties and a resort to the courts and administrative or legal channels may be constitutionally guaranteed, real access may be limited or the application of the law itself may be biased, which could cause resentment and possibly violence. The result – as in this case – would be a poor showing in the rule of law, despite the *de-jure* affirmation of “voice and accountability”.

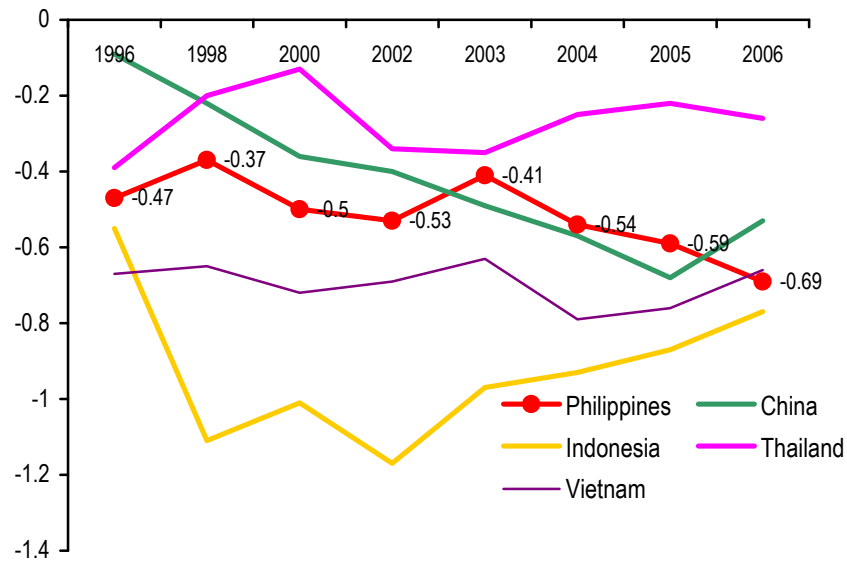
Ultimately the most acute manifestation of these disjunctions is political instability itself, which would otherwise be difficult to explain, given the existence of what one might think are democratic avenues for voice and accountability. The low ratings for political stability coincide with a recent history marked by consummated or attempted popular risings, disputed electoral results, attempted coups d’etat and military mutinies, cabinet resignations, impeachment threats.

A sharper contrast is gained by comparing the Philippines to a smaller set of neighbouring countries. Using the same data from KKM, Figures 1 and 2 show the ranking of the Philippines on two crucial governance aspects where it has performed consistently below average – control of corruption and political stability, and maps these against indicators for comparable countries in the region. The shifting pattern across countries becomes apparent particularly in the last few years. In the control of corruption, Thailand has always remained several notches above the Philippines, while the country has typically been rated better than Indonesia in the recent past. The loss of momentum for the Philippines is apparent, however, which has allowed China, Vietnam (and soon enough Indonesia) to catch up with it in this governance aspect. In terms of stability and absence of violence, Vietnam rates best among the countries included, doing consistently better than the 50th percentile. Again, the Philippines’ loss of ground in this aspect is apparent, particularly relative to 1998. (Political stability in Thailand deteriorated in the years immediately preceding the successful generals’ coup of 2006 that deposed the civilian government.)

Compared to countries in other regions and sub-regions, the Philippines’ corruption indicators are better than those of Pakistan, Afghanistan, and Bangladesh, but worse than India’s and Sri Lanka’s. It performs worse than major Latin American such countries as Argentina, Brazil,

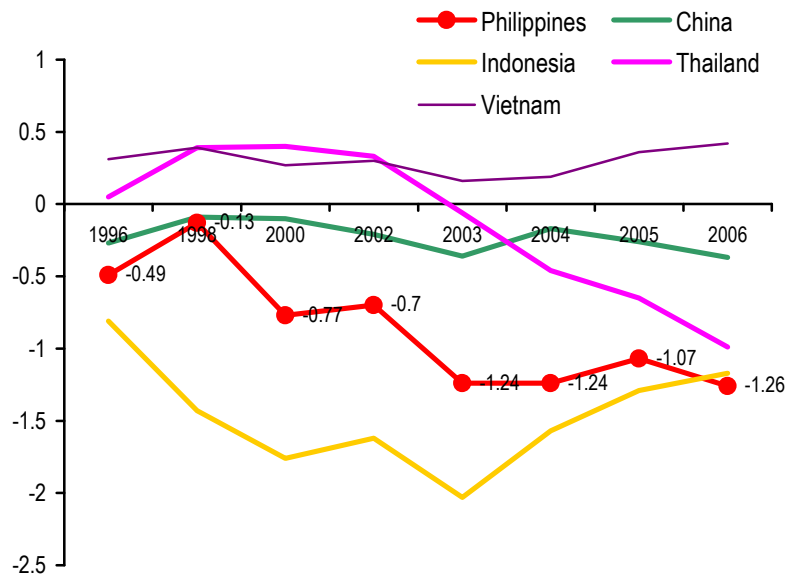
Mexico, Peru, Chile, and Colombia, better than Venezuela and similarly to Bolivia and some smaller Central American states.

Figure 1: Indicator for control of corruption for selected countries
(Range: 2.5 (best) to -2.5 (worst))



Source: Kaufmann, Kraay and Mastruzzi (2007), generated from <http://info.worldbank.org/governance/wqi2007>

Figure 2: Indicator for political stability for selected countries
(Range: 2.5 (best) to -2.5 (worst))



Source: Kaufmann, Kraay and Mastruzzi (2007), generated from <http://info.worldbank.org/governance/wqi2007>

Broadly similar patterns can be found in other data sets. Transparency International's "corruption perception index", for example – which like the KKM data is a composite indicator based on several sources – shows the Philippines being rated somewhat similarly to Vietnam and Indonesia, but significantly worse than Thailand and China, not to mention Malaysia and Singapore (Table 2). Overall, the Philippines has can be found in the lowest 20th to 30th percentile of all countries included in the Transparency International sample.

Table 2: Corruption perception index* and ranking for selected Asian countries and years
(Figures in parentheses represent ranking among countries in the sample)

	2007	2005	2003	2001
Philippines	2.5 (131)	2.5 (125)	2.5 (92)	2.9 (65)
Singapore	9.3 (4)	9.4 (5)	9.4 (5)	9.2 (4)
Malaysia	5.1 (43)	5.1 (39)	5.2 (37)	5.0 (36)
China	3.5 (72)	3.2 (79)	3.4 (56)	3.5 (57)
Thailand	3.3 (84)	3.8 (59)	3.3 (70)	3.2 (61)
Vietnam	2.6 (123)	2.8 (116)	2.4 (100)	2.6 (75)
Indonesia	2.3 (143)	2.2 (137)	1.9 (122)	1.9 (88)
No. of countries	180	158	133	91
Percentile rank of the Phils.	27%	21%	31%	28%

*Index runs from 10 (least corrupt) to 1 (most corrupt)

Source: Transparency International

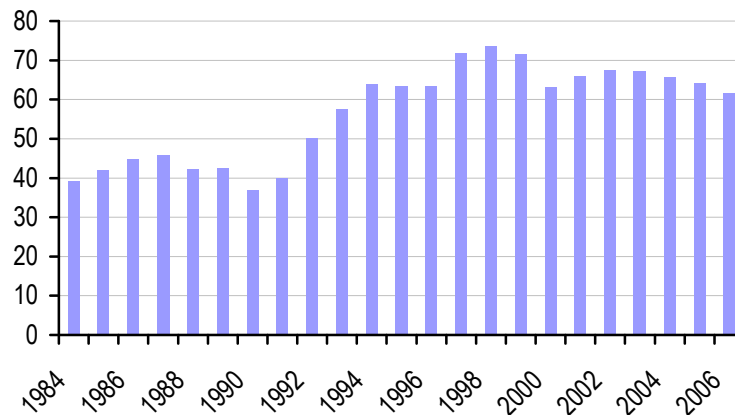
http://www.transparency.org/policy_research/surveys_indices

Finally, a longer historical perspective is obtained from a series of indicators generated by the *International country risk guide* (gathered and maintained by the private risk-rating firm, PRS Group), which is the same set of indicators used in the well-known work by Kiefer and Knack (1995). The total "political-risk" score in this case consists of twelve sub-indices including political stability, corruption, internal conflict, external threat, law and order, and bureaucratic quality⁷, the sum of which is constructed to range from 0 to 100. Figure 3 plots this overall index for the years 1984-2006. The Philippines was in the "very high risk" category for the years 1984-1994; attaining its worst standing in 1991. The index improved gradually thereafter – coinciding with the holding of successful elections in 1992 – and the country reached "moderate-risk" levels by 1997 and even "low risk" for the three years 1998-2000. This significantly coincides with the holding of credible elections in 1998. There was a noticeable turn for the worse in 2001, however, following the EDSA 2 events that led to the removal of President Estrada. By contrast, notwithstanding a minor improvement, perceived overall political risk in the country deteriorated

⁷ The other six components are socio-economic conditions, investment profile, the military in politics, the role of religion in politics, ethnic tensions, and democratic accountability.

after the election year 2004, running contrary to the typical expectation that a successful holding of elections would improve legitimacy and hence stability.

Figure 3: Overall “political risk”: Philippines
(1984-2006)



Source: Political Risk Services. *International country risk guide*

Legend: [0, 50) = Very high risk; [50-60) = High risk; [60-70) = Moderate risk;
[70-80) = Low risk; [80, 100] = Very low risk

Political instability

The most evident and dramatic manifestation of the effect of institutions on Philippine economic performance has been the impact of political instability on growth, particularly as it affects investment. Episodes of overt political instability over the past fifty years have involved attempted or consummated changes in political regime through the declaration of martial law and emergency rule, civilian-military uprisings, coups d’etat, cabinet crises, and impeachment. Apart from this, the country is host to Muslim-secessionist and communist-led agrarian insurgencies that are among the longest-running in the world.

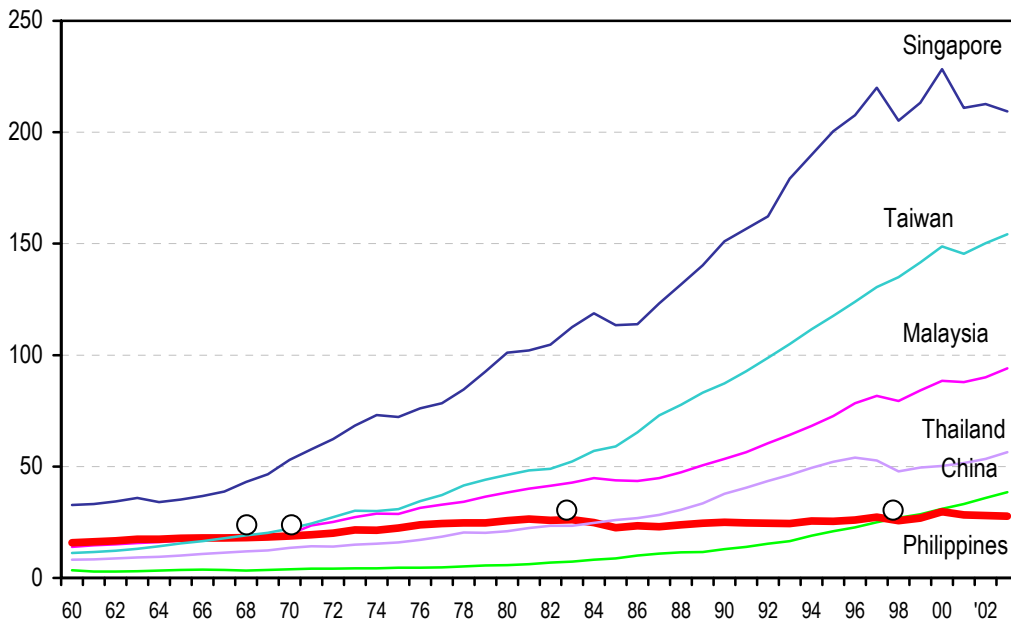
As the preceding section has suggested, large-scale political-regime changes can unsettle distribution and property rights and in this manner affect investment. A major hypothesis, therefore, is that investment decisions should generally be sensitive to the actual or threatened political regime-changes that have characterised recent Philippine history.

The decline and then virtual stagnation in per-capita income in the 1980s must be regarded as the single most significant episode that caused the Philippines to fall behind its neighbours in economic performance. This is immediately evident to anyone viewing the comparative record of long-term growth, such as those provided by Angus Maddison or by Summers and Heston and

their associates⁸. The 1980s and 1990s can justifiably be regarded as the Philippines' "lost decades", when it became the exception in a region in which rapid economic growth was the rule (Figure 4). As a result the country lost economic ground in both relative and absolute terms. Thailand and Indonesia overtook the country in per-capita income terms in 1985; China did likewise by 1998.

It was no accident that this very period was also marked by episodes of severe political instability. The most notable and extended period of political turbulence was associated with the events culminating in the popular uprising known as "the EDSA people-power revolution" of 1986, which led to the toppling of the Marcos regime. The record shows this period leading to the worst post-war decline in Philippine output and investment, as the policy of crony-capitalism and excessive foreign borrowing pursued by the Marcos dictatorship collapsed under a wave of popular protest.

Figure 4: Relative per-capita income levels in East and Southeast Asia
(1960-2000; measured as a percentage of 1960 US income per capita)



Source: Penn World Tables, <http://pwt.econ.upenn.edu>

The installation of a new government headed by President Corazón Aquino, however, failed to produce immediate political stability owing to the fragile and tentative nature of the coalition that stood behind it. In particular, military elements that had originally broken with the Marcos regime

⁸ This is available from various versions of the Penn World Tables at <http://pwt.econ.upenn.edu>.

and initiated the uprising sought to assert what they perceived as their prior claims to govern and sought continually to swamp and ultimately depose the civilian politicians behind Mrs. Aquino. Such claims were behind numerous attempted putsches, the major ones occurring in August 1987 and December 1989.

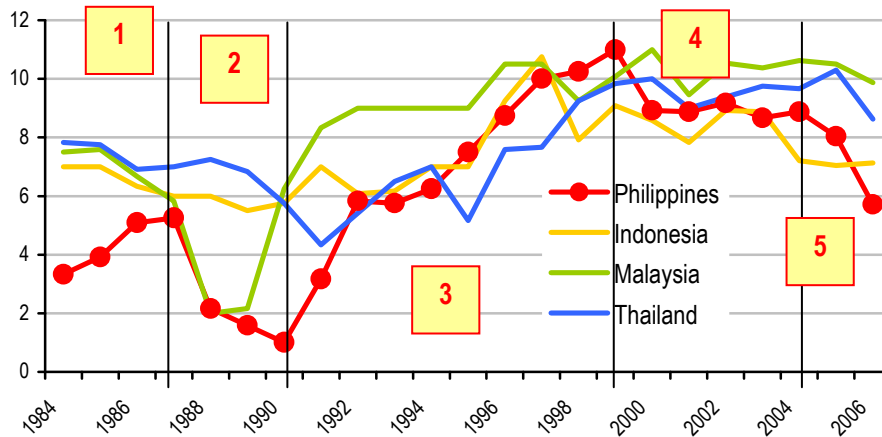
The putsch attempts of 1987 and 1989 could not have come at a worse time, since they coincided with a period of huge increases in Japanese out-sourcing investments throughout the region that resulted from the yen appreciation following the Louvre Accord of 1985 and the Plaza Accord of 1989. Events in the Philippines effectively demonstrated that the newly installed Aquino government was not yet fully in control. The impact of the attempted coup of November 1989 was particularly devastating, since it occurred in the country's financial district.⁹

Figure 5 shows the behaviour of the government-stability index taken from the ICRG data set for comparable countries covering the years after the Louvre-Plaza Accords until the eve of the Asian Financial Crisis. It makes clear that the country's perceived level of stability had already been badly affected by the political crisis in 1984 and was well below those for others in the region. An incipient improvement until 1987 (Panel 1) was interrupted by a sharp decline after 1987 and 1989, lasting until 1991 (Panel 2) and coinciding with the period of violent coup attempts against the Aquino government.

The Philippines failed to benefit from a unique exogenous event, namely, substantial Japanese investment flows following upon the Plaza Accord that lifted other economies of the region, particularly Thailand, Malaysia, and Indonesia, and provided these countries with a valuable stimulus for growth during the period leading up to the Asian financial crisis. Over the period 1984-1997, foreign direct investments in Malaysia, Indonesia, and Thailand averaged respectively \$3.31 billion, \$1.86 billion, and \$1.6 billion annually, with an accelerating trend. In contrast, the Philippines averaged only \$808 million in annual foreign direct investment (Figure 6) in the same period.

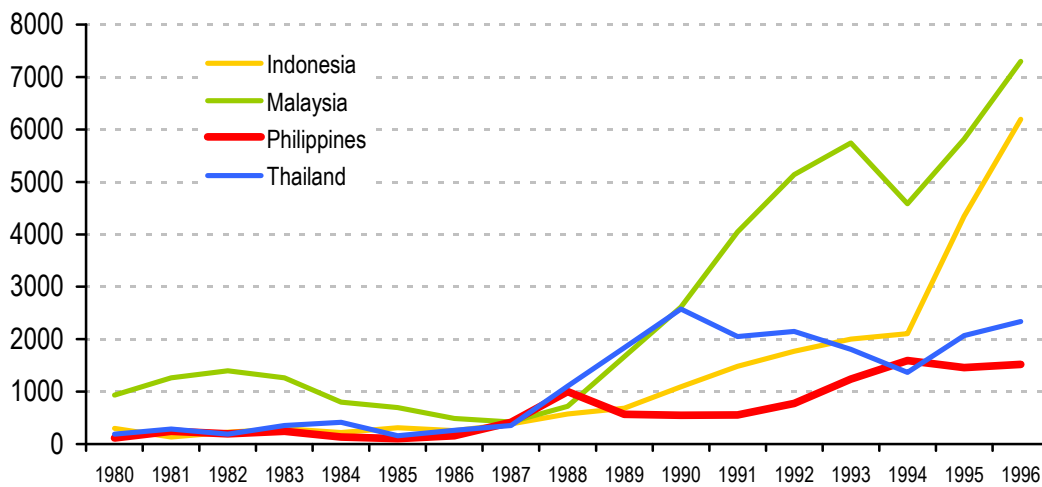
⁹ Contemporary anecdotal accounts recount that the putsch attempt caught a large delegation of prospective Japanese investors at the very Makati hotel that the rebellious soldiers had taken over.

Figure 5: Government stability index for selected countries
(1 = least stable to 12 = most stable; 1984-2006)



Source: Political Risk Services, *International Country Risk Guide*

Figure 6: Foreign direct investment flows
Philippines, Malaysia, Indonesia, Thailand
(in millions of current dollars; 1980-1996)



Source: UNCTAD (www.unctad.org)

This hypothesis can be tested in a straightforward manner, the results of which are reported in Table 3. Per-capita FDI flowing into comparable countries of the region (Indonesia, Malaysia, and Thailand) relative to that of the Philippines is regressed against the political stability scores of those countries relative to the Philippines, with a one-period lag. For the years 1985-2006, the index of relative political stability is positively and significantly related to the relative amounts of per-capita FDI entering the country, that single factor alone explaining as much as 20 percent of the variation in relative shares of foreign direct investment. If the sample is restricted to the critical period following the Plaza-Louvre Accords, the size of the coefficient of relative political

stability is larger and the explanatory power of the equation far greater (up to 50 percent). This suggests the critical nature of the post-Plaza-Louvre period, owing to the one-time investment surge that occurred. That was a tide which the Philippines unfortunately failed to “take at the flood”.

Table 3: Foreign direct investment (FDI) and political stability
(OLS regression; 1985-2006)

Dependent variable	Relative per capita FDI ¹	
	1985-1992	1985-2006
Constant	1.84103 (1.01)	4.07829*** (4.45)
Lagged relative political stability ²	1.59409** (2.50)	1.01625** (2.16)
Sigma	2.51775	2.40543
R ²	0.509704	0.1976747
Log-likelihood	- 17.5877	- 47.1784
F-test (d.f.)	6.237; (1,6)	5.447; (1,19)
D.W.	1.32	1.28
AR 1-1 test: F (d.f.)	0.010330; (1,5)	0.11841 (2,17)
ARCH 1-1 test:	0.49315; (1,4)	0.83755; (1,17)
Normality test : $\chi^2(2)$	2.0642	0.30705
Hetero test: F(d.f.)	n.a.	0.647660; (2,16)
Hetero-X test:: F(d.f.)	n.a.	0.64760; (2,16)
Reset test: F(d.f.)	3.6307; (1,5)	0.0017584; (1,18)

** significant at the 5-percent level; ***significant at the 1-percent level

¹Relative per-capita FDI: mean of annual per-capita of FDI into Malaysia, Indonesia, and Thailand as a proportion annual per-capita FDI of the Philippines

²Relative political stability: mean ICRG Government Stability scores of Malaysia, Indonesia, and Thailand as proportion of the ICRG Government Stability score of the Philippines

Nor has the impact of political instability been limited to direct foreign investment. Table 4 shows estimates of the effects of various sets of governance variables on lending interest rates, which, of course, affect investment more generally. The signs of the coefficients of variables associated with governance outcomes are consistently negative, implying that better governance outcomes are associated *ceteris paribus* with declining lending rates. It also becomes evident that a combination of variables relating particularly to government stability, corruption, and internal conflict (Model 5) performs best in explaining the penalty to investment, as measured by changes in the lending rate. Indeed other aspects of governance-outcomes such as democratic accountability, bureaucratic efficiency, etc. do not appear to contribute to the explanation, as might seen from the fact that their inclusion actually *reduces* the explanatory power of governance indicators (Models 1-3). On the other hand, as previously suggested, special attention

must be paid to the government-stability variable (Model 4): changes in this variable alone account for the bulk of the impact of governance indicators on changes the interest rate, and therefore investment and growth more generally.

Table 4: Dependent variable: First-difference in lending interest rates

(OLS estimation; annual data: 1986-2006)

	Model 1:	Model 2	Model 3	Model 4	Model 5
Constant	- 0.412692 (-0.707)	-0.28575 (-0.512)	-0.273362 (-0.513)	-0.415578 (-0.776)	-0.231485 (-0.474)
Difference in inflation	0.417040 *** (4.03)	0.409148** * (4.22)	0.371635** * (3.82)	0.402492* ** (4.17)	0.344901** * (3.89)
Lagged difference in logs of Governance 1	-7.89052 (-1.15)				
Lagged difference in logs of Governance 2		-7.76819* (-1.88)			
Lagged difference in logs of Governance 3			-8.54232** (-2.28)		
Lagged difference in logs of Governance 4				-8.55233** (-2.00)	
Lagged difference in logs of Governance 5					-8.15274** (-3.05)
Sigma	2.57284	2.43709	2.34798	2.41008	2.16209
R ²	0.54002	0.587371	0.616992	0.596466	0.675237
Log-likelihood	-48.0244	-46.886	-46.1038	-46.652	-44.3717
F(2,18)	10.57	12.81	14.5	13.3	18.71
D.W.	1.89	1.89	2.0	1.95	2.04
AR 1-2 test:: F(2,16)	0.57281	0.13118	0.028501	0.027160	0.029781
ARCH 1-1 test: F(1,16)	1.7259	0.74194	1.2782	0.038058	0.27683
Normality test : $\chi^2(2)$	0.75732	0.17726	0.25946	0.13009	0.67898
Hetero test: F(4,13)	0.13223	0.11274	0.11970	0.091947	0.31736
Hetero-X test:: F(5,12)	0.10554	0.084617	0.098547	0.080944	0.24171
Reset test: F(1,17)	2.6225	2.1435	1.9030	1.5202	1.1075

*significant at the 10-percent level; ** significant at the 5-percent level *** significant at the 1-percent level

Governance 1: Total score on 12 governance components (PRS)

Governance 2: Governance 1 less scores on socioeconomic conditions, external conflict, religion in politics, and democratic accountability (PRS)

Governance 3: Sum of scores on government stability, corruption, internal conflict, and investment profile (PRS)

Governance 4: Score on government stability

Governance 5: Score on government stability, corruption, and internal conflict (PRS)

Even as the problem of political stability subsided significantly in the period 1992-2000, spanning the Ramos presidency and the aborted Estrada administration (Figure 4, Panel 3), it reappeared with the deposing of President Estrada (Figure 4, Panel 4). The situation soon deteriorated further owing to the scandals that hounded the successor Arroyo administration, particularly with respect to serious doubts regarding the legitimacy and integrity of the results of 2004 elections. Serious

accusations and evidence¹⁰ that suggested the president had intervened to manipulate the results of the 2004 elections led to mass protests calling for her resignation, a failed cabinet coup (2005), several attempts at impeachment (2006, 2007), as well as various attempted military mutinies or revolts (2006, 2007, 2008). This broke the hitherto established pattern in the post-Marcos era where periods immediately following regular elections were associated with enhanced political stability.

Corruption

Corruption is the second institutionally-rooted governance-outcome that has most palpably influenced Philippine economic performance. But while examples of corruption and their impact on investment are numerous, they are inherently difficult to document and systematise, much less quantify – owing in no small measure to the inherently illegal and clandestine nature of such transactions. An important distinction to be made in this respect is that between “petty” and “grand” corruption. *Petty corruption*, as practised among the lower- to middle-echelons of the bureaucracy, partakes of the nature of a regular activity. It is typically implemented through the implicit collusion among agency-insiders who exercise discretion through the selective implementation of otherwise well-known rules. Better-understood examples of these occur in the revenue-collecting agencies (internal revenue and customs) and some large line-departments (e.g., education, public works, the police and the military) that routinely engage in large-scale purchasing, recruitment, or front-line dealings with the transacting public (see, e.g., the reportage by Chua (1999) on education; for a survey, see de Dios and Ferrer (2001). Such phenomena are largely predictable and can be comprehended as a “going concern”, the channels of which are well known albeit difficult to close off, since they are integral to the regular mandated functions of these agencies themselves. Left to fester at that level, however, such activities are unlikely to cause large enough shifts in investment behaviour that would change the trajectory of a country’s growth. This is because the scope of the functions of low- to mid-level bureaucrats is well defined, transactions are limited in scale, and large deviations would in principle be relatively straightforward for higher-ups to monitor. For such activities to be ratcheted up substantially and the off-take enlarged, the initiative and protection of highly-placed “backers” will be typically required. Smuggling, for example, or even the protection racket for the widespread illegal numbers game (popularly known as *jueteng*), can assume an unusually large scale only when the

¹⁰ The so-called “Hello-Garci” controversy in 2005 was provoked by the emergence of wiretapped recordings of conversations at the height of the 2004 elections between an election commissioner (V. Garcillano), on the one hand, and various candidates, including the president, on the other.

customary operators obtain implicit support and protection from the highest places in the political establishment and are thus able to expand the scope of operations well beyond what is customary. At the point where routine corruption of this sort becomes elevated to a national scale, it graduates into “grand corruption”.¹¹

More typically, however, the conduits of *grand corruption* – defined as “a substantial expenditure of funds with a major impact on a government budget and growth prospects” (Rose-Ackerman 1998) – are projects and deals of a one-off nature involving the disbursement of huge sums (typically running into the billions of pesos). Again these can occur only through the witting or unwitting complicity of centrally placed politicians, in the Philippines, notably the office of the president itself. It is noteworthy in this respect that virtually the only channels for big-ticket national infrastructure in the Philippines are currently (a) official foreign-loan financing, or (b) various forms of build-operate-transfer (BOT) schemes involving the private sector. The budgetary process within congress itself has in the meantime degenerated into a ritual for legislators to lobby for their own local projects. Both foreign-assisted projects and BOTs, on the other hand, have in practice become the prerogative of the executive branch, notwithstanding the formal requirement that ODA-funded projects are listed in the budget. Most major corruption-controversies that have hounded successive post-Marcos administrations were notably all under the purview of executive discretion: these include the PEA-Amari deal and purchase-power agreements in the electricity sector under Ramos; the IMPSA power project under Ramos and Estrada; the NAIA Terminal 3 project that spanned the Ramos, Estrada, and Arroyo administrations; and finally the NBN-ZTE broadband network and Northrail projects under Arroyo. The explicitly political (rather than routine-bureaucratic) nature of decisions taken at higher levels of government also means that the bases for objective evaluation of such decisions become more elusive for the public at large, and the distinction between well-meant executive discretion and corruption becomes blurred.

Corruption discourages investment in that it effectively functions like a tax on the proponent, with the rent being transferred to politicians, bureaucrats, or deal-makers rather than the treasury. The rent itself adds to the cost of any project and therefore reduces the incentive to invest. A corruption rent is inferior to a tax, however, to the extent it can be unpredictable in the magnitude

¹¹ The plunder case filed against former-president J. Estrada serves as an illustration: Estrada was convicted in 2008 of being at the top of the pyramid of bribes involving the running of the illegal *jueteng* numbers-game in different parts of the country. While the running of *jueteng* racket and its protection by local politicians has existed for decades and is common knowledge, the attempted national organisation of its protection and its implicit sanction by the president was an unprecedented leap in scale.

of payoffs asked and unreliable in the (illegal) delivery of the contract to the briber. Cross-country evidence (Campos, Lien, and Pradhan 2001) exists to suggest that the “predictability” of corruption matters. The much-cited paper of Shleifer and Vishny (1993) explicitly suggests, among other things, that the creation of overlapping jurisdictions and multiple centres of veto in post-Marcos Philippines – to the extent that rules-enforcement per se remained weak – may have increased the scope for uncertainty and extent of corruption.

Beyond such effects, however, corruption can also pre-empt competition and new investment by causing the award of vital projects and economic sectors to interests with credentials and talents other than entrepreneurship and productivity, but rather, say, rent-seeking and political extortion. Finally corruption may introduce a bias or distortion in the choice of investments, particularly public investments. Decisions are more likely to correspond to the priorities and conveniences of corruption insiders rather than those of the public at large: the over-specification in recent proposals for information technology for a government broadband and for “cyber-education” are the most glaring examples in the recent period (Fabella and de Dios 2007).

Another aspect of corruption with an investment impact but which is similarly difficult to specify or quantify is the effect of *regulatory capture*. Unlike overpriced equipment purchases, for example, there is no natural benchmark (e.g., a competitive price) that can serve as a point of comparison to detect the occurrence of an illicit sale of rights and rules for political or financial considerations. Regulations typically affect specific sectors, and a proper specification needs to posit pre- and post- or counterfactual situations that are quite idiosyncratic. As a result, the evaluation of the consequences of decisions by regulatory bodies – which are frequently empowered to make such decisions – will inevitably be a conditional matter, so that instead it may be the integrity of process itself that must be ensured.

The reasonable values the Philippines obtains – close to or better than the income-adjusted norm – for regulatory quality and government effectiveness in the KKM data would suggest that little if any institutional problems exist from this aspect. A shortcoming of such data, however, is that they are based on assessments of a general situation, without allowing for a more nuanced appreciation of actual practice in strategic or critical sectors. As already noted, the worsening assessment of corruption tends to dilute the favourable assessment of regulation in principle with the reality of regulation as practised.

It is true enough that after the Marcos period, successive Philippine administrations (especially under Ramos) embarked on a spate of liberalisation and deregulation reforms in many sectors.

Notable successes have been registered in telecommunications, for example, where the dismantling of a monopoly, notwithstanding an imperfect reform, has resulted in increased investment and customer access. Llanto and Gonzales (2007) and Patalinghug and Llanto (2005) have documented, however, how this initial pace of reforms has subsequently decelerated and even faltered in such sectors as shipping, power generation, and telecommunications, with the respective regulatory agencies hesitating to take what are thought to be essential next steps to complete the reform process and create a more competition in their respective industries. At least some part of this must be traced to the intrusion of political agenda in what ought to be independent regulatory agencies.

Llanto and Gonzales (2007:10) call regulatory agencies “a point of political access for purchasing major influence over government policy” on the part of affected firms or special interests, with *entrée* being provided by the fact that in almost all cases, such regulatory and quasi-judicial bodies are made up of presidential appointees with no fixed tenure. In the power industry, for example, new private investment has been held up owing to a badly designed law that allowed cross-ownership between distributors and generators. This has created uncertainty among potential investors who are at a disadvantage with respect to parties with secure contracts with their affiliate distributors. Similarly, telecommunications rules have allowed incumbent telcos to offer value-added services to their own subsidiaries on terms not made available to third parties. The popular suspicion cannot then be avoided that regulatory agencies tend to treat dominant firms in their industry depending on the political accommodation these have reached with the appointing powers. Ultimately, the question raised is to what extent an independent and professional bureaucracy continues to exist in the Philippines given the extraordinary power of the president and the nature of political institutions and transactions.

A worsening of corruption differs in its effect from deteriorating political stability in that the latter can develop quite rapidly and is therefore more prone to affect volatile price variables, such as interest rates and exchange rates, as well as *potential* new investment, particularly direct foreign investment. A rise in corruption, on the other hand, is likely to be more gradual and to be felt and recognised by investors who are *already* present in the domestic economy. It is therefore more likely to affect the overall investment or accumulation rate, e.g., investment as a proportion of GDP, rather than potential investment. (Separate tests – not reported here – show the corollary: that political-instability variables are not a strong influence on the investment rate.)

Empirically, therefore it is possible to test whether corruption, as measured, contributes significantly to explaining the rate of accumulation or of investment. Table 5 contains various

specifications using either current or lagged measures of the corruption index, together with the typically included variables such as real interest rates, lagged investment, or some measure of predicted or past levels of output. In the great majority of these specifications, what is notable is that the corruption index, whether current or lagged, emerges as an important explanatory variable to explain the investment rate, sometimes overshadowing more traditional explanatory variables such as real interest rates or predicted or lagged GDP. Perceived corruption ratings explain easily from a quarter to a half of the variation in the investment ratio.

Table 5: Dependent variable: Investment ratio
(OLS Estimation: annual data)

	Model 1 1984-2006	Model 2 1984-2006	Model 3 1985-2006	Model 4 1985-2006	Model 5 1985-2006
Constant	19.7433 (0.688)	18.24999 (0.647)	10.6855** (3.26)	8.90129** (2.74)	7.93916* (2.45)
Investment ratio (lagged)	0.438040** (2.90)	0.454500** (3.32)	0.276124 (1.60)	0.354844* (2.05)	0.355959** (2.22)
GDP (lagged)	- 0.891797 (- 0.420)	- 0.814160 (- 0.387)			
Real interest rate	- 0.107748 (- 0.312)				0.326867 (1.17)
Real interest rate (lagged)		- 0.0560761 (- 0.181)	- 0.107073 (- 0.2678)		
Nominal interest rate (lagged)				0.0511975 (0.628)	
Inflation rate				-0.0852405 (-0.896)	
Corruption score	1.88295*** (3.88)	1.87210*** (3.86)			
Corruption score (lagged)			2.12317*** (4.05)	2.00497** (3.46)	2.17246*** (4.39)
Sigma	2.02621	2.02984	1.70948	1.7207	1.65483
R ²	0.629827	0.6285	0.734012	0.745481	0.750745
Log-likelihood	- 46.0585	- 46.0997	- 40.8054	- 40.3206	- 40.0907
F-test; (d.f.)	7.656; (4,18)	7.613; (4,18)	16.56; (3,18)	12.45; (4,17)	18.07; (3,18)
D.W.	1.94	1.91	1.61	1.52	1.52
AR 1-2 test: F(d.f.)	1.4294 (2,16)	1.4280; (2,16)	1.6663 (2,16)	1.3081; (2,15)	1.2204 (2,16)
ARCH 1-1 test: F(d.f.)	6.6314; (1,16)	6.5662; (1,16)	0.3333 (1,16)	0.7562 (1,15)	1.0709 (1,16)
Normality test : $\chi^2(2)$	0.35398	0.25006	0.16153	0.90195	0.61942
Hetero test: F(d.f.)	0.47680; (8,9)	0.50364; (8,9)	0.31008 (6,11)	0.38193 (8,8)	0.15077; (6,11)
Reset test: F (d.f.)	11.656; (1,17)	10.013; (1,17)	0.12708 (1,17)	1.4525 (1,16)	2.2161 (1,17)

To sum up the foregoing, political instability and corruption have been demonstrated to have had measurable effects on Philippine economic performance in the recent past, affecting investment directly, as well as indirectly through interest rates. New foreign direct investment has historically

been deterred by the country's history of political instability, causing particularly it to miss the flood-tide of relocating Japanese investments in the wake of the Plaza-Louvre accords. In a gross sense, it has also been documented that the country's rate of accumulation is influenced negatively and significantly by the extent of perceived corruption.

The institutional and historical bases of the recurring problems of instability and corruption are the subject of the next section.

4. Legitimacy and political economy

Political instability in the Philippines is rooted in a recurring problem of regime legitimacy. The country's recent history is replete with threatened or actual political transitions that spilled beyond prevailing formal constitutional rules or severely tested their limits. As a result, the legitimacy of such changes has been laid open to doubt and rendered vulnerable to credible challenges by at least some sections of the population, resulting in political instability.

Constitutional issues

In the post-war period¹², legal adventurism began with the declaration of martial law by President Marcos in 1972 as a means of evading the term-limits set down under the 1935 constitution. Marcos's term was extended thereafter under the ruse of a "transition" government beginning in 1981 that was putatively allowed by the succeeding 1973 constitution. The travesty of two constitutions committed during the Marcos era ultimately provoked a backlash that was equally audacious, the people-power revolt in 1986 (known popularly as the "EDSA 1 Revolution"), which began as an abortive coup d'état and ended as a popular urban uprising.

Although the legitimacy of the Aquino government ostensibly derived from a victory in the 1987 snap elections – and there need be no doubt about Mrs. Aquino's popularity at the time – it was ultimately enforced in practice by a people's uprising and the defection of a large section of the armed forces. The fact that Mrs. Aquino's mandate could be thus disputed opened her to challenges from military forces that attempted several coups d'état – the most violent being in 1987 and 1989 – which in turn wreaked havoc on stability and investment. Gradual improvements in stability came only when Mrs. Aquino made a credible commitment to abide by a new constitution (1987) and credible local and national elections were held thereafter.

¹² It is worth noting, however, that even in the pre-war period, the president of the commonwealth, M. Quezon, also succeeded in manoeuvring a constituent assembly to change the original stipulation of the 1935 constitution and allow a re-election of the president.

The country's next experiment in extra-constitutionalism was the overthrow of President Estrada in 2000 through an abortive impeachment followed by a second people's uprising backed by a withdrawal of Cabinet- then crucial military support. The constitutionality of Mr. Estrada's removal through what is known as "EDSA 2" has always remained in doubt, since it failed to fulfil the conditions as set forth in the existing constitution. As a result, the Supreme Court needed to dig deep for a legal construction that would legitimise Mrs. Arroyo's assumption of power.¹³ That the legal basis for Mrs. Arroyo's takeover of the presidency was less than clear-cut in turn provided a plausible legitimacy to parties that wanted to weaken or topple the government. What finally determined the ensuing legitimacy crisis, however, was the disputed victory of Mrs. Arroyo in the 2004 elections. Ordinarily, the successful holding of elections under constitutional rules should have enhanced regime stability. The emergence of the electoral scandal involving Mrs. Arroyo, however, further diminished her claim to legitimacy, which led to pressure from the political opposition and various civil-society groups for the president to resign, be impeached, or for snap elections to be held, and more seriously opened the administration to several coup attempts (notably in 2003, 2006, and 2007).

At a more fundamental level, however, the tenuous hold of existing formal political institutions cannot be divorced from an historical failure to justify their existence to broader sections of the population, which have at certain critical points become alienated from a system that has failed to respond to their interests and imperatives. In particular, existing institutions have been continually tested by how in how they have accommodated two types of conflict, namely: (a) contests for political power and rent-redistribution between opposing factions of the elite, and (b) demands for redistribution and economic redress originating from the masses and their political representatives. The failure of formal institutions to accommodate these conflicts gives rise to political instability.

Historically, an important effect of formal independence and the introduction of democratic forms was to release centrifugal tendencies that had heretofore been suppressed by the superior force of the colonial government. Pre-existing networks based on kinship and clientelist relations became operative, even though these were ill-suited to a superimposed political system that nominally

¹³ After losing military and cabinet support, Estrada physically left the premises of the presidential palace in the face of an approaching massive crowd, but he never formally signed a document indicating his formal resignation. The supreme court was left to justify Arroyo's takeover as being due to a "constructive resignation". For an account of these events, see Doronila (2001).

aspired to democratic politics and a meritocratic bureaucracy. Families and clans¹⁴ to this day remain the most stable form of social organisation, often trumping anonymous, interest-based organisations in important spheres of public life. Despite the decline of the feudal agrarian settings in which relations of personal dependence were indispensable, personal ties and kinship nonetheless continue to be major organising principles in current politics and business organisation.¹⁵ Using 1997 data, for example, Saldaña (2000) found that half of the largest 50 corporate entities in terms of sales were affiliated with large family-based groups and that these accounted for more than one-third of the sales of the top 1,000 corporations. Through pyramiding structures, such family-based groups managed to retain disproportionate control of many publicly listed corporations.

A further initial condition that has influenced subsequent development is the social inequality that already existed in the colonial period but which was reinforced with the formation of modern political institutions. Originally rooted in unequal ownership of agricultural land, these inequalities have been preserved, even as the asset-base of elites has through time gradually shifted away from agriculture to extractive industries, to finance and trade, to manufacturing, and real estate, and other services. Privileged access to the legal system has historically allowed members of the social elite to establish *de jure* rights over property that was *de facto* owned by the indigenous poor population. Such privileged access has only been moderated but not offset by subsequent economic growth and the spread of literacy and education. Examples range from the *pacto de retroventa* during the Spanish occupation, to the introduction of the Torrens land-titling system under the Americans, to yesterday's headlines on an agrarian dispute between indigenous farmers, on the one hand, and a land-owning family, and a diversified conglomerate, on the other. The dissonance between the application of the formal law (based, as will be recalled, on the less accessible civil code tradition), on the one hand, and common usage and the sense of traditional moral entitlement, on the other, has been a major obstacle to the widespread acceptance of formal institutions in the Philippines. Persistent inequality and mass poverty have, as a result, formed the

¹⁴ Here broadly defined to include not only blood relationships but also close personal ties.

¹⁵ Clan-based politics is described by McCoy (1994), Coronel et al. (2000), and de Dios (2007). Less has been written on closely-held businesses in the Philippines and their implications. But see Saldaña (2000) for patterns in Philippines and Claessens, Djankov, and Lang (2000) for a more general survey. There is probably no single source of the resilience of kin-based organisations, although the following may be mentioned: (a) pre-Hispanic kin- and ethnicity-based social divisions; (b) the required coordination of labour-requirements in rural rice-farming; (c) ideological reinforcement from Roman Catholicism and the organisation of large-scale landownership under colonial rule; and (d) pre-existing Chinese ethnic business practices (*guanxi*, see Perkins (2000)) combined with emergence of the Chinese-*mestizo* class as the business sector at the turn of the century.

basis for a perennial demand for social redress (and the expectation of state intervention in many economic sectors) that place severe constraints on social decision-making, as well as posing constant challenges to regime legitimacy. The intensity and pervasiveness of this social demand are still evident in the various incarnations of reformist and revolutionary movements for agrarian reform and Islamic secession.

From a new-institutional viewpoint, the exogenous introduction via colonial experience of political and economic institutions amid great and persistent social inequities and a parallel network of informal, personal, and kin-based institutions, clearly placed such institutions beyond the reach of the larger part of the population, for whom these forms little more than abstractions. It is unsurprising, therefore, that these would command weak allegiance, at most. Moreover, where the foundations of secular and impersonal state institutions are historically weak, primordial parallel institutions, such as the clan or family, or religious and ethnic affiliations become dominant by default, with their workings being superimposed upon the formal political processes.

Intra-elite rivalry

Since the political elite themselves lacked a clear articulation of common goals and convergence of ideas regarding the state, no clear limits were placed on the pursuit of clan- or even narrowly personal agendas, which could and frequently did spring the bounds of what was permissible under formal political rules. Political processes can be utilised to expand the interests of informal institutions, while the state's deployable resources are a substantial addition to any elite faction or clan's means in pursuit of its goals. Through elite capture, state institutions can, in short, become major instruments of wealth-accumulation (i.e., the "booty capitalism" described by Hutchcroft (1992)). The well-known Philippine phenomena of clan politics, cronies, corruption, and instrumentalisation of the bureaucracy are then a comprehensible consequence rather than an aberration.

Intense rivalry among factions of the elite for a larger share of political power at various levels results from the unrestrained and unstructured pursuit of clan- and individual-interests and the treatment of state-power and state-resources as a common pool and as a means of wealth accumulation. While intra-elite rivalry may be contained in constitutionally ordained processes, such as regular elections in "normal" periods, this competition has also burst normal bounds and threatened political stability, at times resulting in sudden upheavals. The latter frequently occurs when the state's legitimacy crisis worsens. Historically, periods of visible and vocal mass discontent, disillusionment, or political paralysis have triggered attempts on the part of opposing

elite factions to seize power extra-constitutionally, with weaker or stronger appeals to popular support. A clear example was Marcos's declaration of martial law, a major part of the agenda of which entailed suppressing and dispossessing rival elite factions. Such measures, however, were founded on the specious argument that these were meant to head off a Left rebellion that threatened to co-opt the demands of the poor and undermine government. Similarly, the mass or middle-class disillusionments regarding the personal conduct of sitting presidents and the misconduct of elections were, respectively, the motive forces behind EDSA 2 and the most recent attempts at extra-constitutional takeover.

The intensity of intra-elite political rivalry is influenced by the scale and ambition of an incumbent faction's project to redistribute corruption- and other rents. In a "normal mode", only regular flows and incremental rents are up for redistribution, with an implicit commitment to a terminus, as evidenced, say, in the observance of presidential term-limits to turn over power to other elite factions. This was the "revolving-door" regime that originally characterised the two-party system under the 1935 constitution, with "ins" and "outs" alternating in power in a more or less regular manner¹⁶. The authoritarian project of Marcos, however, broke with this pattern in two ways: first, it sought not only to redistribute incremental rents but to reassign even existing property rights (i.e., dispossessing "oligarch" families such as the Cojuangcos, the Lopezes, the Jacintos, and the Elizaldes); second, it sought to extend the term of the incumbent indefinitely through a *de facto* dictatorship, introducing the military for the first time as an intervenor in deciding political outcomes. Apart from the other abuses committed by that regime, this historical break was a principal reason that the resistance and backlash against the Marcos dictatorship needed to be as massive and thoroughgoing. This same *modus vivendi* was what the 1987 constitution implicitly sought to restore and strengthen, with its specific insistence on a single-term presidency.

Similarly, the intensity of opposition to the Arroyo administration is largely traceable to Mrs. Arroyo's privileged (and constitutionally aberrant) position of having been able to stay in power beyond the prescribed six-year presidential term-limit.¹⁷ Further controversy was stoked by serious allegations that Mrs. Arroyo had stolen the 2004 elections (with the alleged complicity of

¹⁶ Between 1949 and 1965, the Liberal and Nacionalista parties more or less alternated in being the party in power, with no incumbent president ever winning re-election, until Marcos in 1969.

¹⁷ Mrs. Arroyo served out the three years (2001-2003) of the unexpired term of Mr. Estrada after he was deposed, and then managed to win a closely contested election in 2004, making for a potential nine years in office until her term ends in 2010.

the military leadership, as well as members of the electoral commission) as well as her endorsement of constitutional change towards a parliamentary system, which it was feared could be used to abolish presidential term limits altogether. Finally – and as a partial consequence of the first two – there has been a succession of grand-corruption scandals that have dogged the Arroyo presidency in its extended tenure, the major ones involving irregular disbursements for fertiliser; campaign contributions from gambling lords; major railway and highway projects; and culminating in the 2008 “national broadband” bribery scandal that involved official Chinese investment financing, the chair of the electoral commission, and a favoured Chinese telecommunications firm.

The threat that an opposing section of the ruling elite might acquire unlimited power – with the unprecedented access to corruption-rents that implies – is the fundamental reason that elite political conflict intensifies to the point where it threatens stability. A willingness to consider extra-constitutional courses of action is especially provoked by the perception that normal rules and processes have been co-opted and legitimate state agencies have been captured by the incumbent, so that the path to a normal turnover has been blocked off. Particularly important in this respect has been the perceived independence of the military and police, the electoral commission, and the judiciary (particularly the supreme court). The unprecedented politicisation of such agencies beginning with martial rule under Marcos – and more lately the perception of the same under Mrs. Arroyo – has been the defining event that led even the formal political opposition to mistrust and consider abandoning constitutional change-processes. From a general business-interest viewpoint, moreover, prolonged political chaos is anathema, so that as long as the threat of expropriation is minimised, the rest of business can find a pragmatic *modus vivendi* with any political project that re-establishes order, regardless of its features or the means by which it assumes power.

Inequality, poverty, and the middle strata

De facto legitimacy has been measured historically and in popular-cultural beliefs by the government’s ability (or credible promise) to provide decent material standards of living among the population. Such beliefs and traditions are of long standing and continuously reinforced in literature, religion, and the press. The ideology of the Philippine revolution, for example, was founded partly on religious and semi-millenarian hopes of earthly salvation among its mass-followers (Ileto 1979). Moreover, reflecting various ideological streams flowing through it, the

predominant Catholic Church has reinforced the ideal of a government with a social-activist role performing a patrimonial role on behalf of the poor.¹⁸

Owing to erratic economic growth and a long-delayed demographic transition, however, the actual reduction of mass poverty in the Philippines has been far slower than the East Asian norm, while the historically legacy of inequality has persisted. Indeed in the most recent period, the incidence of poverty increased, as moderate growth tended to benefit the already-affluent.¹⁹ Given the high ideal expectations of government among the masses and the failure of its most recent strategies, it is unsurprising, therefore, to find ready political fodder for instability in the large numbers of poor people, particularly in urban centres like Metro Manila, where inequality of incomes is most evident. Festering mass disaffection can be and has been utilised to tilt the balance against incumbent administrations at critical junctures. In the aftermath of the President Estrada's ouster from office, for example, the urban poor in Metro Manila – many of whom regard Estrada as an icon of pro-poor populism – formed the main force in the massive demonstrations seeking to topple Mrs. Arroyo and reinstate the arrested Mr. Estrada, culminating in the violent siege of the presidential palace on 1 May 2001 known as “EDSA 3” or “Poor People Power”²⁰. What was ultimately involved was a rare confluence of factors involving: (a) a radical split among the political elite provoked by (b) a serious constitutional issue, namely the constitutionality of Mrs. Arroyo's assumption of the presidency; and (c) an appeal to long-festering disillusionment among the masses regarding their unchanging condition. The potency of this constituency was again demonstrated after the 2004 elections when the issue of formal legitimacy again came to the fore with the “Hello-Garci” wire-tapping scandal and the suspicion that the president may have directly intervened if not cheated to ensure electoral victory.

Recent experience has made clear, however, that poverty and inequality are not sufficient conditions for political instability since, one can argue, while mass poverty has always been historically present, yet political instability has not been equally acute in all periods. This suggests that what is more decisive is the perceived failure of *formal* institutions and the

¹⁸ Most notably, the “liberation theology” current from Latin America, which sympathised with socialism and national-liberation movements, was influential in the Philippine church in the 1960s and 1970s, a period during which many members in the present Catholic hierarchy were educated.

¹⁹ The Philippines' Gini coefficient was a relatively high 44.5 in 2003. Official poverty incidence (headcount) actually rose from 24.4 to 26.9 percent of all families between 2003 and 2006.

²⁰ After Estrada's arrest on 25 April 2001, a growing crowd, consisting largely of the urban poor, massed on the main thoroughfare EDSA from 25 to 30 April, then marched on the presidential palace on 1 May. The violent dispersal and street battles that ensued resulted in four deaths and hundreds injured. On this, see Bautista (2001: 26 ff.).

willingness of the elite and the middle classes to undertake extra-parliamentary or even extra-constitutional courses of action. From a political viewpoint, the existence – and indeed even worsening – of mass poverty and disaffection assumes the character of a pervasive background – a “red-shift” that is ubiquitous and conditioning but perhaps not decisive in importance.

Factions of the political elite at various times have not shrunk from supporting or even initiating extra-constitutional experiments: these have ranged from proposals for snap elections, to forced executive resignations through people’s power, all the way to various forms of military-initiated actions and proposed juntas. As discussed, the impetus invariably appears to be the disruption of the regular routine of elite-changeovers and a perceived threat that an incumbent faction’s ambitious plans to take on unlimited power. On the other hand, owing to what is often perceived as their unvarying destinies under any of the previous regimes hitherto, poorer sections of the populace are in principle susceptible to new projects promising radical reform, whether or not these are accomplished through constitutional means and whether these assume an authoritarian or democratic form.

In these circumstances, it is the middle classes and the intelligentsia (which should be understood some elements of the political elite) that have often displayed a moral and ideological stake in constitutional and democratic processes. This is aligned with the regularity, observed by Easterly et al. [2006] in cross-country data, that a broad middle class is an important factor for the stability of formal governance, a fact that owes largely to the implied consensus that stratum maintains regarding the efficacy of impersonal institutions. Unlike the masses, whose quotidian existence is rarely affected by the results of intra-elite contests, the middle classes have a material stake in outcomes of policy, on which their future progress may depend; unlike the elite, on the other hand, who can actively intervene and lobby in their own behalf, the middle classes must seek refuge in the uniform application of rules. Thanks to the historical legacy of great inequality, however, the numerically small middle class in the Philippines²¹ has often been squeezed in an electoral environment between the numerous poor for whom the prescriptive rules of a formal democracy tend to be reduced to mere forms and abstractions, and an elite that is not beneath distorting such rules to preserve economic and political privileges in intra-elite competition. The two major popular uprisings experienced in the country, for instance, had very distinct middle-

²¹ Virola (2007) reckons that the “middle class”, defined based on a fixed living standard or expenditure-pattern in 1997, actually shrank as a share of the population, from some 23 percent in 1997, to 20 percent by 2003.

class characteristics and agendas²² and were directed particularly against authoritarianism (EDSA 1) and grand corruption (EDSA 2). In both cases, middle-class rage, culminating in direct action, was provoked by evident attempts to frustrate otherwise legitimate processes: by a manipulation of the results of a snap election in EDSA 1; and the obstruction of evidence in an impeachment trial in EDSA 2. From the viewpoint of the middle classes, therefore, the provocation to extraordinary action was the blockade or frustration of legitimate means of redress – hence the paradoxical point that an extra-constitutional action is needed to reaffirm the constitution itself.

Disenchantment with subsequent governance results of past people-power uprisings and formal electoral contests, however, has gradually eroded the political idealism that previously existed among the middle-class, which has given way instead to a growing apathy and reticence regarding political action. It is significant, for example, that the huge controversy over the “NBN-ZTE scandal” – during which the administration prevented the appearance of witnesses in senate hearings – failed to call forth the level of sustained and massive middle-class protest seen in the EDSA 1 and 2 episodes. Opinion surveys (in Metro Manila) taken during this period record that while more than 70 percent of the upper and middle strata in principle shared the sentiment of protest against this scandal, only 16 percent were personally willing to join protest actions [Pulse Asia 2008]. The reasons given by the middle and upper strata²³ for non-participation were also revealing: “there are more important things to do” (30 percent); the fact that no change can be expected whoever comes to lead government (30 percent); and the greater urgency of earning a living (10 percent).

Weakening political engagement and growing cynicism regarding the integrity and efficacy of existing institutions among the middle classes must be counted among the important reasons for heightened political instability. On the one hand, the trend of growing middle-class apathy may mean less volatility, to the extent that a constituency for extra-ordinary and direct action is no longer available. On the other hand, without positive developments – and taken together with intra-elite rivalry and even an political agnosticism and pragmatism of the broad masses – middle-class passivity also renders the country’s institutions vulnerable to extra-constitutional political projects, particularly power-grabs by elite leaders (whether incumbent or out of power) or autonomous actions on the part of the military.

²² Bautista (2001) estimates that many as 56 percent of those who participated in the EDSA 2 rallies in Metro Manila in 2001 could be classified as middle-class if non-income characteristics such as level of education and type of occupation are taken into account.

Concentration of power

If political economy influences the degree of receptiveness by various groups to formal institutions, the distribution of power implied by those institutions also affects the behaviour and motivation of the political actors themselves. A central inducement to corruption and political instability in the Philippines stems from the centralisation of power in the executive branch (de Dios and Esfahani 2001). More powerful than his US counterpart, a Philippine president exercises unprecedented fiscal discretion and powers of appointment. The Philippine president's fiscal powers are particularly crucial. Besides a line-item veto, the president exercises the unusual power to withhold or impound the actual release of already-appropriated funds, allowing him effectively to pursue or realign priorities quite independently of congress.²⁴ Indeed, in recent years, the executive has succeeded in pushing discretion to the point of selectively withholding pork-barrel funds (hitherto deemed an entitlement of legislators regardless of party-affiliation) as a form of retaliation against opposition lawmakers. Apart from this, the president directly disposes over large lump-sum funds (e.g., intelligence funds, social funds, calamity funds) with minimal congressional oversight, as well as the earnings of government-owned and –controlled corporations. Other features enhancing the president's fiscal discretion include the automatic appropriation of a previous year's budget if congress should fail to pass a new one; automatic appropriation of debt-service; and the power unilaterally to select suppliers and negotiate financing for projects involving foreign official loan finance or build-operate-and-transfer schemes involving the private sector. The wide discretion implied by the latter lay at the root of a major bribery scandal in a proposed government broadband backbone (known popularly as the "NBN-ZTE" controversy), as well as a corruption controversy involving the rehabilitation of the railway running north of the capital (the "North Rail" project). Both were subjects of extended public hearings at the senate that dragged in key members of the Arroyo administration and threatened to implicate the president herself or her immediate family.

The president's appointing power is staggering as well. A former chair of the civil service commission has estimated (David 2007) that presidential appointments may number as many as 10,000, ranging from supreme court justices, to members of the military and police hierarchy, members of the commission on elections, board-members in government corporations, regulatory

²³ The base is the 84 percent who were not willing to take active part in protests.

²⁴ Many of these powers were established by authoritarian decrees under the Marcos regime, particularly Presidential Decree 1177, which was largely retained by the Aquino administration particularly during the period of its "revolutionary government" (1986-1989) prior to the election of the first legislature under the 1987 constitution.

agencies, down to minor officials in far-flung cities and municipalities. The depth of the president's political appointments – to as far down as the level of assistant-director in a government bureau – is unprecedented. Discretion in presidential appointments is virtually absolute, with only feeble checks from congress: cabinet members passed over by congress, for instance, may continue in office indefinitely through the simple expedient of being reappointed by the president in an acting capacity.

The president's wide appointing power obviously opens up the system to manipulation and corruption. Career civil servants who fail to toe an administration's line or do the bidding of powerful politicians can be placed in the "freezer", i.e., assigned to nonstrategic or insignificant positions, and replaced with more pliant political appointees. The expected result is a weakening of the independence and integrity of decision-making among the bureaucracy, whose members gradually realise that retaining their position and seniority depends less on inherent merit and more on being in the good graces of the appointing power. Such a phenomenon is most developed and regular in the revenue-collection agencies (internal revenue and customs), where the quest for political patronage and protection originates from the bureaucracy itself, and corruption is part of a going concern. The larger upshot of such micro-behaviour, of course, is that the government's perennial problem with revenue efficiency is never permanently addressed. Doing so, after all, would require a dismantling of the carefully built web of clientelism and corruption that have become the *raison d'être* of the bureaucrats that populate those agencies.

More than a vehicle for corruption, the inferior quality of executive appointments contributes to destabilisation itself when it relates to (particularly constitutional) bodies that guarantee and moderate the political process itself.²⁵ In particular, the poor and biased quality of presidential appointments to the commission on elections under the Arroyo administration was responsible for the long chain of events and scandals that pushed the administration to the brink of overthrow. The "Hello-Garci" wiretapping scandal – strongly indicating that election officials had conspired to manipulate the outcome of the 2004 elections – centred on a personality whose appointment to the elections body was vehemently opposed by civil society groups and election watchdogs to begin with. Similarly the recent uproar in 2007-2008 over large-scale bribery in the national-broadband (NBN-ZTE) project involved the very chair of the elections body (though since resigned), who allegedly sought to broker a multimillion overpriced deal with equipment

²⁵ Apart from the major branches of government, independent offices specified under the constitution include the commission on election, the commission on audit, the civil service commission, the public prosecutor (Ombudsman) and the anti-graft court (Sandiganbayan).

suppliers, using his leverage with the presidency that owed allegedly to favours done in elections past.

Where there is a need to manage the spread of political scandal and controversy, moreover, it becomes almost inevitable to involve more agencies in a widening web of cover-up and complicity. As an administration becomes more beleaguered, therefore, the pressure increases to use executive discretion in making appointments to strategically placed agencies (e.g., to the military, the police, government prosecutors, the courts, and so on) based on proven political loyalties rather than on inherent merit. The danger in this trend lies in the further erosion of legitimacy of such agencies, with ultimate consequences on people's beliefs in the efficacy of governance in general. In the extreme, as already mentioned and as history shows, the pervasive politicisation of appointments could lead to the assessment that all legal recourse has been blocked, and that therefore, only extra-constitutional remedies and direct action will suffice.

One of the major challenges for the country in the coming decades is changing the balance of power in government, away from the executive and mainly towards congress and the local governments. The present administration in particular has illustrated and tested the limits of presidential powers (e.g., declaring a state of emergency; invoking executive privilege; concluding executive agreements without congressional approval; persistently reappointing persons passed over by the congress, and so on). Congress' subordinate and financially supine position has meant it has failed to assert its prerogatives (de Dios 1999), with only the supreme court in recent times interposing objections to the further expansion of presidential powers. The result has been a growing culture of impunity within the executive branch, with the negative consequences already mentioned regarding opportunities for corruption and regulatory capture, and the open invitation from opposing elite factions for a more radical response.

To summarise: political instability and corruption have clearly affected long-term Philippine growth and investment. These, however, merely point to deeper roots of institutional dysfunction. Factions of the elite have exploited the fact of glaring social inequalities, on the one hand, and the concentration of political power at the centre, on the other, to engage in struggles for political power that test and occasionally spill beyond constitutional bounds. The substantial prize in these contests consists of the corruption-rents and the reassignment of rights made possible by the capture of political power, particularly of the executive branch. Extra-constitutional elite projects are possible – and indeed could occasionally succeed – because the hold of formal political institutions (superimposed owing to colonisation) on the greater mass of the population has been weak, abstract, and historically dominated by elites. More accessible to the majority are informal

relationships based on personal ties and kinship; but these correspond poorly with the prescribed impersonal and meritocratic values of the formal political and economic institutions. In the meantime, the middle classes, a natural constituency for the spread of impersonal rules and public accountability, are numerically weak and increasingly disillusioned with the historical experience of governance and with political life more generally. Absent intervening factors, such circumstances render current political institutions vulnerable to capture by narrow elite interests or to prolonged social conflict that paralyses social decision-making.

Taking a longer and larger view, the difficulty for Philippine society becomes evident: its historically inherited formal institutions are far from optimal in that they do not correspond to people's beliefs, customs, and expectations. For this reason, such institutions fail to command people's allegiance or fully regulate their behaviour. The result is institutional instability with its concomitant consequences –social fractiousness and corruption.

5. Recommendations and conclusions

From some perspective, the foregoing may be seen as vindication of a point made by North, Wallis, and Weingast [2006], who argue that economic and political institutions are mutually reinforcing, so that “limited-access order” societies like the Philippines may find it difficult to move forward by means of social and political institutions that seek to enforce impersonal rules, meritocracy, and democratic processes – i.e., institutions that presuppose societies with highly-developed economies, contestable markets, and pervasive social organisations based on objective secular interests beyond kinship. The country's failure to bring the actions of its elites to heel under the rule of law; its difficulties in forming enduring social organisations that go beyond personal ties and kinship; and its erratic record in controlling violence, particularly from the military – all point to the distance Philippine society needs to traverse before it can create the conditions to escape underdevelopment.²⁶

The momentous question is whether attaining those threshold conditions is more likely if the country pursued a *different* institutional path. To be sure, the “Asian values” debate of some decades past suggested that greater social order and congruence with grass-roots beliefs and expectations – hence more rapid growth – might be better achieved under authoritarian and

²⁶ This enumeration closely corresponds to what North, Wallis, and Weingast (2006) have termed “doorstep conditions” for the transition from “limited-access orders” to “open-access orders”.

paternalistic institutions that regularly create and dispense rents in order to buy social peace.²⁷ Nor has there been a shortage in the Philippines of harbingers of retro-authoritarianism (as well as a few thoughtful individuals²⁸) who point to the all-too-obvious inadequacies of formal democratic institutions to advertise the potential benefits of more authoritarian political institutions.

This paper on the other hand contends it would be foolhardy and costly to radically change the country's direction of institutional development. Such an argument is based on the simple assessment that the traverse is itself likely to be costly, chaotic, and fraught with social risk. The difficulty presented by the Philippines to social scientists lies in its ambivalence: on the one hand, there is the observable disconnect between the real behaviour of the majority of the populace and that prescribed by formal institutions; on the other hand, there is an almost hegemonic clamour for and acceptance for "open-access order" political institutions in public discourse and rhetoric. This is strongest among the middle classes and the intelligentsia (including the Catholic Church), who have been educated and socialised into democratic values; but it also finds support among the more conservative sections of the elite who fear the challenge that radical changes pose on existing property rights. It may be more prudent, given this, to inquire instead into the possibilities for incremental change under the present institutional set-up that could bring the country closer to threshold conditions. The three broad directions in which this might occur are as follows: (a) greater adherence to constitutional processes; (b) a reduction of presidential prerogatives within the present constitution; and (c) a rebuilding civil society and the spread of political education and organisation.

Elections and adherence to constitutional processes

First, there is an obvious need to promote the greater adherence to constitutional processes and limits. This is required if society is to escape the downward spiral of diminishing legitimacy, where both incumbent elite factions and those who oppose them constantly threaten to infringe normal constitutional limits in order to retain power or seize it. Moving forward, people and government both need to make a common investment in the infrastructure of secular constitutional processes that should be allowed to operate normally and regularly, regardless that

²⁷ North, Wallis, and Weingast (2006:36) argue that rents are an indispensable feature of limited-access orders, since these are necessary to secure the elite's political ends, such as, e.g., buying political support from the masses, or from allies. As a corollary, the proscription of rents in such a context would undermine social order. Some writers (e.g., Jomo and Gomez (2000)) have sought to explain Malaysia's discriminatory *bumiputra* policy under Mahathir Mohammed in this fashion.

²⁸ The most consistent has been the prominent business leader Mr. Washington Sycip. On this, see Fabella [2007].

the results fail to conform immediately to immediate elite interests, or to middle-class or religious ideals.

The crucial condition is the restoration of the credibility of the electoral process, which has been severely tarnished by recent electoral controversies and other scandals involving electoral officials. Reforms in this area are particularly urgent in the light of approaching presidential elections in 2010.

Towards this end, there is a need for a thoroughgoing revamp of the commission on elections through the appointment of competent and professional members that command the acceptance and assent from all parties and civil society. It is worth seriously considering the possibility of removing the appointing power from the president and vesting it instead in a special body for the purpose involving both the legislature and the supreme court, in the spirit of electoral tribunals.²⁹ Short of a constitutional change and as an interim measure, the president might make a public commitment to henceforth appoint members of the commission from a small set of nominees openly submitted and scrutinised by an impartial public body.

Operationally, the completion of the long-delayed modernisation and computerisation of the voting and canvassing is indispensable.³⁰ The currently tortuous process of manually tallying and canvassing votes (with a tedious stepwise aggregation of election returns at municipal or city, provincial, and national levels) is the single most important circumstance that renders the present system highly vulnerable to the manipulation and misrepresentation of election results. That it is still possible to delineate spheres of public life and place them beyond the operation of narrowly partisan interests is demonstrated by the transformation of the central bank into an independent agency and the abiding public trust vested in the supreme court. The electoral commission itself is also probably in need of a radical reform that will professionalise its lower echelon personnel and expand its coverage and organisational capacities. A professionalisation of the electoral commission is also necessary if the role of the military and the police in elections – heretofore controversial and suspect – is to be clearly delineated and substantially reduced.

Beyond the conduct of elections themselves, reforms pertaining to campaigns and election-finance should also be placed on the agenda of a national debate. Particularly important are

²⁹ Article VI, Sec. 17 of the constitution specifies the composition of electoral tribunals.

³⁰ As of this writing, there has only been agreement to implement a computer-aided system during the special elections in the autonomous Muslim region. The computerisation of the 2010 elections hangs in the balance

effective disclosure requirements for large campaign contributions imposed on both candidates and donors. Candidates themselves may be required to agree to disclosures of assets and interests, while extraordinarily large campaign contributions can possibly be monitored administratively as part of the country's money-laundering laws.

Serious questions regarding the integrity of elections have repeatedly been the trigger for prolonged political instability in the past. The recent series of controversies over election irregularities and the involvement of high electoral officials, particularly the large public outcry it provoked, aside from the instability it has caused, on the other hand also provides a unique opportunity for action – namely, a political crisis that is the impetus that galvanises multi-sectoral action on an issue.

Limiting executive power and strengthening the bureaucracy

Limiting the scale of intra-elite competition implies not only keeping conflict within the bounds of existing rules, but also reducing the size of the prize itself. The magnitude of resources, effort, and ambition expended on political competition more generally is directly related to the huge resources and wide discretion associated with the presidency. It therefore stands to reason that the scale and violence of intra-elite contests can be reduced if the presidential power is credibly reduced.

Key steps must include an effort to reduce by statute the president's powers of appointment in favour of ensuring the integrity and security of tenure of the career civil service and enlarging the role of the other branches of government and civil society organisations in the selection of members of constitutional bodies. A landmark step would be a sharpening of the civil-service law to limit direct presidential appointments only to the level of assistant secretary or its equivalent. Members of regulatory bodies should generally be appointed to fixed terms (the monetary board being an exemplary success in this respect). Strengthening the independence and professionalism of the sub-cabinet bureaucracy should permit them to resist political behests to justify grand-corruption. This weakness on the bureaucracy's part and the lack of clarity and integrity in internal processes was, after all, what allowed the intervention of hangers-on and high-level fixers to intercede and pervert policy and project decisions, such as occurred in the NBN-ZTE broadband deal.

In the same spirit, and as part of an effort to extricate the revenue agencies from the milieu of political patronage, earlier proposals to corporatise them (while binding agency heads to a system of performance contracts) should be seriously revived in the legislature. The point is to improve

incentives as well as to strengthen those agencies' hiring and firing powers as part of the plan for massive recruitment of new personnel for these agencies.

Appointments to offices dealing with the investigation and prosecution of corruption cases within government are particularly crucial and should be treated with same circumspection as those for constitutional bodies. The independence of the department of justice, the solicitor-general, the ombudsman's office, the police, and the higher courts are particularly sensitive and would benefit from a transparent selection process that involved civil society and other branches of government. The point is to reverse the current situation, in which the independence and integrity of agencies with a role in anti-corruption efforts are highly suspect, owing to the perception that these offices have been thoroughly politicised and co-opted to favour the incumbent administration.

Equally important are the appointments to agencies vested with regulatory powers that draw up guidelines for strategic economic sectors. Chief among these are regulatory or quasi-judicial bodies dealing with power, telecommunications, and air, sea, and land transportation. There is a need not only to improve the quality of appointments to these bodies themselves, but also to invest in the investigative and analytical capacities of their professional staffs to create a countervailing force within government against the capture of such bodies by vested interests. For the same reason, a larger investment in professional staff and an independent capacity to undertake feasibility studies is needed in the National Economic and Development Authority to offset the bias in favour of donor- or supplier-driven projects. A credible commitment to exercise executive discretion prudently could take the form of a published set of procedures (e.g., submitted to congress) in approving foreign-assisted or build-transfer projects, as well as the disclosure of feasibility studies and other supporting documents leading up to project approvals.

The vast fiscal powers of the president need to be curbed and the role of congress in the budget process strengthened instead. This means systematically involving congress in a year-round review of national expenditures (i.e., engaging legislators beyond the budget period); reducing lump-sum allocations over which the president has discretion; and instituting congressional oversight to review prospective foreign borrowing for various projects.

A major step to increase congressional responsibility for the government's spending programme would involve passing legislation limiting or removing presidential discretion in the release of funds appropriated by congress: this would essentially constrain the administration to fully spend for each fiscal year whatever amounts congress has passed and according to the priorities outlined

by the latter.³¹ Such a measure would obviate the need for individual legislators to become subservient to the executive branch simply to have the funds released for their constituencies.

A further reduction of presidential power would be helpful if applied to devolving more power to local governments; in particular, the formula for internal revenue allotments to local governments should be redesigned to at least partly reward local governments that effectively exert their own revenue efforts.

In principle, many of these changes could be addressed in one fell swoop through constitutional amendments or perhaps a shift from a presidential to a parliamentary system. In practical terms and given the low level of trust for government, however, *any* proposal to change the constitution at this time will – for good or ill – be suspected as self-serving. The more prudent course, therefore, is to seek smaller changes within the ambit of the current constitution; this will be less destabilising than open-ended charter reforms that have historically been an opportunity for the realisation of ulterior motives and extra-constitutional projects.

On a more general note, the reduction in the powers of executive is compatible with and reinforces a smaller role for government in the economy. Fewer government corporations and the sale of government shares in companies not inherently imbued with a public-goods character would be a step towards curtailing the patronage that comes with the appointment of government representatives to these entities, as well as reducing economic inefficiency and promoting competition. It may well be true – as North and his co-workers have suggested – that such rents are essential in sustaining a limited-access order, so that the demand for smaller government disturbs that correspondence between economic and political spheres. On the other hand, real progress will require one to upset that equilibrium in any event; and in this instance, the almost universal political outcry against corruption at this time – an outcome of a history of scandals and anomalies – may motivate a real economic change, reconstituting the political-economic equilibrium on a slightly higher plane.

Rebuilding the constituency for reform and political education

It is ultimately convergent expectations that the rules governing public life do work – and the fact that these are normally serviceable – that yields political stability, stabilises investor expectations, and gives a fair chance for superior economic growth to occur. The historical heterogeneity of

³¹ This would require a review and revision of Sections 43, 44, and 38f, among other provisions of Presidential Decree 1177.

Philippine society, however, currently militates against this occurring: instead it causes a dangerous feedback from inequality to divergent beliefs, to political instability and corruption, to low growth and high poverty, and thence again to further differentiation.³²

The crucial question then is as follows: where will the constituency for future changes and reforms come from, and what will induce elite factions to so moderate their conflict so as not to become destabilising?

One source of anxiety in the present situation lies in the growing mood of despair among many of the intellectuals and middle classes and their waning interest in further participation in the political system itself – i.e., the decimation of civil society. This is particularly true for those with the option of “voting with one’s feet” to seek institutions more in accord with one’s beliefs.³³ Left unchecked, such a trend would mean an even smaller and weaker constituency in support of formal political institutions that were accountable to the public interest – which would be an invitation to greater impunity and more intense rivalry among the political elite, hence a deeper legitimacy crisis.

On the other hand, the present stability in economic circumstances situation (and caused partly by that very trend, i.e., the migration overseas with the resulting return-flow of remittances) may itself afford a small opening, to the extent that it affords upward social mobility and a higher education among a larger number in society. In one sense, therefore, even the middle-class diaspora may be helping to recreate the future middle classes. If the example of successful middle-class civic organisations (e.g., *Gawad Kalinga*) are any guide, then the process of repoliticisation begins not from explicitly political organisations themselves but from common professional, business, civic, or local interests that build up a sufficient solidarity to hold political institutions to account. It should also be noted that economic differentiation over the past decades due to goods- and capital-flows liberalisation has created a section of big business with a greater stake than before in long-term political stability. Typically larger, more established, and diversified interests (e.g., conglomerates like the Ayalas and the *taipans*, or large Filipino-Chinese business people) have emerged that are less bound up with lobbying for advantage in

³² The gulf in political values becomes evident, for example, as between the middle classes and the masses (*masa*) in their differing appreciations of the judicial fate of former president Estrada, both before and after conviction – what was perceived by some as the operation of the rule of law is regarded by others as unusual and demeaning punishment for a popular leader (Bautista 2001).

³³ In some public-opinion surveys, as many as a fourth of adults from the rich to upper-middle classes and from the educated express a preference for living and working abroad permanently.

narrow economic sectors. Like the middle classes, these, too, are potentially a part of a reform constituency insisting on adherence to constitutional rules regarding transition and turnover (since political unrest could endanger the value of their holdings) and an even-handed policy on (since their size and ubiquity implies they need not cater for any sector in particular). The Philippines will have reached a threshold of a sort at that point where powerful elite interests come to realise that the common cost to them of seeking large changes in rules may be far greater than simply operating under existing ones. But such a point cannot be reached without a re-involvement of other social sectors that are willing to stake a claim in the existing order.

The remaining question then becomes whether and how to speed up the re-engagement of such new emerging elements in the rebuilding of the country's ravaged institutions.

Annex Table 1: Deviation of Philippine governance scores from mean controlling for per capita GDP¹

Governance Indicator	N	Deviation ²	P-value ³	Significance ⁴
Voice and Accountability				
2006	180	0.04	0.50	
2005	180	0.26	0.00	***
2004	180	0.18	0.00	***
2003	183	0.27	0.00	***
2002	179	0.34	0.00	***
1998	179	0.62	0.00	***
1996	176	0.42	0.00	***
Political Stability				
2006	180	-1.03	0.00	***
2005	180	-0.83	0.00	***
2004	180	-1.01	0.00	***
2003	179	-1.00	0.00	***
2002	175	-0.45	0.00	***
1998	175	0.12	0.08	*
1996	171	-0.27	0.00	***
Govt Effectiveness				
2006	180	0.22	0.00	***
2005	180	0.16	0.00	***
2004	180	0.03	0.49	
2003	179	0.05	0.27	
2002	179	0.04	0.33	
1998	179	0.02	0.65	
1996	173	0.17	0.00	***
Regulatory Quality				
2006	180	0.16	0.00	***
2005	180	0.19	0.00	***
2004	180	-0.06	0.20	
2003	179	0.17	0.00	***
2002	179	0.16	0.00	***
1998	179	0.69	0.00	***
1996	174	0.80	0.00	***
Rule of Law				
2006	180	-0.22	0.00	***
2005	180	-0.17	0.00	***
2004	180	-0.39	0.00	***
2003	179	-0.35	0.00	***
2002	179	-0.32	0.00	***
1998	179	0.13	0.01	***
1996	162	0.23	0.00	***
Control of Corruption				
2006	180	-0.47	0.00	***
2005	180	-0.35	0.00	***
2004	180	-0.31	0.00	***
2003	179	-0.20	0.00	***
2002	179	-0.32	0.00	***
1998	179	-0.15	0.00	***
1996	146	-0.22	0.00	***

Source: Own computations based on Kaufmann, Kraay, and Mastruzzi (2007)

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