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Philippine industrial policy? Why not?

Manuel F. Montes*

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Recent changes in trade policies in developed countries are sparking new interest in industrial policy programs. Among developing countries, failures against expected outcomes of structural adjustment programs in Latin America and Africa versus the perceived development successes of East Asia generate lessons about how different configurations of industrial policy can be more effective. This overview paper presents a definition of industrial policy and surveys the arguments for and against industrial policy. In the Philippine context, the consideration of industrial policy is a contravention of the state project since the 1980s to rely on an open trade regime as a key pillar of a development strategy. In the last decade, however, numerous legislative initiatives have sprung up to support industrial policy interventions. The papers in this volume represent updated thinking about industrial policy challenges and opportunities as they apply to the Philippine situation.

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“There’s nothing you can do that can’t be done.”

Lennon and McCartney [1967]

“All You Need is Love”

1. Introduction

The studies in this volume explore the issues in industrial policy as these could apply to the Philippines, in the midst of ongoing distinct shifts in international views and unmistakable redirections¹ of public policy, especially on the part of developed countries. In the Philippines, as illustrated in the comments of discussants, the political/policy contestation over this framework continues. The authors of the papers in this volume are proponents of a more deliberate use of industrial policy in the Philippines, while national policy debaters agonize over whether industrial policy should be considered at all as part of the public policy

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¹ Juhász et al. [2024:221-222] document the unambiguous shift in international policy stances.

toolbox. In the meantime, legislative initiatives and actual legislation which mandate industrial policy motivated state interventions have proliferated.²

The Philippine economy emerges from a roughly 30-year effort of relying as faithfully as possible on an open trade regime as the touchstone of its development strategy. Prominent policy experts have been consumed by the need to stamp out vestiges of import-substitution and head off new industrial policy initiatives. The papers in this special issue allow us to consider how new analyses and approaches to industrial policy might be more effective in the current context.

2. What is industrial policy?

There is a widespread perception among the global policy elite that the view about the undesirability of industrial policy is being discarded³ (see, for example, Evenett et al. [2024]; WEF [2023]; Shih [2023]). There is a related perception that economic policymaking, especially in the developed world, has tipped decisively toward a revival of the explicit⁴ practice of industrial policy. It is not clear if industrial policy, whether hidden or explicit, as a policy ever ended in developed countries. Given the relentlessly persistent contempt that has greeted developing country measures that are seen to fall into “protectionist” or “de-globalization” schools, it is also not clear if industrial policy ever really ended in developing countries.

Taking off from Chang [1996:60], this discussion classifies as industrial policy state actions “aimed at *particular industries* (and firms as their components) to achieve outcomes that are perceived by the state to be efficient for the *economy as a whole*.” Industrial policy must be marked

by selectivity as far as industries are concerned. Differential tariffs, financial support for specific sectors of industry, and tax and import privileges for specific sectors are examples of selective state policies. State policies that support an increase in capability of the whole economy, such as expenditures on education, are not properly part of industrial policy. [Memiş and Montes 2008:4]

Genuine industrial policy picks not only “winners;” it also chooses “losers”, either explicitly or implicitly, the latter if only in general equilibrium terms. General equilibrium models, especially when practiced as the innumerable

² For example, the Tatak Pinoy (Proudly Filipino) Act, designated as Republic Act No. 11981 became law in February 2024.

³ The “revival” literature has proliferated in the last four years or so and will not be reviewed here. Evenett et al. [2024] herald the creation of a data base called the New Industrial Policy Observatory (NIPO) housed in the University of St. Gallen in Switzerland.

⁴ In the case of the US, for example, Wade [2017] points to its longstanding, often hidden, practice of industrial policy.

evaluations of free trade agreements, provide some capacity for identifying in advance losing⁵ sectors resulting from accession to these kinds of agreements.

The extensive retreat from import-substitution policies by developing countries in the 1980s and its aftermath informs the reconstructions of the concept of industrial policy. In many developing countries, open trade policies, privatization, and deregulation appeared to promise ready-made solutions to political ills—corruption and bad governance [Krueger 1992]. Efforts, often heroic, to apply open trade policies, privatization, and deregulation did not necessarily lead to the end of these sociopolitical ills; in some cases, especially those involving privatization, these programs aggravated national political vices. Disappointing economic results, particularly regarding stronger export performance and lower dependence on external debt financing in Africa and Latin America attended economic reform programs designed according to the open trade paradigm [Cherif and Hasanov 2019; Ainginger and Rodrik 2020]. The onset of another external payments crisis often constituted the aftermath⁶ of a trade liberalization program [Montes 2021].

The failures of post-liberalization programs also disinter the macroeconomic malfunctions of industrial policy pre-liberalization. The cumulated cost of tax expenditures and subsidies motivated by industrial policies have often been “singled out” as the source of chronic fiscal deficits and pronounced levels of sovereign debt. Tradeoffs among the fiscal costs for different privileged sectors through time cannot be avoided. Legislative logrolling which can result in a proliferating set of industrial policy supported sectors can prove macroeconomically costly and unwieldy in terms of accountability, even as the space for wider tariff dispersions under industrial policy can potentially contribute more fiscal resources in net terms.

New thinking on industrial policy is also informed by the experiences of the few countries generally regarded as ‘successful’ in development since the 1980s—the Republic of Korea, Taiwan (China), and the People’s Republic of China. Intense attention to exports and the applicability of industrial policy not just to industry but also to agriculture and to services sectors are now generally accepted as “good practice” in industrial policy. Balaoing-Pelkmans and Mendoza [in this

⁵ While I have mentioned this issue in a footnote in an earlier piece [Montes 2021], I have yet to find an analytical piece about why the practice of trade liberalization has almost invariably featured (1) minimal Pareto-triggered compensation to the losers and the budgeting of adjustment costs for losers and (2) the absence of new resources—in practice, reduced resources when undertaken within a sovereign debt resolution program—to finance new investment seeking to respond to the new price vectors trade liberalizations is meant to afford. General equilibrium-based evaluations have difficulty incorporating “credible” capital-augmenting investment equations such as in Petri and Plummer [2016], Park et al. [2021], and Capaldo and Izurieta [2018].

⁶ In structural adjustment programs, there could be a “time inconsistency” between the speed of trade liberalization as the government chases quantitative targets toward the timely release of the next program tranche. The resulting rapid rise of imports not matched by the projected improvements in export performance which must be built with bricks and mortar needs to be financed externally [Montes 2021; Winters 2004].

volume] seek to throw light on the country's poor manufacturing record, before and *after* liberalization; their paper directly examines the structural interactions among the main economic sectors.

Cases of successful application of industrial policy to agriculture in particular have garnered attention. The emergence of export activities in cut flowers (Ethiopia, among other countries) and out-of-Northern hemisphere season fruits (Chile, South Africa, among other countries) are part of the industrial policy lore. To the extent that fishery is “part” of the agricultural sector, Chile's exports of salmon and sea bass (Patagonian toothfish) are other examples.

In developing countries, agriculture is the sector with the greatest number of private small-scale enterprises and presents itself as a fertile area for productivity and income upgrading. In the Philippines, in the last decade, the reform of government agricultural policies became a prominent feature of debate and political contestation. As in other sectors, protection from imports—too much industrial policy, as it were—was seen as a foremost cause of the stagnation of agriculture productivity and its removal a prime target of reform. The passage in 2019 of Republic Act No. 11203, or the Rice Tariffication Law, in which tariffs replaced quantitative restrictions, has removed this impediment. In theory, the tariff revenues represent new resources for financing programs to raise the productivity of the sector. The debate has mutated into another impediment—the land reform program's restrictions on land consolidation as an obstacle to productivity upgrading and for attracting foreign investment. Any discussion of possibly applying industrial policy tools—government interventions other than tariffs—in the agricultural sector appear to be obstructed by the debate over yet another impediment originating in the blockages over land consolidation.

In countries perceived to be successful practitioners of industrial policy (e.g., Israel), industrial upgrading has been significantly accelerated by state facilitated national innovation systems⁷ which stitch together university, private sector, and state research agencies to drive product development and upgrading, with the end in view of introducing commercially profitable goods and services. Aldaba and Aldaba [in this volume] explore the challenges of this important element of industrial policy.

In contrast to earlier periods, there is increased research interest in mechanisms of corruption which could later prove useful for better understanding governance debilities, as constraints over and disablers of industrial policy practice.

2.1. Why should a government NOT even try to do industrial policy?

The costs of protection of domestic production against imports—and industrial policy in general—is an old⁸ question and has merited a lot of political

⁷ See Chapter V in UN [2011] for a survey of the elements of national innovation systems.

⁸ In 1848, Marx's [1848] “On the question of free trade” characterized the “Repeal of the Corn Laws in England” as “the greatest triumph of free trade in the 19th century.”

discussion and analytical methods and empirical estimation. There have been two dimensions to the question of why a state should not even try to make industrial policy: analytical and practical.

The modern **analytical** case against industrial policy builds on Ricardo's theory of comparative advantage updated to modern parlance in the Heckscher–Ohlin–Samuelson (HOS) model. For purposes of this discussion, the following key features of this model are: (1) unfettered free trade permits each trading party to take advantage of resources and production inputs it has on hand in relative abundance; and (2) if other trading partners do not practice open trade, including as a consequence of industrial policies, it is costly directly to them, and other parties can minimize the cost to themselves by continuing to practice open trade. An immediate implication is that the most appropriate response on the part of developing countries to the rise of industrial policy in the North is to maintain their open trade policy stances. Abrenica and Sabarillo [in this volume] examine empirically whether indeed industrial intervention can benefit or hurt the Philippines in the context of the current US-China trade “war.”

To reach the equilibria near which the HOS model's beneficial policy impacts are derived, markets must allow the smooth transfer of resources from one sector to another. Otherwise, unfettered free trade will not equalize labor and capital incomes among economies at different levels of development. Diminishing returns to scale is mathematically critical to this result—Samuelson [2004] emphasizes this point. The absence of diminishing returns often has provided arguments in favor of state intervention. Bartelme et al. [2024:1] suggest the “existence of sizable economies of scale across manufacturing sectors . . . opens up the possibility of substantial wedges between private and social costs of production.” However, in the same piece, the empirical application of the analytical model does not indicate substantial quantitative gains from industrial policy.

The **practical** case against even attempting industrial policy (and conversely to justify its comprehensive elimination) is broadly presented in Pack and Saggi [2006]. Pack and Saggi perceive industrial policy—if done properly—as a response to informational gaps and uncertainties. They consider industrial policy as quite a complex undertaking, which few governments are capable of managing. Decisions over the use of industrial policy appear to many pundits to demand high caliber state management or upgraded governance capabilities as a precondition. In this view, advances in industrialization on the part of successful countries have been less the result of intentional state intervention—including as measured by the relative proportion of investments in eventually successful sectors—and more a matter of serendipitous outcomes of working relations with foreign producers and foreign buyers.⁹ Since industrial policy does “not work”

⁹ Successful exploitation of the termination of the WTO Agreement on Textiles and Clothing (ATC) by a few Asian countries were anchored on working with jobber firms (which in turn coordinated the purchasing activities on behalf of international brand name marketers) that controlled the quota allocation system when that system was in place [Montes 2019].

or is “too complex” to make it work and is costly in general equilibrium, i.e., “microeconomic”, terms, countries with “weak states” [Fabella 2018] are well-advised not to *even* try industrial policy.

The analytical and practical warnings are consistent with the retreat undertaken by many developing countries from industrial policy in the 1980s. However, seen as a political event—in the case of developing countries, a pivot in development strategies—the retreat itself can only be fully understood in political terms, as would be the case, anyway, in all changes in public policy. While interpretations have been controversial (discussed, for example, in Wade [2013]), there has been a growing perception that some countries in East Asia have been more successful in development terms than others even without a general withdrawal of state industrial intervention [Cherif and Hasanov 2019].

At stake for every country/every society at this juncture is whether another policy pivot is timely and whether local politics are aligned for effective industrial policy, effective in the updated or modern sense of industrial policy, of, say, more export-oriented or more selective policies. At this point, most policies embodying a policy pivot back to industrial intervention must contend with international restrictions on such policies, which have been codified in WTO and free trade agreements. Most of the recent infringements on these disciplines are being committed by authorities in economically advanced countries.

Arguably, realigning government policy closer to “dirigiste”—to use a previously loaded term—policies have been sparking new thinking on the part of national policy designers and decision-makers. The HOS model recommends the ideal array of trade policies with unfettered trade as the finish line. International agreements have restricted the space for state policy which, in turn, secures the space for private decisions [Lawrence 1996] and pulls societies closer to that finish line. These obligations—written on the tablets of trade agreements—absolve domestic authorities and politicians from a significant amount of democratic accountability for decisions of commission or omission over policies with society-wide, often long-term, impact.

Irrespective of whether the Philippines can succeed in reaching the holy grail of a truly HOS-grounded policy pathway, Williamson and de Dios [2014:47] suggest that beginning in 1970 and decisively after 1982, the country has strayed from the catch-up path shared with other countries through import-substitution. They find that “political instability, institutional weaknesses, liberalization policy, labor emigration, and Dutch disease”¹⁰ present unmovable barriers to Philippine industrialization. From an industrial policy lens, the question is whether there are state or state-private sector cooperative policies—at costs Philippine society can absorb—that can shatter these barriers.

¹⁰ Osmani [2019] interprets Nepal’s growth record and development prospects in a similar vein as being overly dependent on remittance flows.

For the sake of completeness and beyond the classic¹¹ references, such as List and Hamilton, Thirlwall [1979;2011;2019] makes a macroeconomic argument¹² that has been deployed to advocate the application of industrial policy in developing countries. In an extension of the Harrod-Domar model, this model suggests developing countries must wrestle with their balance-of-payments constraints in the process of growth by moving away from imports with high domestic income elasticities and expanding exports with high international income elasticities. Countries condemn themselves to periodic balance-of-payments crises if the growth process mainly increases imports with high income elasticities. The considerations that emerge from the Thirlwall research agenda are an antidote to the proposition that economies with chronic fiscal and balance-of-payments deficits “cannot afford” to devote scarce resources to industrial policy.

This takes us to the question of the political economy of government intervention in all its forms. Arguments over government intervention pivot over the primacy of private actions over government¹³ actions in the matter of economic processes and outcomes. States, most particularly the Philippine state, are seen to suffer from informational and resource infirmities. Debaters deploy anecdotes and case examples to support their side¹⁴ of the argument.

2.2. Why consider doing industrial policy at all?

Aiginger and Rodrik [2020:190] portray many of the political pressures that appear to have triggered the change in course on industrial policy but suggest that the question at hand should be

what shape industrial policy should take in this period of disruptive political and technological change. How can policy makers craft an industrial policy that is future- and welfare-oriented, which not only mitigates market failure, but also addresses society’s most important social and environmental challenges, without stoking national chauvinism.

This approach continues the political pose that industrial policy advocates used to take during the dark days of unfettered free trade dominance. Advocates

¹¹ Friedrich List’s classic work was entitled the National System of Political Economy in 1837, and Alexander Hamilton’s was entitled Report on the Subject of Manufactures, a report to the US Congress in 1871.

¹² Empirical applications of this model have been in applied in many developing countries, most recently, see Lockwood [2022] in Indonesia.

¹³ See also Yap and Turla [in this volume] about how an industrial policy lens privileges a relation of cooperation, instead of substitution, between public and the private sectors and the role of feedback loops.

¹⁴ Tendler [1995;2018] is notable for suggesting that the boundaries of capabilities, decisions, and activities between the private and public sectors are quite blurred (and not a matter of Manichean rivalry). One insight that can be gleaned from this writing is that a fully formed private sector, capable and keen to engage in international competition, does not emerge by itself; in many situations, government agencies enjoy a capability advantage over private enterprises. This view is not a mainstream one, especially in “the West.” The capabilities of the state itself (including the benevolent content of its choices especially in societies that aspire to democratic ideals) are themselves a work in progress.

sought to outmatch the practical pitfalls of industrial policy with ideas such as government-industry councils and stringent sunset clauses.

In a series of publications from around 2011, Mazzucato [2011] has followed a similar research and advocacy path of presenting solutions to the menace generally identified with the practice of industrial policy (see also Mazzucato et al. [2024]). Economically successful societies have been blessed with “entrepreneurial states” (including local governments) who have shaped private markets, a formulation that stretches beyond state interventions devoted only to resolving market failures. These ideas, derived from historical cases, are comforting and motivational for analysts who detect any possible developmental role for public policy, and have gained traction in some policy circles but have not directly overcome questions about the governance obstacles needed for deliberate industrial policy.

Some of the Mazzucato case examples trade on the view that complexity of operation is not a necessary feature of real-world industrial policy, as suggested by Pack and Saggi [2006] and that informational hurdles are not necessarily insurmountable. To the extent that effective industrial policy introduces new products, new services, new corporate practices, and new types of jobs to the existing, possibly technologically backward, array of commercial markets both in developed and developing countries, ventures of “entrepreneurial states” could be classified as operating in non-diminishing returns-to-scale spaces.

Most developing countries never fully abandoned industrial policy because almost all have maintained foreign investment priorities programs (with the corresponding tax incentives) even in the wake of programs of economic liberalization. In East Asia, the salad days of unfettered trade ideas in the early 1980s appeared just at the time when the hasty realignment of Japan’s exchange rate created a surge of Japanese relocations of labor-intensive production to the region. Japan’s major currency realignment overlapped with the policy debates in the Philippines over the elements of a thoroughgoing economic reform program occasioned by the collapse of the thirty-year Marcos regime.

Batalla [2011] suggests that one reason the Philippines benefited less than neighboring countries is that Japanese companies, in their urgent decisions to find new locations for production, found the country’s array of investment incentives, while quite comparable to those in nearby locations, to be insufficiently secure given the uncertainty over the overall stance of the long-run policy regime under construction (and domestic debate).¹⁵

¹⁵ One interpretation is that potential domestic losers and local pundits both protest too much, and initiated policy uncertainty [Chikiamco 2022]. But an alternative interpretation which can be drawn directly from the Batalla [2011] analysis of the Japanese viewpoint is that in utility terms, Japanese companies had a strong revealed preference to be part of a host country’s long-term development strategy and worried more about ideas that a government presiding over a truly liberalized economy should not have the tools to choose winners and losers through investment incentives.

Open trade is often¹⁶ seen and has been advocated as an all-encompassing development strategy. Under this strategy, industries that arise and thrive through time are those that are internationally competitive without the need for either infant or continuing state support. In the late 2000s, Western researchers (e.g., Hidalgo and Hausmann [2009]), seeking to be able to compare European vs. US industrial capabilities, introduced the concept of “product space” as a means to measure the “distance” countries have to upgrade their domestic production activities. The title of the Hidalgo and Hausmann [2009] piece gave the name to a research program under the umbrella of “complexity economics”, a methodology that has been applied most extensively to developing countries and to related aspects—such as export structure and import dependence—of comparing countries according to the complexity of what they produce. Yap and Turla [in this volume] take advantage of the complexity ranking from this methodology to compare the relative success of industrial policy between Philippines and neighboring, more successful, economies.

Because sectoral interventions are already taking place (and perhaps were never truly abandoned)¹⁷ and threaten to proliferate as a result of recent analytical and policy trends, I take the view that use of the standards and benchmarks from industrial policy thinking to evaluate government policies, whether these originate from the executive or the legislative branch, is vastly more appropriate in terms of measuring their social cost and determining whether society should absorb the costs of specific projects and programs. Industrial policy principles supply operational benchmarks to evaluate sectoral interventions.

In the first quarter of the 21st century, the most prominent source of political/policy pressure towards industrial policy interventions is climate action. The urgency of climate action, and their corresponding nationally determined contributions to transition from fossil fuel-dependence on the part of all countries, oblige societies to ignore market “signals.” Even as clean primary energy sources, notably solar and wind, have become competitive per unit of generation in most areas of Earth [IRENA 2023], the transition will be “too slow” to avoid irreversibly unfavorable climate dynamics. Canlas and Jandoc [in this volume] explore a transition away from coal through the fossil fuel of natural gas.

The astronomical growth in international trade in services, facilitated by the rise of the digital economy, is another area of interest. With the ebbing of what he calls “hyper-globalization”, Rodrik [2024] suggests that developing countries apply industrial policy to building the services sector and the creation of good jobs, including those in non-tradables, instead of seeking to rely on manufacturing in which their proportion of value-added is very small and their competitiveness

¹⁶ For the Philippines, the classic reference is Power and Sicat [1971].

¹⁷ For example, the grant of a subsidy to a hesitant foreign investor to defray the high cost of electricity is a use of a standard tool of industrial policy. A proliferation of such special privileges, even when obtained through contacts with high level officials, without recourse to a selectivity criterion is not industrial policy.

reliant on low wage labor. While the Philippines has provided tax incentives to the business process outsourcing (BPO) sector *subsequent* to its success, should such resources be made available in the future? Would resources be better deployed to open other areas of services exports? How can the sector be developed to better enhance domestic productivity and incomes? Serafica [in this volume] examines the potential and the challenges inherent in this sector.

3. The times are a-changing but the international rules are still the same

While interest in industrial policy swells in international circles, Philippine industrial policy thinking¹⁸ and practice are quite modest, despite the ample popular commentary¹⁹ over the adverse role of protectionist policies in a variety of sectors. The Department of Trade and Industry (DTI) for about a decade has explored various means by which limited state resources can be deployed to upgrade productivity and competitiveness in selected sectors.

International trade rules are one clear area where obstacles abound for any increased use of Philippine industrial policy. Tracing the changing views and practice of industrial policy in terms of the actual government interventions that are involved, there are many elements in the industrial policy toolbox. The panoply of well-known industrial policies has included subsidized credit, state support for state-owned enterprises, domestic content requirements in exchange for tax incentives, quantitative restrictions on imports, government procurement, protection for foreign investors, among others.

Differential tariffs among industries which evolve through time as protected sectors attain international competitiveness have been practiced since the 19th century [Akyuz 2005;2006]. In developing countries, state policies, since the 1980s, very often under the auspices of World Bank or/and IMF structural adjustment programs, often seek to narrow the range of tariffs among tariff lines; this state policy is interpreted as a renunciation of industrial policy [Pack and Saggi 2006]. A key feature of prominent free trade agreements is the reduction of tariffs on all tariff lines to zero or a low ceiling after an adjustment period.

Beginning in 2018, the US government imposed tariff surcharges²⁰ on imports of steel and aluminum, after imposing these on solar panels and washing machines. The US government called upon the security exception, a standard but little tested feature of free trade agreements, but also mentioned the need to reduce the level of imports. The surcharges have triggered WTO dispute actions.

In Europe, starting in October 2024, the Carbon Border Adjustment Measures (CBAM) program will impose a surcharge on the carbon content of imports of

¹⁸ See, for example AER [2015].

¹⁹ As an example, see Chikiamko [2022].

²⁰ Most studies indicate that US resident users have borne almost all the incidence of 2018 tariff surcharges. See, for example, Amiti et al. [2020] and Fajgelbaum et al. [2020].

iron and steel, cement, fertilizers, aluminum, electricity, and hydrogen in order to match the carbon price in the domestic emissions trading system internalized by domestic producers. Competitiveness is a key concern²¹ of the program, despite the wink to climate action.

In the case of **foreign investor protections**, there are legitimate questions over their provisions' inclusion in the list of industrial policy tools. Dedicated protection for foreign investors in investment chapters in free trade agreements and in bilateral investment treaties conflicts with the basics, if not the spirit, of a liberalization program. Investor protections conform to the spirit of the liberalization paradigm in one sense: that they have severely inhibited state policies to regulate foreign investment, including policies for social protection and environmental objectives [Montes 2019a]. However, in practice, acceding to foreign investor protections has been an indispensable element of liberalization programs and in free trade agreements.²² Foreign investors are perceived to be critical to export success and, in a liberalized economy, for raising the investment rate.

In June 2024, EU countries withdrew from the Energy Charter treaty on the grounds that treaty obligations over hydrocarbon-oriented investors tend to obstruct climate-motivated regulatory actions. Earlier, from 2009 to 2012, some developing countries withdrew from the mandatory arbitration process of investor protections; South Africa, which signed onto investor protections wholesale in 1994 at the end of apartheid and as part of its liberalization-based development program, cancelled its investor protection treaties in 2012. With the EU action, investor protections of the type that has proliferated will likely decrease, even though the incidence of dispute cases is not expected to decline because existing treaty obligations have sunset clauses that protect investors for ten to 20 years, depending on treaty provisions.

The United States has been a global leader in international disciplines to curb the use for industrial policy purposes of government procurement; the US has led in the realization of the WTO's plurilateral agreement on government procurement, which meant that existing members of the WTO can voluntarily join the agreement, which stipulates levels of procurement beyond which bidding must be open to foreign suppliers. WTO accession negotiations often feature a discussion of acceding to the plurilateral agreement. Free trade agreements regularly include a government procurement chapter.

The US has noticeably weakened its devotion to and advocacy of **government procurement** disciplines. Beginning in 2017, the US government in word and in deed has been upgrading operational mechanisms of its 1933 Buy American

²¹ Draghi's [2024] report identifies the array of causes behind the lack of international competitiveness among European Union countries, even before taking into the account the carbon price factor.

²² Before the Indo-Pacific Economic Partnership for Prosperity (IPEF), the United States would not be party to any free trade agreement that did not feature an investment chapter.

procurement laws,²³ including hardening the process of granting exemptions for government agencies buying from non-US suppliers and relaxing domestic content standards. A US congressional office study indicated that the new operational practice would require the US to consider renegotiating its procurement disciplines [Congressional Research Service 2024]. A new US administration in 2021 strengthened the operational approach of the previous administration by creating an office and a website based in the White House where requests for US suppliers must be published—to alert domestic suppliers of the business opportunity—and cleared before a grant of a procurement exemption.

Clarete and Pascua [2016] find the Philippines' government procurement law wanting, in terms of meeting the standards enshrined in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in particular, by requiring that Filipino suppliers be accorded priority in procurement actions.

Competition policy is yet another government policy which restricts industrial policy interventions. Singh [2002] alerts us to the existence of two approaches to competition: the Western and the Japanese styles. Western-style competition policy represents the consumer interest; it places a high premium on free entry into markets and competition through prices, on the presumption that such a process will secure the lowest prices. Japanese competition policy emphasizes the steady upgrading of productivity and efficiency of enterprises to secure low prices for consumers and intermediate input users, and international competitiveness. Japanese competition protects the capital investment of private companies, whilst Western competition views the life-and-death cycle of firms as a natural consequence of competitive pressures, including those introduced by foreign suppliers. Japanese competition policy seeks to restrict ruinous competition while Western competition policy celebrates it.

During the US occupation, military authorities imposed Western-style competition policy in Japan as a policy to weaken the economic prowess of the *zaibatsus* which they viewed as pillars and beneficiaries of Japan's war effort against the West; Japan eagerly reverted to its own style of competition policy at the end of occupation in 1952. While this approach allowed fierce competition among firms within an industry through investment in internal production efficiencies, it regulated the use of price-based competition. This approach secured the continued existence and advance of participating firms, ideally of equal size within a market. Japan managed monopolies for a long time in domestic retail markets and especially in export trade, say, car companies, in export markets.

Free trade agreements enshrine Western-style competition policy and include disciplines facilitating the entry by foreign firms into domestic markets, including

²³ The main law is the Buy American Act passed in 1933 by the Congress and signed by President Herbert Hoover. In 2021, a bipartisan infrastructure law incorporated stipulations in the so-called Build America, Buy America (BABA) Act. BABA establishes a domestic content preference for federal financial assistance obligated for infrastructure projects. The BABA preference applies to three separate product categories: (i) iron or steel products; (ii) manufactured products; and (iii) construction materials.

their ability to initiate monopoly investigations, as is the case in domestic US competition law. Industrial policy tools such as domestic content requirements and balancing of imports against export earnings run afoul of investment measures disciplines of free trade agreements and competition policy disciplines.

Japanese-style competition policy enables the building up of competitive capabilities of national firms. However, it is very demanding of the governance capacity and of independence of the state to referee the demands of competing market participants.

4. The contributed papers

If industrial policy needs to be “selective” and choosy among sectors, subsectors, or firms to be accorded state privileges, the contributors to this volume do not take strong positions on which sectors to promote but, instead, deal with question of how industrial policy can be practiced in a variety of economic sectors. Almost all the papers trigger new demands on fiscal resources. Lurking behind the industrial choices are the chronic deficits, both fiscal and external, which must be “husbanded”²⁴ even more strictly should the proposals contained in the analyses gain technical and political acceptance. It bears reminding, once again, that political initiatives in the Philippine Congress are already underway, not to mention the budget-constrained initiatives in various departments: trade and industry, science and technology, information and communications technology, and others.

Quantitative analysis, applying the data and methodologies suggested in these papers to design, cost, and implement industrial policy is only a first step. However, there is the “uncertainty about both the effectiveness of policies and the location/magnitude of externalities”, [Juhasz et al. 2024:218] The next step is the difficult one: how to choose among the variety of proposals within a budget.

In “Industrial policy and complexity economics”, Yap and Turla contrast the neoclassical and the structuralist analytical approaches over development. The neoclassical approach places great store in drawing its policy insights from a unique equilibrium, while a variety of structuralist approaches emphasize the centrality of learning both at the firm and the policy levels. The linkage analysis builds on Kaldor’s three “laws” (derived from historical patterns) regarding manufacturing growth and GDP growth, real manufacturing growth and manufacturing productivity growth (Verdoon’s Law), and manufacturing expansion and the productivity growth of non-manufacturing sectors. The paper tests a proposed model in which the dynamics of structural change is driven by the co-evolution of investment, manufacturing and exports. The cointegration results confirm a necessary condition for feedback loops to exist between the investment GDP ratio, the export-to-GDP ratio of goods and services, and the manufacturing value-added to GDP ratio.

²⁴ In many Asian families, it is the mother that allocates the household budget.

Yap and Turla apply the feedback loop framework in comparing the effectiveness of industrial policy among the Philippines, Malaysia, and the Republic of Korea. They suggest that low investment rates undermined Philippine efforts to promote manufacturing, which a poor record in latching onto international production chains in the 1980s and 1990s worsened. The authors attribute the superior performance of Korea in comparison to Malaysia to the additional effort in the former to promote domestic innovation activities.

In “Mapping feasible routes towards economic diversification and industrial upgrading in the Philippines”, Balaoing-Pelkmans and Mendoza, start with the problematique of how to diversify an economy and the proposition that a more industrialized economy enables economic diversification. The paper uses the term “re-industrialize” to capture the idea that economies must escape the increased domestic concentration of economic activities left over from the trade liberalization era starting in the 1980s. The reported empirical results support the view that an increased contribution to aggregate output by the industrial sector, especially relative to services, promotes economic diversification and widens the distribution of the sectoral sources of growth.

Balaoing-Pelkmans and Mendoza examine three possible routes towards economic diversification, drawing upon the product space literature: (1) leapfrogging, (2) scaling the value ladder through global value chains, and (3) expanding local industries by upgrading the operations of small and medium-scale establishments. Their analyses of the content of each alternative reveal the range of industrial policy tools that would be required to pursue each of them.

Aldaba and Aldaba examine the role of innovation in industrial policy and in an overall development process in general. The paper exemplifies that an industrial policy process is directed at new products, new production methods, new organizational configurations, new collaborations among different professions, and so on (as opposed to civil society/academic preoccupation in blowing up deadweight losses arising from suspected Harberger triangles). The paper proposes two arenas where innovation takes place: (1) value creation through developing new ideas and technologies and (2) fostering entrepreneurship. Aldaba and Aldaba propose nurturing collaboration, “which depends on social capital, trust, and information sharing.” Successful innovation requires the collaboration between academia and industry. However, they find that “Philippine universities generally remain detached from problems signaled by the market and often fail to appreciate the importance of commercialization.” Research activities in universities lack the personnel with skills in technology transfer and commercialization. The authors advocate specific interventions that foster government-academe-industry linkages and those that upgrade education, human capital development, and workforce training.

In the case of entrepreneurship, the study suggests that the startup system is still quite limited but growing in both real value and volume. The paper provides

a window into the ecosystem of startups and entrepreneurship. The authors cite how artificial intelligence (AI) has been exploited to strengthen the operations of business process outsourcing (BPO) firms. If innovation activities are to respond to the perceived needs of firms and local areas, the authors recommend the establishment of Regional Inclusive Innovation Centers (RIICs), a proposal from focus group discussions and stakeholder consultations convened by the DTI.

In “Exploring the prospects of services-led development for the Philippines”, Serafica turns the spotlight on the services sector. She examines its status and assesses the challenges and opportunities confronting government strategies to enable the sector to generate more domestic value-added and raise the incomes of workers in the sector. For services to contribute to economic growth (instead of being impelled by the growth in other sectors), it must attain sufficient rates of productivity growth while creating jobs, especially for low-skilled workers. This is the daunting industrial policy challenge in a sector that conventionally absorbs the unskilled and low-skilled through low wages. Where and how will the upgraded skills be learned? She cites literature that, for example, suggests that firms and other places of employment themselves should be sites for skill upgrading.

Serafica identifies the opportunities for upgrading and expanding the services sector in the Philippines. Services are poorly developed outside metropolitan Manila; “classical” industrial policy thinking rightly used regional development to justify government intervention. The paper highlights the opportunity to expand the export of digital services and the need to accelerate digitalization by improving connectivity and the competencies of workers and firms. Serafica also discusses the importance of structural reform to overcome various industry constraints, including the impediments to entry of foreign investors codified in the Constitution.

In the chapter entitled “Natural gas and transitioning to renewable fuels: considerations from industrial-policy economics”, Canlas and Jandoc explore the implications of abandoning policy neutrality and, instead, expanding government support for “soft industrial policy”²⁵ in the natural gas sector. Soft industrial policy involves a “package of economic policies consisting of foreign-trade tariffs, subsidies, tax exemptions and other fiscal and investment incentives.” The underlying motivation is the transition to cleaner technology in primary energy generation as part of the country’s nationally determined contribution in the Paris Agreement. State support for the Philippine Upstream Indigenous Natural Gas Industry (PUINGI) can draw upon the precedents and lessons learnt from the operation of the Malampaya Fund.

In advocating industrial interventions, the authors recognize two key additional objectives. First, they underline the critical role of affordable and reliable energy in any development effort. They draw on input-output data to illustrate the interdependence of the various industry sectors and their dependence in turn

²⁵ The terminology is from Harrison and Rodriguez-Clare [2010].

on energy as input to their outputs. Second, recognizing the indispensable role of foreign partnerships and technology in promoting natural gas, the proposed natural gas development program has the potential for learning by doing as part of the development process. The effort will involve the design and awarding of new petroleum service contracts and the drilling of at least five exploration wells.

In “How might China-US industrial policies affect the Philippines?: a quantitative exercise”, Abrenica and Sabarillo apply a multi-sector Ricardian trade model with external economies of scale at the sectoral level to the question of how China-US industrial policies, including their trade war policies against each other, affect the Philippines. The paper joins a growing literature of neoclassical models that incorporate scale economies to measure the impact of industrial policies. Chinese and US industrial subsidies decrease scale economies in the Philippines, thereby imposing welfare losses on the country, net of cheaper imports made possible by the said subsidies. The authors then use the model to consider what kind of trade policy tools the Philippines can employ to counter the negative welfare and sectoral effects.

The paper estimates the effect of tariff and subsidy policies on the part of the Philippines which would allow the Philippines to recoup most of the identified losses. With the same model, the authors are able to suggest that if the Philippines had practiced industrial policy before China and the US carried out theirs, the Philippines would enjoy greater welfare gains because of larger domestic scale economies in place. The net welfare effect would be smaller when netted out against tax revenue losses and higher cost of goods. A similar pattern—of higher welfare gains at the price of lower tax revenues and more expensive goods—is also observed if the Philippines targeted the sectors that were directly affected by China’s subsidies.

This set of papers provides many useful insights into industrial policy and its application to the Philippine context. Clarete’s comment on the paper regarding state intervention to promote natural gas imbeds the issue in the context of alternative renewable and cleaner primary energy sources; this is a natural question that arises from an industrial policy approach.

Industrial policy studies have a particular focus on the long-term—as opposed to the privileging of short-term welfare losses or gains measurable under static models. There is a long tradition of applying static models and these enjoy more credibility in policy debates. *Ceteris paribus*-based policy arguments can be quite compelling, though the economics literature, such as those about the employment effects of minimum wages,²⁶ have begun to uncover their limitations. Analyses and models with a long-term perspective tend to rely on relatively novel assumptions.

Especially as documented in the Abrenica and Sabarillo paper, but also in the other contributions, industrial policy generates costs and is not a free lunch. There are real costs to industrial policy and welfare reallocations among the population

²⁶ For the issues, see, for example, Neumark [2017].

which enormously dwarf the relatively free lunch that can be had by removing an administrative regulation, reducing a tariff, or amending a Constitutional provision. Development is not a free lunch.

5. Final remarks

The content of the collected papers presented can be read as proposals for government action. Many of the analytical views and suggestions in the papers and the comments merit serious consideration by various agencies of the Philippine state.

To appreciate the context, the ideas presented here will have to contend with the question of whether the Philippine state, with its limited resources and capabilities, is best qualified to respond to them, instead of preoccupying itself with protecting and enhancing the country's neutral economic policy stance in order to keep the space open for private sector action. On the other side, as indicated above, political forces have begun introducing sectoral interventions.

I commend the papers to the kind readers of this journal to consider whether the models, analyses and proposals presented are sufficiently intriguing to pique their interest toward modifying their own approaches for evaluating state interventions, away from one purely in terms of their potential to magnify the distance of actual policies from the neutral policy stance to that of measuring the net costs and benefits of interventions based on benchmarks arising from the new versions and models of industrial policy.

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