Study 3

The detrimental role of biased policies: Framework and case studies

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1. Content and objectives of the paper

The political and economic crisis facing the Philippines during the twilight days of the Estrada administration showed the clear link between weak institutions and governance structures and the poor economic performance of the country. This had been a known fact long before the Estrada scandals, but its significance and importance had not been felt so palpably and strongly as then. If any lessons should be derived from this episode of our country's history, it is that careful and more historically rooted studies should be done in analyzing the role of institutions, governance structures and the state in the economic development of the country, and how the nature of these institutions and structures, as they evolve over time, affects economic development.

The older economic literature on corruption had concentrated on rent-seeking and the burdensome 'tax' this may entail on the economy. More recent literature (Campos 2001) had started concentrating on the lost investments and output that result from corrupt practices. The paper to be written follows more the second approach as it explores how policies that emanate from processes that are dictated not by national and common interests (and usually not transparent and accountable) would bring about negative impact on the economy. It is one of the few attempts in the Philippine setting to study corruption not from the perspective of ill-gotten wealth, or illegitimate and under-handed procurements and granting of contracts, or rent-seeking and its negative effects on the economy, but from the prescription of wrong policies to the advantage of narrow vested interests.

The objective of this study is to find out how such policies impact negatively on the economy. The hypothesis is that such policies are more damaging: 1) the more they are inconsistent with the main economic program of the government, 2) the more they impair the capacity and credibility of important regulatory bodies which enforce property rights, ensure fair competition and/or address 'market failures' in the economy, 3) the stronger the adverse feelings of the public with respect to the unfairness of the policy, 4) the more social

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cohesion is broken and the more key economic players withdraw their cooperation due to the adoption or disclosure of such policies.

Since our topic concerns policies that promote narrow interests at the expense of national interests and their impact on the economy, it would be beneficial if we come up with some loose framework that will situate these policies within the institutions and governance structures of the country. In particular, the first part of this paper will give some discussion of how institutions and governance structures are vital to the economic development of the country. The second part will try to show how the state transitions in the Philippines, as they historically unfolded, had not sufficiently strengthened these institutions and governance structures, and had not displaced the dominant clientelist type of relationship in the state bureaucracy and institutions. Thus biased policies not based on transparent and accountable processes continue to persist and allow short-run vested interests based on personalistic patron-client ties to dominate long-term national ones, and eventually to sabotage economic development. The next section will look at and analyze within the above context some 'hot' issues involving the Estrada administration. The last section will tackle the political possibilities of correcting the governance structures of the country in order to effect economic development.

2. The role of institutions, governance structures and the state in economic development

It is not very productive if we study biased policies (that lack transparency and accountability) in a vacuum, isolated from the institutions, governance structures and economic programs of the country.

There is currently a growing literature (Stiglitz (2000), Rodrik (1996 and 2000)) which emphasizes the necessity of strengthening institutions and governance structures in order to achieve economic development, especially under a regime of economic liberalization. These are due to the following prerequisites for economic development.

2.1 Efficient and adequate physical infrastructure

Competition in the domestic market and, more importantly, competition in the world export market, necessitates productivity and efficiency of domestic production. Thus good physical infrastructure and facilities, and efficient provision of transportation, public utilities and ports become vital. Governance structures and bureaucracies that are either inept or whose criteria for awarding projects are not performance-based (such as the case with many corrupt governments) will, most likely, not provide these infrastructure and facilities adequately and with the appropriate quality. This will result in higher overhead costs in transportation, power, utilities and the like, thereby reducing the competitiveness of the country's products.

2.2 Ascription of clear property rights and enforcement of contracts

Both Adam Smith and Douglas North (1984) point to the important role of the capitalist state to ascribe clear property rights and enforce contracts. This is important for market operations so that firms and households have clear control of their assets, profits and income in order to continue their participation in the economic processes and so that there are incentives to increase productive capacities, introduce innovations and improve human capital.

Enforcement of labor contracts, business contracts, debt contracts, rental contracts is important so that economic activities can be made with some assurance of a modicum of security and predictability. The great John Meynard Keynes (1936) had stated that contracts and ‘conventions’ are required to cope with uncertainty and volatility, and this allows the capitalist system to survive as it faces an unknown future.

The set of institutions and practices in the executive, legislative and judicial branches as well as informal sources of power and authority is crucial in the ascription of property rights and enforcement of contracts. This includes activities related to: 1) the formulation of laws, rules and regulations that guide the protection of and limits to property rights, 2) the implementation and policing of these laws, rules and regulations, 3) the punishment of the breakers of these laws, rules and regulations.

The granting of special franchises or licenses to undertake specific economic activities and earn corresponding profits (such as franchises for construction of physical infrastructure, for managing and operating public utilities, for forest or gambling concessions) is an important aspect of ascription of property rights. Institutions and governance structures dominated by vested interests and personalistic relations would prefer the proliferation of such franchises (which can be captured by those close to the powerful authorities) and would give them to the dominant faction or cronies of those in power.

On the other hand, stronger institutions and governance structures might not be completely bereft of corruption but would: 1) limit these franchises only to areas of natural monopolies and special cases where franchises are really necessary, and 2) for these areas, require the winner of franchises to subscribe to a minimum performance standard and to revoke the franchises in case this standard is not reached, or important rules and requirements are broken.

Even if this pre-requisite of ascription of property rights and contract enforcement has always been taken for granted by most (neoclassical) economic studies, the fact stands that many states of developing countries -- including that of the Philippines -- lack the capacities and political will to ascribe correct property rights, and enforce legal contracts needed for capitalist development.

2.3 Market regulation

Markets do not exist in a vacuum and are part of the social and political milieu of a particular country at a particular point in time. The quality of the market and its performance therefore is only as good as the quality of the social and political institutions and governance structure wherein it is situated (Polanyi (1957)).

Apart from the ascription of property rights and enforcement of contracts, the state and economic institutions should ensure that good competitive policies are being followed and that anti-competitive and fraudulent behavior should be checked and punished. This is not only important to get efficient production and allocation of resources (as neoclassical theory would take great pains to prove) but also to assure social cohesion and cooperation of key economic players in the development process.

Furthermore, the latest economic literature further points to the importance of governance structures in dealing with 'market failures'[2]. Market failures arise because of: 1) adverse results of market processes that cannot automatically be corrected by the market itself, or 2) the need for additional provision of resources, information or technology which will make the economic system improve its performance but which the market itself cannot adequately supply. Important examples of the positive effects of regulation or interventions in the market are:

1) regulation or taxation of firms to prevent them from degrading the environment and natural resources,
2) regulation of natural monopolies and public utilities to protect the consumers from unfair pricing and substandard services,

[2] In economic parlance, market failures occur when there arise problems in externalities, moral hazards, adverse selection, and asymmetric information.

3) quality control and ensuring health standards for consumer products,
4) prudential regulation and supervision of the financial system to avoid over-risky transactions which may cause self-fulfilling crises and runs,
5) regulation and policing of the stock market to prevent 'insider trading' and other fraudulent activities,
6) regulation of market activities which may have adverse social effects, such as cigarette smoking, alcohol drinking, gambling, etc.,
7) the requirement of regular and honest information from firms, banks and individuals to ensure transparency and accountability, and the processing and dissemination of such information,
8) provision of quality education and research and development infrastructure to improve human capital and technology of the country.

A cursory look at the list above -- plus the need to ensure fair competition and prevent fraudulent activities -- would bring out the importance of the efficiency, capacity and integrity of institutions and governance structures in dealing with market regulation and related activities.

2.4 Provision for social insurance

It should be emphasized that one of the major reasons the world capitalist system did not degenerate into chaos or become socialist (as Marx predicted) was that capitalism, after uprooting people from feudal and kinship ties, eventually had to provide social insurance and minimum standard of living to the mass of unemployed and poor people. This involved successful economic and social programs for poverty alleviation as well as efficient and fair systems of safety nets for the unemployed and the poor.

The Asian financial crisis has made it clear to the stronger East Asian economies (South Korea, Malaysia and Thailand) that social insurance and safety nets should be institutionalized in order for their economies to become even stronger and more resilient.

2.5 Social cohesion and conflict management

Successful handling of all of the above contributes to social cohesion and social cooperation (at least by key economic players) in the development process. No doubt the above are necessary but not sufficient to ensure social cohesion and cooperation from key economic players. Many societies have strong divisions and rivalries along ethnic or religious lines. Others have different factions of the business and landed elite vying for both political and economic power. In economic and market activities, even with the best rules and regulations, there will bound to arise areas of conflicts over policies, property rights or the sharing of the economic pie (e.g. labor vs. capitalists, farmers vs. real estate developers, indigenous peoples vs. mining firms and builders of power plants or dams). Even if conflicts are not especially prominent, there will also be coordination failures (another new literature in macroeconomics) wherein individual actions of the various economic players do not contribute to the overall welfare of the economy[3].

All the above require an astute state which has the respect of the key economic players in order to effect compromises and solutions during times of conflicts, and coordinated collective action during times of possible coordination failures. Social institutions will also have to be such that some minimum level of social cohesion and social cooperation in national development is achievable. This means that there has to be a workable social contract in dealing with areas of tension and conflict.

2.6 Macroeconomic stability

For securing strong investment and production potential from both domestic capital and foreign capital, there is a need to generate political and socio-economic stability which will instill confidence in the economy.

Macroeconomic stability includes many diverse things but is traditionally restricted to minimal up-and-down volatility in output, employment and prices (which means of course increasing or accelerating output and employment and low inflation), low fiscal and external deficits, and a modicum of political stability (and social cohesion).

Achieving macroeconomic stability -- what the International Monetary Fund (IMF) insists as conditionalities during crisis and recession periods -- is not simply a result of 'correct' economic policies but a result of institutions and governance structures that include bureaucratic institutions and institutions and governance structures for social cohesion and conflict management.

[3] For example, in times of recession lack of confidence prevents firms from investing and households from spending, but it is precisely the joint increase in investors' and consumer spending that is needed to regain confidence and get out of the recession.

Economic and political stability implies some confidence in the economic system and some level of social cohesion and cooperation, which in turn implies some acceptance of the power of the state and the rules it imposes.

Sustained low inflation implies a healthy labor-management arrangement that does not lead to destructive wage-price spirals (which is very much an institutional and governance problem) just as much as it implies appropriate exchange rate and aggregate demand policies. Similarly, the size of the fiscal deficit is itself a partial reflection of the state's capacity to collect revenues (which depends on the bureaucracy of tax and customs bureaus and related institutions). It is also a reflection of the capacity, willingness and cooperation of the business, propertied and labor sectors to be taxed (which most likely will be low during crisis and recession periods). It is also a reflection of the state's spending priorities and capacities (such as whether they put more priority in provision for basic social services, pump priming the economy or sustaining government 'fat' for corrupt officials). These are not independent of the institutions, governance structures, social contracts and relationship between the state and its people, and the nature of the state itself.

History has confirmed the theories of Marx, Keynes and the new institutional economists (using 'market failure' approaches in the real and financial sectors) who said that the market system by itself does not automatically bring about a situation of equilibrium and full employment. In fact, uncertainty, changing moods and varying confidence levels bring a lot of volatility and instability to the system. And globalized world markets often create these volatilities and instabilities, as proven by the East Asian crisis (not to mention all other previous economic and financial crises) and the impending world recession due to the dire prospects on the Japanese and US economies.

Thus to manage the instabilities and to stir up and maintain confidence in the system is another big task for the state. Again its capacity and capability becomes a critical factor.

2.7 Tainted policies sabotage these functions

It is this need for strong institutions and governance structures that provide the framework of the study. The ability of vested interests, patronage politics, clientelism and personalistic power relations to thwart and distort policies through non-transparent and non-accountable mechanisms sabotages the credibility, consistency, capacity and commitment of institutions and governance structures to deliver the important functions described above.

This either puts in doubt the capability and fairness of regulatory bodies needed badly in an increasingly liberalized economic and financial setting and/or breaks the social cohesion and cooperation of key economic players needed by government to push the economy forward. This in turn negatively affects investors' confidence, investment inflows and economic efficiency and productivity. The extent of negative public perception contributes to the depth and gravity of the impact. This brings about efforts from civil society to undertake watchdog activities and, in extreme circumstance like the recent people power uprising, to organize massive protests and rallies. This in turn leads to offsetting moves from affected government officials to tame public outrage and to avoid punishment, oftentimes using legalities and technicalities. The uncertainties and potential dangers (military coups, bombings, a 'wag the dog' war, social unrest following an impending acquittal amidst overwhelming evidence) we just experienced (and, hopefully, ended) further decreases investors', lenders', producers' and consumers' confidence and brings the economy into further jeopardy and distress.

3. Patronage politics and clientelism in the Philippines

3.1 Concepts, processes and adverse impact of clientelism

This section attempts, in a quite amateurish way, to give a political analysis of the Philippine state and power relations so as to shed light on the nature of ' biased policies not based on transparent and accountable processes'. It follows Hutchcroft's ((1996) and (1997)) approach in analyzing corruption in the Philippine context. His thesis is that the main reason why corruption in the Philippines (particularly during the Marcos regime) had been more malignant and deleterious than corruption in other East Asian countries (with the possible exception of Suharto's Indonesia in the nineties) is the fact that patronage politics and clientelism (or to use another phrase of Hutchcroft, booty capitalism) dominate state institutions and relations, and account for much of the pernicious effects of corrupt policies.

A strong manifestation of this fact is, according to Hutchcroft, the fact that in areas of governance where clientelism and personalistic ties dominate, informal networks have stronger authority than formal structures (e.g. Mafia-type networks of drug lords or kidnapping gangs have stronger authority or have stronger hold over local police). In this case, corruption tends to be more prevalent and more malevolent.

Furthermore, in areas of governance dominated by clientelism and personalistic ties, patron-client networks do not 'coincide with formal lines of authority' and 'constitute competing source of orders and inducements[4]. This would result in more variable and more unpredictable forms of corruption and therefore would yield more pernicious results. Good examples of this are the three cases in this study. If the charges against President Estrada are true, then his informal circles of friends (through the authority of the presidency) flaunted the rules and regulations of the Philippine Amusement and Gaming Corporation PAGCOR and the Civil Aeronautics Board (CAB), and more seriously, the Philippine National Police (PNP) and the Department of Local Government without any possible resistance from the formal authorities. President Estrada also allegedly attempted to do this less successfully with the Philippine Stocks Exchange (PSE) and the Securities and Exchange Commission (SEC).

To further explain this point, we again lift from Hutchcroft (1997, p. 231-2):

> 'In the former (pre-1980s) Thai bureaucratic polity, for example, formal bureaucratic authority was well developed and informal networks of power and formal status overlapped to a large degree; in such a system, businesspersons were likely to have a good sense of whom to approach and what to expect from one transaction to another. In the Philippines, by contrast, lines of formal authority are weaker and the disjuncture between authority and power is often quite pronounced. In this loosely structured system, where patrons are as often found outside formal structures of authority as within them, there is likely less regularization of corruption from one case to another….[In this sort of] disorganized bureaucracy, the official chain of command is unclear and constantly shifting and the decision-making criteria are similarly arbitrary and unknown.'

We have two things to add to this insight of Hutchcroft:

1) the unpredictability is aggravated by the fact that because of elections, there are periodic changes in the local and national political leadership and heads of executive, legislative and judicial branches. If clientelism and personalistic ties predominate, different factions with different interests alternate with each other and the more 'decision-making criteria become arbitrary and unknown'.
2) It is not just unpredictability that is causing the problem because of the above processes. The volatility and instabilities are often more importantly caused by periodic shattering of social cohesion and the withdrawal of key players in cooperating with the perceived 'unjust' arrangements.

The gist of the above is that patron-client and personalistic relations dominating governance structures in the Philippines result in the dominance of very narrow vested interests over national interests. Since vested interests are varied and changing, predictability

[4] Hutchcroft (1997) p. 231

and consistency of policies are lost and investments and economic confidence are reduced. Furthermore, vested interests become more malignant and rapacious as they become shorter in time horizon, since terms of office are limited.

The blatant 'corruption' further destroys social cohesion periodically and leads to various non-cooperation from the aggrieved and bigger sector not benefiting from the 'corrupt' practices.

3.2 No qualitative change in governance structures in the post-Marcos period

Hutchcroft's paper concentrated on the clientelist state during the Marcos regime. Why are we still using the same framework in our analysis? The answer is clearly that the post-Marcos regimes failed to qualitatively change state institutions and governance structures and veer them away from patronage politics and clientelism.

To be sure, there had been substantial improvements in many respects from the Marcos regime. Institutions and state apparatus for repression and human rights abuses had been weakened and less consolidated and therefore less malevolent than during the Marcos period. More democratic processes also allowed watchdog activities, airing of grievances and exposés of wrongdoings to be widely practiced and to effectively check corrupt and harmful practices and policies. The general public's recollection of the Marcos days had made this a strong weapon against corruption and anomalous practices

The Aquino administration also set up a new constitution, which despite its flaws, allowed civilian rule to take over and to reduce military power and abuses.[5] The buffer Aquino provided against right-wing military ambitions was a contribution not quite appreciated by many.

Still, the more radical sectors of our society would be correct in claiming that the break with the Marcos regime was not a revolution since the basic institutions and governance structures remained intact and the processes of clientelism preserved. The Aquino regime viewed the victory against Marcos as a vindication of the pre-Marcos regimes of democratic elections and alternating governance of different factions of the elite. This view saw the Marcos tragedy as caused by one man's or one family's greed and lust for power. Institutions of governance and systemic roots of corruption and bureaucratic inefficiencies were completely ignored and not dealt with.

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[5] This was done in a highly charged volatile and explosive atmosphere of a 'low-intensity conflict' where many left organizations and individuals were being harassed and threatened.

The preservation of clientelism and personalistic power relations in the state bureaucracy and institutions of governance was a key disenchantment with the Aquino regime. The rise of certain power blocs identified with the regime was used by the right-wing coup plotters as one of the reasons to sabotage the government. The rise of the political power of the Cojuangcos (with President Aquino's brother gaining leadership of the main political party and gaining hold of Tarlac province), the Sumulongs (uncle of the Cojuancos in Rizal province) and the Oretas (in-laws of the Aquinos in Malabon, Rizal) indicated a return of political clans in Philippine politics. Building genuine parties based on clear platforms and policies took a back seat to power politicking, first by the anti-Marcos faction of the elite, and later on joined in by the previously pro-Marcos faction.

Evidence of the preservation of patronage politics and clientelism (where personalistic ties and connections dominated formal rules and regulations) was best demonstrated in the dismal performance of the Presidential Commission on Good Government (PCGG), which was tasked to acquire and sequester ill-gotten wealth and assets of the previous regime. Marcos cronies were able to go into compromise deals, retain their assets and corporations (in what many consider to be corrupt deals) and return to the Philippines unscathed. Other institutions (Department of Justice, Bureau of Immigration, Office of the President of both Aquino and Ramos) cooperated in the rehabilitation and comeback of what were previously denounced as the country's looters. The most prominent of course is Eduardo Cojuangco who regained much of his former economic and political power, and was even a major presidential candidate who could have succeeded President Aquino. He also was able to capture his former prize, the country's top food conglomerate San Miguel Corporation, by the time President Estrada began his administration. The Marcoses themselves were allowed to enter the country under the Ramos administration and join in the power game of national and local politics.

The Ramos administration, though improving the style of management and leadership (and mixing it with some developmental vision), also did not basically try to eradicate the patron-client relations in state institutions and governance structures. In fact the biggest corruption case of the Ramos administration – the Public Estates Authority (PEA)/Amari scandal – involves two possible personalistic ties: one involving George Triviño and then Speaker Jose de Venecia, and the other involving Justiniano (Bobby) and Agnes Montano and no less than President Ramos himself (see Coronel (2000))[6]. Both

[6] It also may involve some stock manipulation reminiscent of BW Resources with the sudden surge in price of the shares of Centennial City.

independently used their connections to affect the result of the deal. The other big corruption case in the Ramos administration is the Expo Centennial, which involved questionable diversion of government funds for a Marcosian white elephant project and possible fund raising activities for the administration party (again see Coronel (2000)).

The alleged link of corruption cases in the Ramos administration and fund raising for the administration party is quite prominent. Rumors were that even the rise of kidnapping cases during this period was related to the funding of election spending. The corruption cases of the Ramos administration, even with the large amounts that were involved, were reserved to questionable bids and contracts of large special projects and did not cause much disturbance and unhappiness from much of the big business players and the general public. They did not involve changing policies that would effect a large number of players[7], nor did they involve known controversial personalities which may have caused a furor and a sense of unfairness from a large section of the public.

The fact that then Speaker de Venecia, who himself has been tainted with ill-gotten wealth charges from the Marcos days, as the biggest king player and coalition builder in the Ramos' administration, points to the choice of an expert in Philippine political maneuvering to effect important compromises and negotiations during the administration. To be fair, the result was positive as Congress support for key bills of the administration were assured and the legislative and executive branches seemed to have a common economic and political program. This increased the level of confidence and improved the economic performance during most of the Ramos period.

The achievement, however, was undertaken again without changing (and perhaps using) the basic nature of patron-client relations in Philippine state institutions and governance structures. The improved leadership and management achieved during the Ramos administration was more of good style and astute politics rather than leaving a legacy of performance-based rules and conventions in state institutions and replacing personalistic and patron-client relations.

It is this legacy of patronage politics, patron-client relations and informal networks capturing formal structures of authority that was supposed to be used to the hilt by the Estrada administration.

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[7] In fact, from the PCIJ accounts, it seems that the other competitor for the bidding of the reclaimed land in the PEA/Amari deal was allegedly 'bought off'.

3.3 Economic liberalization as the main economic program

While the state institutions and governance structures did not qualitatively change, the post-Marcos governments went into high gear in qualitatively changing the economic program of the government into domestic and external liberalization, deregulation and privatization.

Lifting of import quotas was undertaken in the second half of the eighties, while in the nineties, the country locked itself into further trade liberalization and tariff reduction with its entry into the ASEAN Free Trade Area (AFTA), the World Trade Organization (WTO) and the Asia-Pacific Economic Cooperation (APEC). Simultaneously, deregulation of the oil, telecommunications and shipping industries were done in earnest. Deregulation and privatization of the water sector was done in the second half of the nineties while privatization and deregulation of the power sector is being planned. Capital account liberalization was undertaken in 1992.

The logic of these moves, pushed by multilateral agencies (the IMF and World Bank and economic technocrats of the country) was precisely to replace the state with the private sector and with markets and to reduce possible areas of intervention by the state on the national economy, under the assumption that efficiency and productivity will be increased and that the temptation of corruption and the Marcosian cronyism is still ever present. The view that reducing the areas of state intervention, without initiating state and institutional reforms to reduce clientelism in governance structures, would at best be a valid short-term policy for a corrupt and inept state, but completely ignores the entire section 2 discussed above. This type of economy (a liberalized economy with bad institutions and governance structures) would definitely fail in the medium and long term. As the latest charges on the BW Resource scandal and the air war with Taiwan show, even supposedly liberalized and market-determined areas can be badly affected by allegedly malicious interventions in the regulatory institutions charged to ensure competition and to prevent fraudulent activities. Similarly, inimical policies even in the non-tradable sector of gambling, can cause large adverse effects on social cohesion and economic confidence in a liberalized economy.

In fact, economic liberalization actually puts more demand and pressures on the state to effectively enforce property rights and contracts, to ensure competitive and non-fraudulent market processes, to regulate the markets to avoid socially undesirable activities (pollution, over-risky transactions, monopoly and predatory pricing, low quality and standards of goods, etc.) and to undertake or promote socially productive ones (infrastructure, access to quality education, research and development). Liberalization and deregulation also require the cooperation of a bigger mass of domestic and foreign players who should at least feel confident and secure of fair play and adequate macroeconomic handling by the state.

Policies that promote the interests of a particular few at the expense of national interests, especially if they go against set policies already prescribed and attack the fair and unbiased management and relatively autonomous role of the state, will leave many players unhappy and unwilling to cooperate in the market processes that have supposedly been liberalized.

The growing role of clientelism in the state under the Estrada administration therefore directly clashed with the economic thrust of the post-Marcos governments and presented a major stumbling block to economic development for the country.

4. Analysis of selected policies catering to vested interests

If the corrupt charges on Estrada and those close to him are true, then the Estrada presidential victory in 1998 should be seen as a takeover of a faction of the old elite which viewed election victory as a feudal conquest that would put the state apparatus at the helm of the winning clique and their friends. This view would be substantiated by the alleged wanton and unabashed attempts by the President to influence various government agencies to give special consideration to his friends, many of whom allegedly turned out to be acting as his proxies.

The benefiting friends of President Estrada were varied ranging from big established businessmen like Eduardo Cojuangco (the coco levy fund issue) and Lucio Tan (the Philippine Air Lines and Philippine National Bank issues), to bankers and stock market players (George Go and Dante Tan), to shady businessmen (Mark Jimenez, Lucio Co and Jaime Dichaves), to movie actor friends (the Paquito Diaz bid for firetrucks), to in-laws and relatives (textbook scam, use of government aircraft and vehicles, questionable funding of Miss Saigon), to known gambling aficionados (Luis Chavit Singson and Atong Ang).

4.1 The jueteng scandal

What brought on the impeachment of the Presidency was his alleged love and interest in gambling (the stock play of BW resources and the *jueteng* scandal) and his seemingly obvious connections and friendships with shady characters of the underworld. The alleged attempt to centralize in the national level the illegal *jueteng* payoffs, many say, proceeds from a small town mayor or 'local boss' mentality. One common belief about local officials is that one of their methods of accumulating funds would be to consolidate proceeds from illegal activities in the local area. With clear loyalty from the local police chief and operators, this can be done smoothly and without much fanfare at the local level.

But once the small town mayor becomes the President of the country, and a feudal conquest mentality dominates, the ambitious attempt to centralize *jueteng* payoffs becomes a very risky move especially if it involves siding with one faction of the syndicate over another, and especially if the attempt is leaked out in the national media.

The biggest evidence of informal networks and transactions (with personalistic ties and patronage system) dominating formal authorities and rules was the entire process followed in the scandal: from the alleged centralization of *jueteng* payoffs to the President from the various regional gambling lords of the country involving direct participation and complicity from the PNP and local government heads, to the alleged money laundering in the formal financial institutions, to the legalization of *jueteng* by the Philippine Amusement and Gaming Corporation (PAGCOR) as Bingo 2-Ball but allegedly giving the franchise to a privileged crony of the President, to the alleged use of threats of violence to balking factions of the gambling world, to the alleged cover-up and blatant suppression of vital evidence by the eleven senator judges in the impeachment trial. All these processes have led the Estrada govenment to be termed by some as a 'mafia' government (Bello (2000)). True enough, a 'mafia' government or 'bossism' can only hope to succeed and thrive when institutions and governance structures can be 'captured' via personalistic ties, bribes and acquiescence to requests via the sheer use of political (e.g. presidential) power and threats.

Let us look at some of the processes described above:

1. The alleged attempt to centralize the illegal *jueteng* payoffs and give the President a 3% share of all proceeds is perhaps the most blatant crossing of lines between illegal activities and formal authority lines. It is in a way a direct capture by a faction of the underworld of no less than the Presidency itself. The temerity to organize an illegal gambling tax for the highest position in the country, and to centralize the collection and accounting of such proceeds, is the biggest corruption case to be exposed. It is even more scandalous given the facility of obtaining cooperation from the police as well

as gaming and local authorities. Given that the scandal erupted only because part of the faction and a close Presidential friend squealed on him, fears are raised that all these would have been undetected if the underworld friends did not quarrel. It also puts in the forefront the question everybody seems to be afraid to ask before as to how far up in the government hierarchy payoff bribe money from drugs, kidnapping and gambling have gone in the past and in the present.

2. The laundering of money documented so well in the impeachment proceedings involving at least one of the biggest banks of the country and its ex-president of that bank[8] exposes that close ties between powerful persons in government on one hand and powerful persons in the big financial institutions contribute to legal financial processes being bastardized into money laundering and accumulation of ill-gotten wealth. The issue here also exposes the use of bank secrecy laws and leniency in opening deposits and accounts in camouflaging illegal financial activities. This points to the twin need to correct financial rules and regulations and institute more transparent and accountable processes on one hand, and to remove clientelism and patronage systems in legal financial and big business dealings. The two should be done simultaneously, and may not be achieved simply by changing rules and regulations, if relations between bank officers and politically powerful people remain as personalistic, under-the-table and based on patron-client relations.

3. The otherwise correct policy of legalizing *jueteng* by PAGCOR was completely sabotaged by giving the exclusive franchise and operation of the Bingo-2 ball game to a close presidential friend and alleged head of a faction of the gambling underworld. Viewed by many as simply a continuation of the centralization of gambling proceeds via a more greedy attempt to give legal control of gambling funds to a favored gambling crony, this aspect of the scandal also shows how policies are distorted by informal networks and pressures, and how national interests are completely overshadowed by and subsumed to vested (in this case, criminal) interests. Regulatory bodies (such as PAGCOR) becomes stooges of inimical policies.

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[8] Further investigation would most likely reveal that another bank owned by a Presidential friend would also be involved.

4. The attempt to silence Ilocos Sur Governor Luis Chavit Singson in his exposure of the entire *jueteng* scandal based on his defiance of the new underground/Presidential policy on gambling is a case study of 'Mafiosi' tactics as well as clientelism. The alternate tactics of using mutual friends and presidential relatives as intermediaries, promises of possible favors, the reversal of the policies that brought about the grievance in the first place, and finally (as Singson claims) the full use of the threat of violence to life and property are all reminiscent of strategies of Mafia-like gangs and local warlords. These same tactics would be used in the attempted silencing of former Security and Exchange Commission head Perfecto Yasay in his media war with the President and testimony at the Blue Ribbon Committee and of former Finance Secretary Edgardo Espiritu in his testimony in the impeachment trial.

4.2 The air war with Taiwan[9]

The air war with Taiwan demonstrates that when vested interests conflict with the liberalization thrust of a sector of the economy, regulatory institutions become susceptible to reversals and flip-flopping of policies that are damaging to predictability, efficiency, investor's confidence and, most importantly, mutual trust and goodwill required in bilateral economic relations. The issue is again aggravated by apparent Presidential intervention in favor of a close friend.

4.2.1 A summary of the issues and the events

The Air Liberalization Law (Executive Order 219) was signed in 1995 by then President Ramos. The Law follows a gradualist approach and does not provide for a full open skies policy. It envisions a phased progressive improvement of the air transport industry to world-class efficiency before full liberalization and deregulation is undertaken.

The Civil Aeronautics Board (CAB), the civil aviation policy-making body within the Department of Transportation and Communication (DOTC), was tasked with the regulation responsibilities and implementation of this law. In undertaking this task, its charter called for 'taking into consideration the larger interest of the country, especially users of air services.'

Under the Law, the Philippines has been maintaining Air Service Agreements (ASAs) with several nations, which give their air carriers fixed passenger quotas in specific routes.

ASAs with Taiwan and Hong Kong were signed in 1996. The quota given to Taiwan carriers was 9,600 passengers weekly. The ASAs also gave 'sixth-freedom rights' to the countries' national carriers. The concretization of this in the agreement with Taiwan was that China Airlines and Eva Airways were allowed to recruit passengers from the Philippines and fly them, via Taiwan, across the trans-Pacific route to North America.

These ASAs were said to have effectively weakened Philippine Air Line's monopoly over certain air routes, particularly to North America. Other blows came when the CAB granted franchises to other domestic airlines in the local air routes, and designated at least one other Philippine flag-carrier (Grand Air[10]) to also serve international routes.

Despite perceptions that the CAB had been biased in its policies in favor of Philippines Air Lines (PAL) ever since Lucio Tan revealed his majority shareholdings and takeover[11] of PAL in 1996, it had to take a call from President Estrada in early 1999 to review the bilateral agreements after PAL blamed foreign competition for its poor showing. This 'favor' to Presidential friend Tan was apparently a response to Tan's agreeing not to fold up the country's flag carrier after being crippled by labor strikes. Few then expressed disapproval of the President's intervention, and many even praised him for saving the national flag carrier.

CAB, following Estrada's intervention, communicated to Taiwan aviation authorities the Philippines' desire to cut down the 9600 weekly seats flight quotas given to Taiwanese carriers to 4000 seats.

Because international practice and provisions in the 1996 agreement called for a 12-month cooling-off period before any attempt to abrogate the arrangement, the Philippines did not use unfair competition as the main reason of the break-off but invoked the one-China policy, which points to the extent that the administration was willing to risk productive economic relations to effect the change in policy. As expected invoking the one-China policy did nothing to make Taiwan come to heel and only offended them greatly.

On 2 Aug. 1999, the Philippines decided to make a unilateral move: Taiwan must accept only 3000 seats or have all flights suspended by September 30, unless a new agreement was reached before the deadline. The decision was relayed by Manila Economic and Cultural Office (MECO) chair Eva Estrada-Kalaw to the Taiwan Economic and Cultural

[9] This section is largely written by Grace Ong, the research associate of this project.
[10] Grand Air of course died a natural death some years later.
[11] Lucio Tan's hidden shareholdings of PAL (via Tony Boy Cojuangco) and eventual takeover of PAL should itself be a study of how key privatization of lucrative state enterprises had not been based on very transparent and accountable processes.

Office (TECO). At the time the news broke, Philippine aviation authorities were also reviewing the bilateral agreements involving Korean Airlines, Asiana, Cathay Pacific, Singapore Airlines, Pakistan Airlines, Royal Brunei and KLM.

No agreement was reached before the deadline. On September 30, flights continued as both sides met and waited for President Estrada's final decision – whether to halt the route or extend it another month while negotiations were ongoing. Direct air links were severed the next day (Oct. 1).

As early as October 3, 1999, Taiwan News said the Philippines stood to lose more than Taiwan from its decision. In mid-October there was still no impetus for renewal of talks. In late October the Philippine government approached Taiwan for the resumption of direct flights. The analysis in China Times on October 27, 1999 added that apart from the losses to the Philippines in terms of Taiwan's investments, tourism and labor and product exports to Taiwan, the suspension has not helped PAL but proved a boon to charter flight operators and other airlines that link Taiwan and Philippines via third countries.

Taiwan set preconditions for resumption of talks, the main being reinstatement of the 1996 agreement. Taiwan also wanted talks to be official – being stung by Manila's earlier stress on the one-China policy, and having had a taste of Manila's inconsistent voices. And they specifically wanted no more unilateral cancellation.

After rejecting Taiwan's conditions in the media, Manila reinstated the 1996 agreement on November 3, 1999 on condition that talks should be completed by January 31, 2000 and that China Airlines (CAL) and Eva Air (EVA) give up their sixth freedom rights. Manila claimed Taiwan had earlier tried to employ delaying tactics and were abusing the sixth freedom rights by offering cut-rate prices to passengers bound for the US via Taiwan.

Taiwan's foreign minister received the Philippine CAB resolution the night of November 3, 1999 and criticized the Philippines for negotiating through the media. The minister said they would review Manila's offer before responding, although officials at Taiwan's Civil Aeronautics Administration (CAA) commented that the offer did not directly address Taiwan's demand that the 1996 pact be reinstated officially. Taiwan essentially took its time to respond to Manila's offer to resume flights.

Incidentally, Taiwan's labor market was opened to Vietnam on November 1, 1999. The Taiwan Association of Manpower Agencies shifted recruitment policies, gradually replacing Filipinos migrants with Vietnamese and Indonesian workers. This was with the endorsement of their Council of Labor Affairs, which advised them to prepare for the possibility that Taiwan might declare a ban on recruitment of Filipinos.

In mid-November President Estrada sent aides to Taiwan to negotiate for a preliminary air agreement. Manila said CAL and EVA could maintain their quota of 9,600 passengers a week provided they did not fly them to third country destinations via Taiwan. Estrada said, and Taipei denied, that Taiwan agreed to give up the sixth freedom rights. A planned trip by Taiwan officials to the Philippines was cancelled. The reason according to CAA was that the Philippines failed to put in writing that it was recognizing the 1996 agreement. The reason according to a Philippine official involved in negotiations was that CAA officials refused to sign a preliminary air agreement, which was supposed to be the purpose of the trip. By this time both sides were aware that the Philippine government was facing a lot of pressure from overseas workers in Taiwan who wanted to go home for Christmas. Adding to the pressure was the CAA's recommendation that charter flights not covered by the ASA be suspended before Christmas.

Another attempt at negotiations on December 14, 1999 again broke down on the issue of sixth freedom rights, which Taiwan said they would not give up though they might be willing to set a quota on it. The Manila representatives said they did not go to Taiwan to negotiate. Manila was pushing for an immediate resumption of flights, while Taiwan wanted the ASA to be cleared up first. The CAA announced that charter flights will be suspended by the end of the year, and rejected PAL's application to operate charter flights. The move was not expected to significantly affect Taiwanese charter flight operators, but would hurt tourism and overseas labor in the Philippines.

An interim agreement in the form of a letter of understanding was signed on January 28, 2000 setting the quota at 4,800 weekly. Flights resumed February 16, 2000.

CAL then applied for a Kaohsiung-Manila route where they expected to carry another 4,800 passengers monthly. CAB rejected the application. Taiwan retaliated by cutting PAL's flights by half and did not push through with a March 1-2, 2000 meeting for a new agreement.

In a letter to CAB on Mar. 6, 2000 MECO chair Kalaw advised CAB to disregard the January 28 understanding. CAB cancelled all flights. The CAA said they were informed late night of Mar. 14, and an EVA flight, not informed, was refused entry to Philippine air space at NAIA. Taiwan responded by cutting all links, and the situation reverted back to the one before but with a lot more ill will.

Meantime, the involvement of CAB in the Taiwan controversy prompted Japanese firm IASS Co. Ltd. to air its grievances against CAB at the Philippine Investment Seminar in

Tokyo. CLA Air Transport, their joint venture with Filipino firms, had not moved forward owing to obstacles that appeared only since Estrada assumed office.

Tourism Secretary Gemma Cruz-Araneta and foreign business groups had also come out with public disapproval of CAB's actions, which was seen as openly serving the interests of PAL, and Lucio Tan in particular. They were joined in by Filipino overseas workers going to Taiwan, by local businessmen doing business with the Taiwanese, and the business sector in general who saw the policy as directly linked to the President's biased policies and protection of close friends and cronies. The overwhelming pressure to end the air war from various government officials and entities came not only from Secretary Araneta, but also from then Trade Secretary Manuel Roxas II, the entire Economic Coordinating Council (made up of all the economic and finance secretaries) and the Senate Foreign Relations Committee. The Committee strongly recommended the resumption of flights between Manila and Taipei.

The principal author of the report, Senator Francisco Tatad, a close ally of the President, emphasized the positive effect that resumption of flights with Taiwan would have on reducing and correcting the perceived cronyism of President Estrada, whose public rating had gone through a see-saw – nose-diving because of perceived cronyism and scandals and recovering due to military victories against the Muslims in Mindanao.

By end of September 2000, the President and the CAB succumbed. A new agreement was signed with Taiwan, which was almost a carbon copy of the abrogated 1996 agreement. It restored the 9,600 weekly quota to Taiwanese carriers, and allowed sixth-freedom rights to both countries' national carriers. The main difference with the 1996 agreement was that there was now an increase of 1700 monthly seats to Taiwan carriers on the Manila-Kaoshiung-Manila route.

4.2.2 The costs of the erroneous policy

Figures 1 to **4** give us the large costs to the Philippines of the air war in terms of losses in: Taiwanese tourists, overseas workers to Taiwan (and implicitly their remittances), foreign direct investments and Philippine exports to Taiwan.

Visitor arrivals from Taiwan plummeted from 10,273 in Sept. 1999 (the month immediately prior to the cancellation of flights) to 6,764 in October, 1999, to around 5,000 by mid-2000. Overseas workers to Taiwan plummeted from 20,363 in the third quarter of 1999 (the quarter immediately prior to the cancellation of the flights) to 14,798 in the next quarter, and remaining around this level till the resumption of flights. Foreign direct

Figure 1. Visitor Arrival from Taiwan

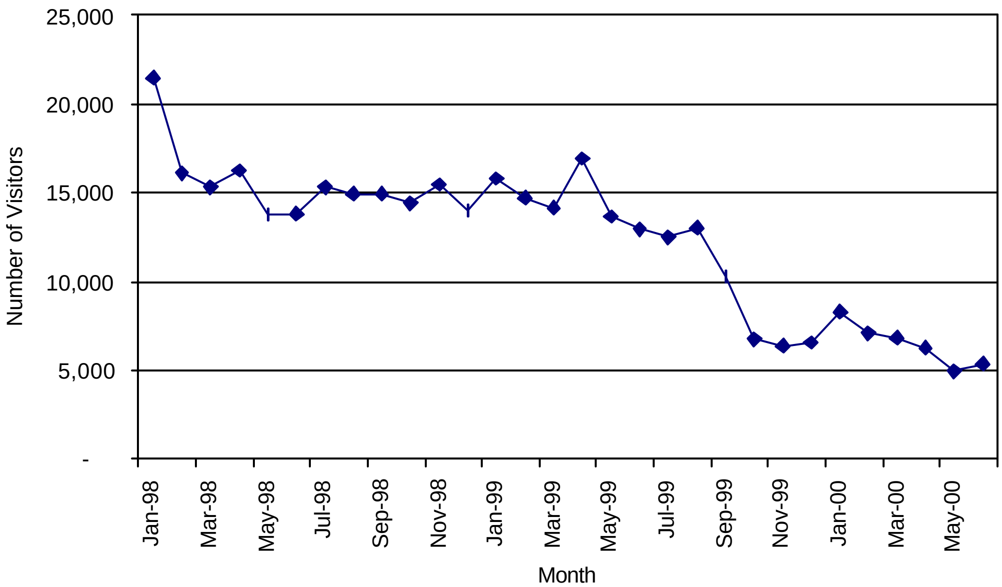


Figure 2. OFW Deployment to Taiwan

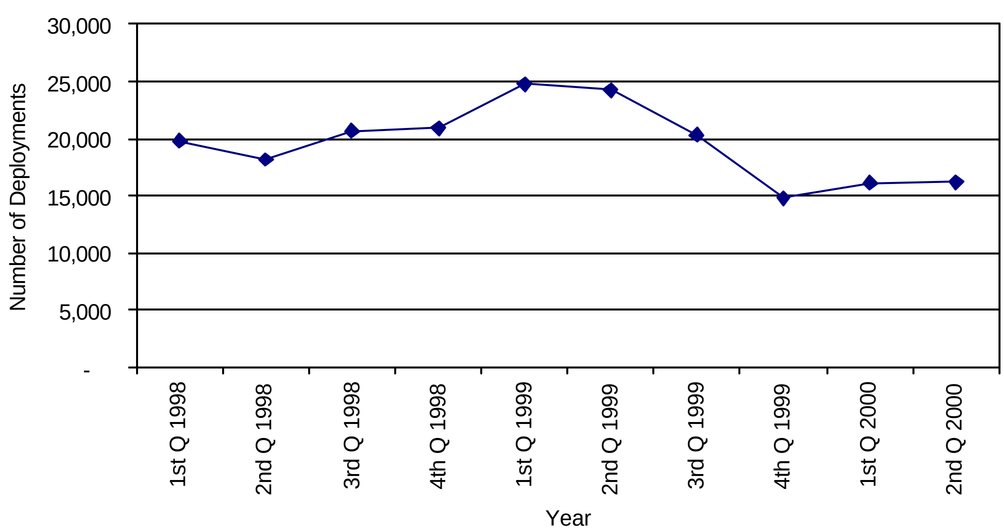


Figure 3. Registered FDI (BSP) Investor=Taiwan

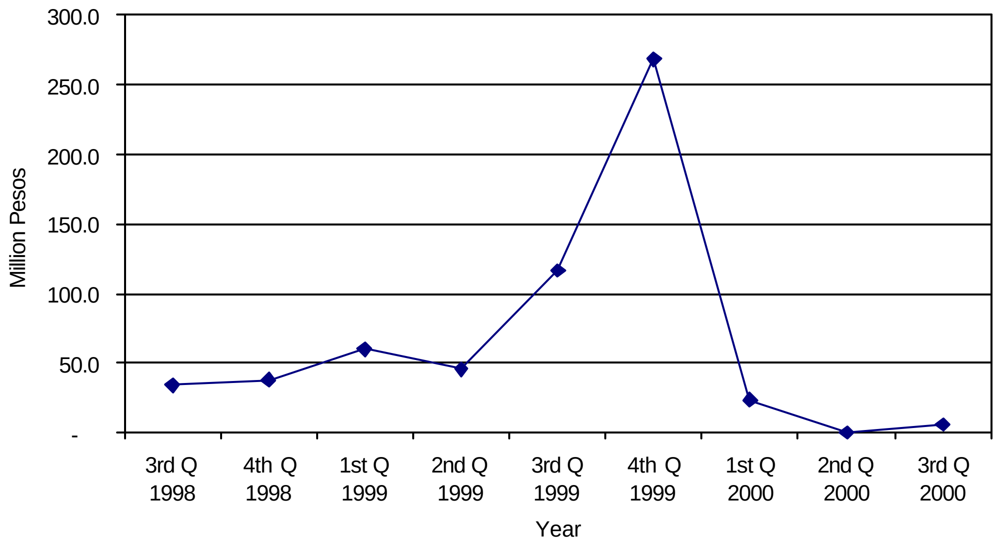
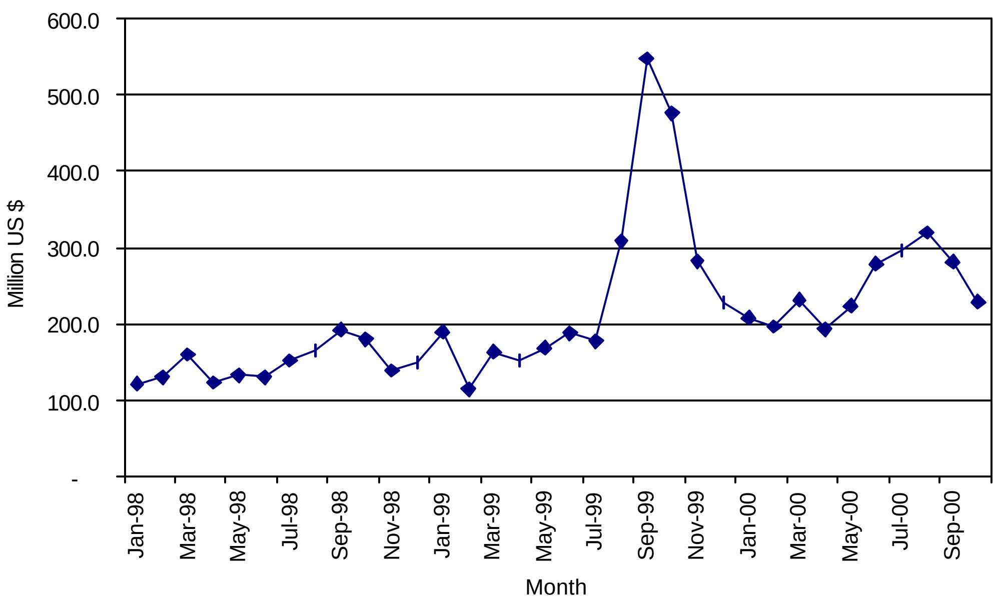


Figure 4. Exports to Taiwan



investments plummeted from P268.8 million in the fourth quarter of 1999 (the quarter when flights were cut) to P23.6 million in the next quarter, to practically nil in the second and third quarter of 2000. Philippine exports to Taiwan plummeted from around $500 million (the highest level ever achieved) around September and October of 1999 (just when the flights were cancelled) to around half the amount starting November 1999 to October 2000.

4.2.3 Salient points and insights from the air war

The salient points and insights from the air war are:

1. In this case, the dominance of vested interests (Lucio Tan or at best the Philippine Air Lines) over national and bigger interests set into motion a process which contradicted and reversed previously set economic policies and already negotiated bilateral agreements. The counter-reaction, not only of the aggrieved other country, but all other losers within the country – such as overseas workers, tourism, trade and economic officials, and businessmen (foreign and local) – set also into motion a round of protests and countermoves to reverse the reversal. This costly process involved not only debates in the Economic Coordination Council, but also a media war between tourism officials, businessmen and overseas workers' organizations on one hand, and officials from Philippine Air Lines, CAB and Office of the President, on the other. It also led to a Senate investigation and recommendation that was contrary to the original reversal of policy. The final result was another reversal of policy, which brought the resulting agreement back to where it was in the first place. This costly process (only to end up where they started) also entailed along the way huge losses of investments, exports, tourist receipts, overseas workers' remittances and a significant souring of goodwill, which is irreversible despite the reversal of the reversed policy.
2. The irrationality of the government move was further emphasized by the fact the PAL was cost cutting and reducing the capacity of their flights, including those in the Taiwan routes, thus aggravating the difficulties of our overseas workers, tourists, exporters and investors.
3. Again, the direct intervention of the President contributed to the gravity of the problem, as predictability and security was lost and possible reversals of policies became very genuine realities. The complaint of IASS Co. of Japan,

after the air war erupted, precisely pointed to the perception that Presidential interventions were causing business transactions to be arbitrarily halted or derailed due to vested interests. The effect of this on longer term investments, not only from Taiwan, should also be considered here.

4. It should be pointed out that it was the intervention of people close to the President that reversed the reversal. These people were those with formal authority (Tourism Secretary Gemma Cruz-Araneta, Trade and Industry Secretary Manuel Roxas II, close ally and party-mate Senator Francisco Tatad, other economic, cabinet officials and party mates). Thus, informal personalistic ties caused the initial reversal of policy. Personalistic ties with people with formal authority caused the second reversal. This emphasizes: 1) the unpredictability the whole process generates, 2) the need to win over political allies of the administration to offset damages done by wrong policies in a system of patronage and clientelist politics.

5. There are still debates up to now as to whether Taiwanese carriers Eva and China Air Lines were actually undertaking ‘dumping’ and ‘under-pricing’ activities in the Philippines, which would have justified the Estrada administration’s actions. Whatever the case may be, it appears that the Philippine government’s actions did not give due importance to proving and demonstrating anti-competitive behavior of the Taiwanese airlines, and seemed by all indications mainly affected by the close relations between the President and Lucio Tan and the need to immediately return the dominance of Philippine Airlines over the Manila-Taipei route.

6. This is corroborated by the anger elicited from Lucio Tan by the second reversal, which almost caused another crisis in Philippine Air Lines. Lucio Tan threatened to sell his majority stake in PAL, demanded the return of the $200 million he used to recapitalize the ailing national flag carrier, and called for the cancellation of all the guarantees he and his companies have extended to PAL to keep it afloat. Journalist Armando Doronila quipped: “Tan’s terms of quitting PAL (were) so tough that these (would have) entail(ed) huge costs to the government, raising questions on whether the government would succumb to this blackmail and whether it could sustain a breakaway from a

crony relationship."[12] The vehemence of Tan's reactions seemed to indicate that somebody in the government owed him a favor, which was initially promised but eventually broken.

5. The BW resources stock market scam

This section deals with the BW Resources price manipulation scandal that rocked the local stock market in 1999. The case provided the backdrop for one of the most dramatic moments in the impeachment trial of then President Joseph Estrada – the testimony of former finance secretary Edgardo Espiritu against his former boss. Its inclusion in the impeachment charges against Estrada signals the growing importance of the stock market in our national life. It also shows that like in other spheres of economic activity, the stock market cannot be divorced from the larger social and political context.

The stock exchange is the icon of free market where prices are determined solely by the interaction of supply and demand and transactions are carried out on arms-length basis. But as the scandal shows, market performance is only as good as the quality of institutions within and outside the market. (Lim, 2001) In this case, the interaction of anachronistic market institutions and political corruption in the context of a liberalized but poorly regulated market produced a crisis of unprecedented scale.

From P2 at the start of 1999, the price of shares of stock of BW Resources Corp. (henceforth, BW) reached a high of P107 on October 11 of the same year. (**Fig. 5**) Acquired by Dante Tan, an Estrada crony, BW was hyped as listing vehicle for Estrada's various business interests, particularly in gaming and property development. Massive trading in the stock overwhelmed a lethargic market. Average value of daily trades reached P3.1 billion in 1999, compared with P2.7 billion in 1996 when emerging markets like the Philippines were at their peak. At the height of the bubble, trading in BW shares accounted for as much as half of total market turnover. Within a week after it peaked, the stock lost 60 of its value. By February 2000, it had dropped to P3 a piece.

[12] Armando Doronila, "New Air Pact Puts Strain on Estrada-Tan Relationship," *Philippine Daily Inquirer*, Oct. 2, 2000.

The phenomenal rise and fall in the price of BW shares was a classic stock market bubble. But it was not only a bubble: it was also swindle of a scale never seen in the history of the exchange. Investigations by the Philippine Stock Exchange (PSE) and the Securities and Exchange Commission (SEC) revealed a grand scheme of market manipulation. It involved several Estrada cronies led by Tan, a close circle of friends and relatives, and a group of influential brokers. Perpetrated for the benefit of Estrada and members of his family, combined elements of political corruption and financial fraud or market manipulation.

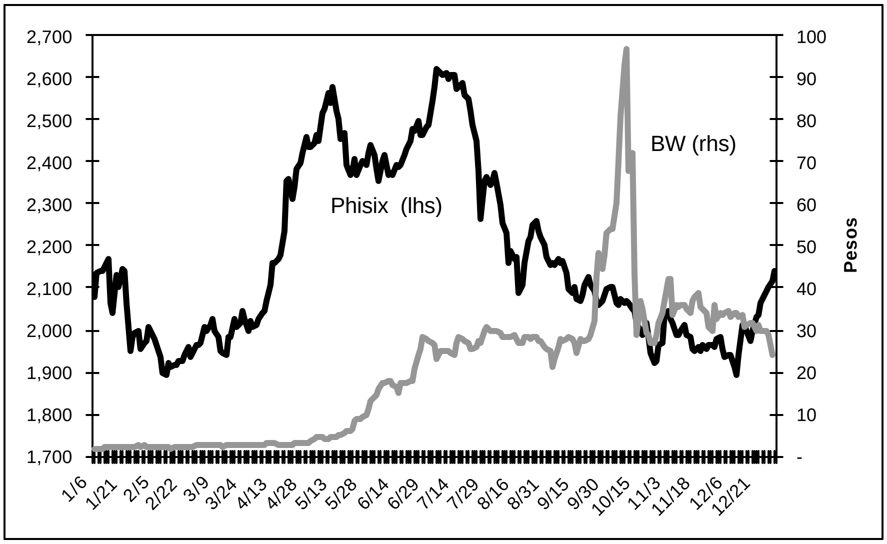


Figure 5. Price of BW Shares and the Phisix, 1999

(Source of basic data: Technistock)

This section examines the role of political corruption in the scandal, the nature of institutions within the stock exchange, and the state of market regulation. The BW scandal provides a fascinating study of how political corruption under the Estrada administration underwent significant transformation in both magnitude and scope. Gains acquired through traditional methods of political corruption – grant of franchises, government contracts, and behest loans – were leveraged in the securities market for greater profit, albeit through fraud. The use of state-controlled financial institutions to abet this process perhaps marks another milestone in the history of corruption in the Philippines.

What sets the BW scam apart from the equally grand schemes of corruption under the Estrada administration was the combination of political corruption and financial fraud. But this raises the question: why is the Philippine stock market vulnerable to this new type of corruption? This paper argues that the answer may be found in the nature of institutions within the stock exchange and the poor regulatory framework that governs the market. Ownership and control of the stock exchange by family-controlled houses, high ownership concentration among listed stocks, the influence of informal networks, and the absence of independent, effective regulatory mechanism render the exchange vulnerable to corruption. These institutions work against transparency of transactions and fair price formation essential to the growth of capital markets.

Weak market institutions and poor governance pose a serious challenge to deregulation, liberalization and the growth of markets. Weak market institutions allows a corrupt state to extend its ‘grabbing hand’ beyond its traditional spheres of influence, that is, the public sphere or at the interface of the public and private spheres. In such context, the growth of the market could imply greater volatility and risk of crisis. As the BW scam shows, the growth of the Philippine stock market as a result of capital account liberalization in the early 1990s has magnified the risk of financial fraud and crisis. The reorganization of the exchange (two bourses were merged into a single exchange) and the opening up of the market to foreign players did not alter the structure of economic interests that underlay the market. Partly as a consequence, market regulation hardly improved. The result is greater risk of crisis as the potential gains from financial fraud increased even as market regulation remained poor.

The discussion below is divided into three parts. The first part discusses the role of political corruption in the BW scam. The second part examines market manipulation and identifies features of the stock exchange that render it vulnerable to financial corruption. The third part shows the failure of market regulation with respect to the BW case. It traces weak governance to the structure of interests in the stock exchange, weak regulatory capacity, and the permeability of regulatory agencies to influence of vested interests and political pressure.

5.1 Political corruption: old and new

The first element of the BW stock market scam – and one that has received the most attention – is political corruption. The case shows the persistence of old forms of corruption and the emergence of new ones. The grant of franchises, government contracts, and behest loans by state agencies (government-owned or –controlled corporations) are familiar tricks of the trade among the politically corrupt. Moreover, the nature of these privileges, the way they were approved, contested and confirmed betrayed the powerful hand of the President. What was new in the BW case was the capture by the President and his cronies of the stock market to leverage assets acquired through corruption for greater profits.

Scams do not always begin as one. It is not inconceivable that Tan's foray into stock trading was inspired by a legitimate business idea: to transform BW Resources (formerly Greater Asia Resources Corp) into the gaming stock of the market. The viability of this plan hinged on two major projects. The company's flagship project was the construction of Sheraton Marina Square Hotel, a hotel-gaming complex acquired from Megaworld Holdings, Inc through a share-for-property swap. In June 1999, BW Resources signed a tenancy agreement with PAGCOR. The latter would occupy 30,000 square meters of the hotel for a monthly rental fee of P55 million or P15,000 per square meter. The state gaming agency agreed to relocate its corporate offices and casinos in Metro Manila.

The other major project involved the merger of Best World Gaming and Entertainment Corp (BWGEC), a company registered with Dante Tan as controlling owner, and which was granted a franchise and license to operate a nationwide on-line Bingo[13]. A second franchise was granted BWGEC in 1999 to operate an online version of the popular numbers game, *jueteng*. With projected income of P14 billion a year from the Bingo business alone, the possible merger of BWGEC and BW Resources made the latter an attractive bet. In July of the same year, Tan acquired a P600 million loan from the government-controlled Philippine National Bank (PNB) with BW Resources and BWGEC as co-borrowers and using the former's principal asset as collateral. The money was supposedly intended to develop the Bingo business.

Talks of the merger began in early 1999, but it was not until the end of the year that a memorandum of agreement was signed formalizing the acquisition of the capital stock of BWGEC in exchange for BW Resources shares. It should be noted that at that point, the online Bingo business has yet to commence. The merger was called off in February the following year as the share price dropped to P3.

Franchises, government contracts and behest loans are tried-and-tested technologies of political corruption. But the BW case went beyond the old boundaries. In this case, the fruits of corruption were not simply appropriated but leveraged in the stock market for even greater profits, albeit through fraud. The combination of political corruption and financial corruption sets the BW scam apart from the many grand schemes of corruption seen in the previous administration. It is to the aspect of financial corruption that we turn below.

[13] A similar application filed by Tan before Estrada assumed the presidency was rejected by PAGCOR.

5.2 *Corruption in the stock market*

Price manipulation involves creating the appearance of active trading of a certain stock in order to drive up the price. There are many ways to manipulate the market – wash sales, matched order, painting the close, transfer of shares to various accounts then selling the shares back to the original owners. Tan and his group managed to do most – and more.

Such manipulative schemes are amply documented in the reports issued separately by the PSE and the SEC. Take wash sales in which the buyer and seller of the shares is one and the same person. The SEC documented 45 such sales by Tan involving over 40 million shares worth some ₱216 billion at market price.[14] In a slight variation of the same scheme, Tan would sell his shares to a dummy, Mario Juan, in a matched order – a pre-arranged sale in which the buying and selling brokers synchronize the posting of their transactions on the PSE's computer system to ensure that the orders match. The shares were then transferred back to the account of Tan.

Another manipulative scheme used was 'over-the-counter' transfer of BW shares from Tan's accounts to the accounts of various individuals. Such transfers do not go through the exchange (hence, over-the-counter). Tan subsequently bought back the same shares, this time through the exchange using matched orders. In a single month, Tan moved 141 million shares from his accounts to various individuals. The biggest recipient was Lucio Co, another Estrada crony, who received some 92 million shares from Tan. In turn, the shares were distributed to various accounts.

To raise fresh funds to finance his trading activities, Tan entered into 'private placement with lock up' agreement with various investors, mostly affiliates and clients of PCCI Securities. In a typical transaction Dante Tan acted as seller of BW shares via an investment contract outside of the exchange. The contract provided that the buyer/investor cannot sell within a certain period, say 180 days. In return, the shares were sold at a discount. Should the market price fall below a prior agreed level then the shares are freed from the lock up provision. The aim was to create a shortage of BW shares by locking them up in these contracts while raising money to finance Dante Tan's manipulative transactions. The device was successful in driving up the price of BW shares. **Fig. 6** shows the volume of shares locked up under these agreements during the period May-October 1999. The rise in the number of shares taken out of the market coincides with the steep rise in the share price over the same period.

[14] Market price is of course misleading as an indicator since it is grossly inflated.

The BW scam is remarkable for sheer boldness. Average value of daily trades in 1999 reached P3.1 billion compared with P2.7 billion in 1996 at the height of the stock market boom. (See **Fig. 7**) At the start of the year, BW shares, which then traded at P2 per share, accounted for a mere one-fourth of one percent of total market turnover. On October 11, value of trades of BW shares hit P3.2 billion or half the market turnover. The share price hit an astonishing P107 during the day. The share price collapsed the following day and went on to lose 60 percent of its value within that week.

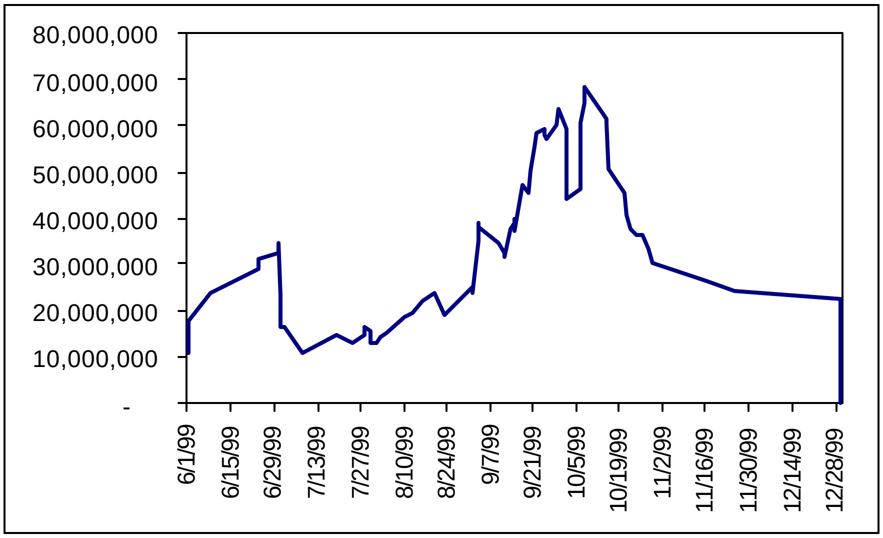


Figure 6. Number BW Shares Under Lock Up Agreement

(Source of basic data: SEC)

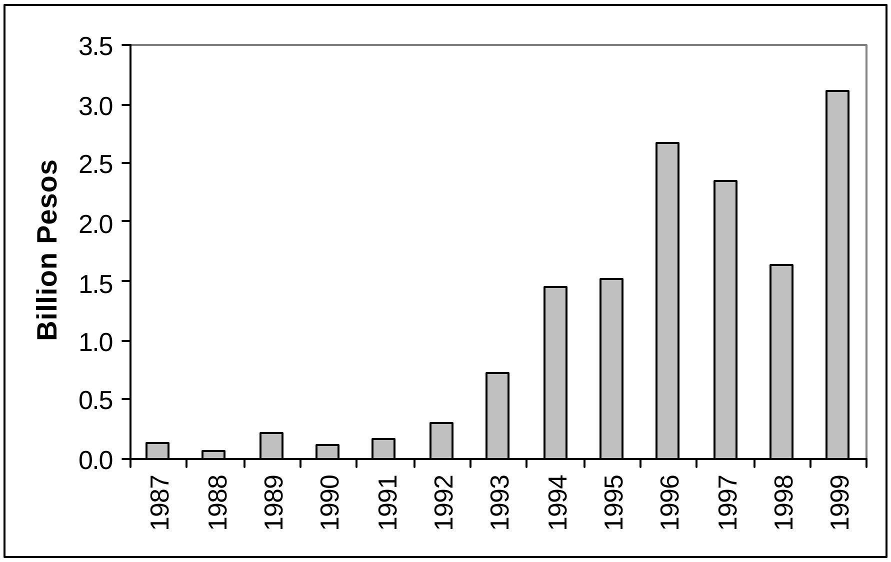


Figure 7. Average Daily Market Turnover

(Source of basic data: Technistock)

The BW scam involved more than a few brokers, including influential members of the PSE. Investigations conducted by the Compliance and Surveillance Group (CSG) of the PSE and the SEC identified 19 domestic brokerages to have repeatedly violated trading rules and regulations. Five of those implicated occupied at that time or have occupied in the last four years a seat in the PSE Board of Governors, including the Chairman Emeritus. Over a period of 10 months, an eternity in stock market reckoning, most every rule in the book was violated. Brokers, Tan and his accomplices and officials of BW Resources were found to have violated a dozen rules all for a single purpose: to drive up the price of BW shares.[15]

5.2.1 Vulnerable institutions

The apparent ease with which the stock market was transformed into a playground of Estrada and his cronies raises a number of questions. For one, price manipulation was independent of political corruption. It did not require the exercise of state prerogatives or political power, although it did refer to assets acquired through political corruption, not to mention the backing of the Office of the President. Moreover, Tan, a distributor of imported tires before he became a business partner of the Estradas, was new to the stock market, naïve in the cunning ways of stockbrokers and dealers. He could not have planned nor orchestrated the scheme. He had to work through a group of brokers familiar with the intricacies of stock trading and price manipulation. This raises the question: why is the stock exchange vulnerable to manipulation and corrupt trading practices? The answers are found in the history and institutional nature of the stock exchange.

First, the PSE is a cartel controlled and managed by brokers. Stock trading in the country takes place on the PSE, an organization of brokers and traders. Arising from the merger in 1993 of two rival exchanges, the Manila Stock Exchange and the Makati Stock Exchange, the PSE became the sole stock exchange in the country. Membership is limited to 200. Members elect a Board of Governors on a one-seat-one-vote basis. The Board of Governors oversees the management of the exchange and the enforcement of rules. It appoints members to the various committees, including the Listing and Disclosures Committee (LDC) and the Business Conduct and Ethics Committee (BCEC). The latter decides on sanctions against erring members based on the recommendations of the Compliance and Surveillance Group (CSG) and the PSE President.

[15] The illegal acts included wash sale, matched order, marking the close, over-the-counter transfer of shares, private placement with lock up, short sale rule, kiting, 'done thru' trades, improper extension of credit, net capital rule, listing and disclosure rules, broker-director rule.

The current structure of ownership and control of the PSE creates serious problems of conflict of interest. Despite the existence of a professional staff to manage the daily affairs of the exchange, the Board of Governors and the various committees exercise enormous influence over management. The conflict of interest engendered by the current setup was played out for all to see in the BW case when the BCEC refused to endorse the findings of the CSG investigation into the case prompting the latter to resign en masse. As we shall discuss below, the same ownership and control structure has created a weak regulatory mechanism within and without the stock market.

Second, small privately-held brokerages dominate the leadership of the PSE. While a handful of brokerages, mostly foreign, are affiliates of large financial institutions such as banks and investment houses that are listed in their respective countries, the majority of securities firms in the PSE are privately held, family-controlled businesses. Out of 174 active members of the PSE, 36 are foreign houses who account for 40 to 45 percent of market share. Serving mainly foreign institutional investors, eight are in the list of top 10 brokers in terms of sales.

The rest of the market is divided among domestic corporate members (120) and individual members (63). Except for a few established brokerages and local bank affiliates, domestic brokerages are mom-and-pop operations with their roots in the old stock exchanges. They cater to domestic retail clients – high networth individuals – and make money trading their own accounts. **Fig. 8**, which plots cumulative market share of member firms against votes held, illustrates the disproportionate influence of small brokerages over the PSE.

Indeed, the composition of the Board of Governors reflects the collective power of small brokerages over the exchange. Between 1996-2000, 25 brokerages held 79 Board seats[16] available to members. Of the 25 brokerages whose nominees were elected to the Board, only six were in the list of top 20 brokers during their year of tenure. The rest were small firms, whose market share ranged from 0.03 percent to 0.76 percent. It was only in 2000 that nominees of foreign brokerages[17] were elected to the Board.

The structure of ownership and control of the PSE accounts for a number of facts of the BW case. For one, all of the brokers implicated in the scandal were domestic brokers,[18]

[16] One board position per year is counted as one. The rest of the board seats are reserved for non-brokers.
[17] ING Baring and Merrill Lynch.
[18] Foreign brokers did not play an active role in the scam owing to internal controls but also because foreign institutional investors as a rule cannot invest in stocks like BW which did not meet certain criteria such as stock liquidity, track record of dividend payments, etc.

each controlled by one or few large shareholders.[19] While some of the key players in the scandal had a corporate/institutional character – PNB Securities is the brokerage arm of PNB and PCCI Securities is part of an investment group of the same name – the mother institutions were also dominated by single large shareholders, Lucio Tan and the government in the case of PNB and the Galang and Lopez (of Meralco fame) families in the case of PCCI. The presence of effective minority shareholders put pressure on the controlling shareholders to disclose information about the firms operations. In the securities industry, minority shareholders act as counterbalance against the controlling shareholders decisions and actions, including engaging in fraudulent trading.

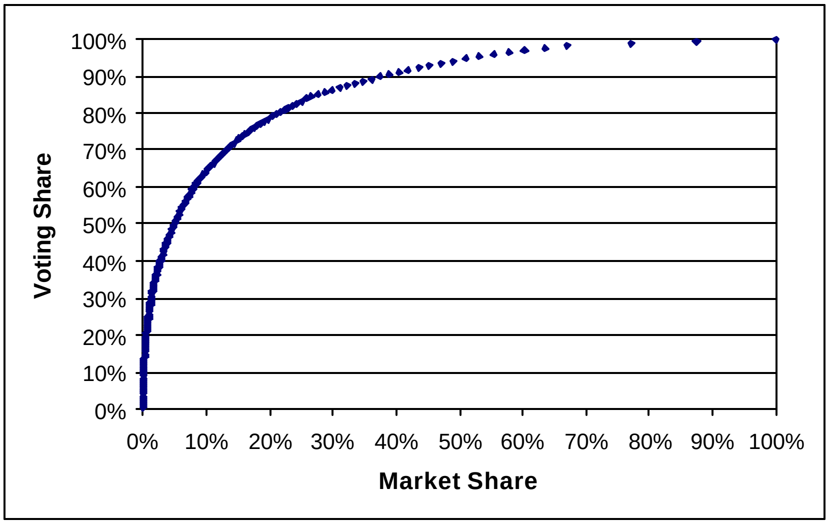


Figure 8. Cumulative Voting and Market Shares of PSE Member Brokers, 1998

(Source of basic data: Technistock)

Moreover, six[20] of the brokers implicated by the PSE and SEC reports were members or have been members of the Board of Governors. Most notable was Belson Securities owned by the Lims. Belson nominee Federico C. Lim was Governor from 1997 to 1999. Eduardo C. Lim Sr. is the Chairman Emeritus of the PSE and presidential adviser to Estrada.

Formal control over the PSE is reinforced by kinship, friendship and business ties. Social ties are indispensable in manipulating the market owing to the illegal nature of transactions involved. In the BW case, a web of relationships leading all the way to the President kept the parties together and ensured loyalty to the group's objective. To give a few

[19] Firm size does not say much about willingness to engage in fraud. Abacus, PCCI, Securities 2000, Angpin and Associates, and Wealth are among the top domestic brokers in the country found to have been actively involved in the BW scandal.

[20] The following are the brokers who held a seat in the Board and the year they were members of the Board: Aurora (1998), PNB (1998), Wealth (1996), Belson (1996-1999), Abacus (1997-1999), and Angpin and Associates (1996).

examples, Eduardo ‘Moonie’ Lim Jr, President of BW Resources is the son of Lim Sr, a presidential adviser. A veteran broker, he is believed to have orchestrated the price manipulation scheme.

Moonie Lim’s daughter is married to Francisco Liboro, the chief executive officer of PCCI Securities, which facilitated the private placement of BW shares. Liboro moved to PCCI from Belson-Prime East Securities which he used to head until it folded up following the Asian crisis. He brought with him his traders and staff. Liboro is known to be a close friend of Raul de Castro who runs the family-owned A.T. de Castro Securities. PCCI is owned by the Galangs and the Lopez family (of Meralco), a son of whom was recently married to Estrada’s daughter.

Armstrong Securities, which is owned by the family of George Go (of Equitable PCI Bank), an old friend of the Estradas is another local broker found by the CSG to have violated trading rules. Go’s name is mentioned in the PSE report as the original recipient of 10 million shares from Tan’s account with Armstrong. Tan later instructed Armstrong to transfer the shares instead to the account of Ramon Lee. The same report noted that the Textite branch of Equitable PCI allowed a check with payee ‘3707’ to be deposited to a checking account maintained in the bank.

The same social ties bound the individuals involved in the scam. Besides Dante Tan, other known presidential cronies implicated were Lucio Co and Carmelo Santiago. Co brought into the picture his wife, two sisters-in-law, a business associate and several friends. Ramon Lee who figured in the transfer of shares to various accounts was a business associate of Tan and former Director of BW Resources. Most of the shares sold through private placement arranged by PCCI were bought by members of the Galang family, various investment accounts of PCCI and staff.

The *third* factor that renders the stock exchange vulnerable to corrupt trading practices is the fact that companies listed in the exchange are publicly owned only in name. For most of these companies, operating (simple majority) and strategic control (two-thirds majority) remain in the hands of a few large shareholders. Ownership data for 194 listed firms in 1997 reveal that the top shareholder owned an average 41 percent of the market value of non-financial companies and 27 percent of financial companies. The same data show that the top five shareholders controlled 65 percent of listed non-financial companies and 59 percent of financial ones. In other words, five shareholders have more than majority control over a typical listed company. Control is virtually complete for the top 20 shareholders: 76 percent for both financial and non-financial sectors.

High ownership concentration encourages corrupt trading practices in two ways. First, through its impact on the quality of corporate governance in which ownership is a key element. Effective participation of minority investors in the firms improves corporate governance by ensuring that management and large shareholders do not expropriate company assets for their private benefit. Information disclosure is crucial to the ability of minority investors to effectively exercise control over company decisions. To such extent, dispersed ownership improves transparency.

Second, ownership affects share price formation through stock liquidity. Dispersed ownership implies that a greater proportion of equity is traded in the exchange. The data on ownership however shows that listed companies barely trade the required minimum number of shares – 10 to 20 percent of outstanding shares. The lack of liquidity renders stocks vulnerable to manipulation.

A related issue is the continued trading of shell companies and the use of these companies for speculative trading and 'backdoor listing'. This practice and the danger it poses to market integrity became evident in the BW scam. If things worked out the way Tan and his cohorts planned it, BW Resources would have served as a vehicle for the public listing of Best World Gaming and Entertainment Corp. BWGEC is a privately held company owned by Tan, which was granted two online gaming franchises by PAGCOR. A small capitalization stock (roughly a billion pesos at the start of 1999, of which 25 percent was floated on the exchange), BW Resources was ideal for manipulating the market.

Finally in this list of institutional weaknesses is poor market governance. The absence of an effective regulatory system is a product of the history of the market, the balance of economic interests within exchange, and the nature of the political regime whose influence permeates the market. We discuss the state of market regulation in more detail below.

5.3 See-no-evil-hear-no-evil regulation

The BW highlights the failure of market regulation. Estrada's intervention in the investigation of the case was only the tip of the iceberg: at bottom is a system that has been rendered ineffective by deliberate design and neglect. Failure was evident at all levels of regulation, from the PSE, which briefly enjoyed self-regulating organization (SRO) status, to the Securities and Exchange Commission (SEC), the watchdog of the capital market, all the way to the Department of Justice (DoJ), tasked to prosecute parties found violating the laws on stock trading. Several weaknesses are evident in the existing regulatory framework. For one, self-regulation in the context of the control of the exchange by brokers gives rise to issues of conflict of interest. Moreover, regulatory capacity is weakened by the lack of clear rules governing illegal trading activities and the inability of the PSE and the SEC to implement existing rules. And finally, lacking a tradition of independence, regulatory agencies are permeable to external influences.

When the BW scam took place, the PSE has just become a self-regulating organization. Under self-regulation, it writes and enforces its own rules and regulations in accordance with the laws governing stock trading, the Securities Act, even as the SEC continues to exercise its regulatory powers. Two advantages present itself in a system of self-regulation. First, a self-regulating body derives status, respect and self-respect from the fact that it is trusted to regulate itself, which in turn motivates it to make the system work. Second, a body in charge of its own standards and their enforcement is well placed to find appropriate and workable methods to maintain standards, whereas externally imposed regulation may turn out to be inappropriate, inflexible or unworkable.

Revoked it the wake of the price manipulation scandal[21], self-regulation was doomed to fail in the context of ownership and control by brokers of the exchange. Self-regulation requires a high degree of separation and independence from the affected parties without which serious conflicts of interest arise. We have mentioned above the dominance by small brokers of the Board of Governors and key committees of the PSE, which explains the reluctance of the PSE leadership to look into the BW scam unfolded and go after the parties involved. This despite sufficient evidence gathered by the Compliance and Surveillance Group (CSG), the PSE's internal regulator, and mounting public pressure to do so.

Besides conflict of interest, self-regulation is undermined by weak regulatory capacity. The problem lies not so much in the law as in its implementation. Many provisions of the RSA have no implementing rules and regulations making it difficult to prosecute erring brokers.[22] The adoption of the system of self-regulation in 1998 was not accompanied by procedural guidelines leaving the PSE and the SEC to do as they please. In some cases, the PSE and the SEC conducted joint investigation. In others, SEC took the initiative. In the BW case, the PSE complained that it was left alone to deal with the fiasco. The SEC had sent two teams of investigators to the PSE to look into the BW case only to pull them out two days later without any justification. On November 25, 1999, the SEC suspended all investigations related to the case to avoid duplication of the PSE's efforts.

[21] The concept of self-regulation is formally adopted by the revised Securities Act of 2000.
[22] Until recently, the lack of clear rules and procedures was not confined to the securities law. In 1999, the SEC finally adopted corporate bankruptcy procedures on the basis of PD 902-A promulgated in 1972.

Where the rules are clear, there is readiness to set them aside. For example, the share-for-property swap between BW and Megaworld, another publicly listed company, was signed in October 1999. The agreement required the former to issue 1.2 billion in new shares, raising the company's outstanding shares to 2 billion. A month later, the additional shares had yet to be listed with the PSE as required by the rules. The increase in capitalization was assessed and approved by the SEC.

Weak regulatory capacity combined with a laid back attitude allowed the BW scam to proceed unchecked. As a rule, company disclosures are rarely if ever examined critically. Several times, trading was suspended because the price breached the range within which it is allowed to move during the day. No action was taken beyond asking the company the reason behind the unusual price movement. This response of company officials was unvarying: we have no knowledge of any material information that might have affected prices.

Nor did PSE regulators question BW officials who presented to the public a number of acquisition plans which would have involved the issuance of several billions of new shares despite the fact that the company's outstanding shares amounted to no more than 425 million. Company officials were not required to present business plans and the necessary financial projections. Instead, they adopted a company report issued by PCCI Securities as part of company disclosure, but even this was based on overly optimistic assumptions and was not supported by the necessary financial statements.

The entry of Stanley Ho into the company did not raise alarm among PSE regulators. Ho was shown the red carpet by PSE officials and given the honor to ring the trading bell at the Ayala trading floor. Company officials claimed that Macau's gambling tycoon who was elected chairman infused some $30 million into the company. Records, however, showed he had no more than 10,000 shares to his name.

Under the existing regulatory framework, regulatory authority is primarily lodged with the SEC. Self-regulation by the PSE provides an additional layer of market regulation, but it does not diminish the responsibilities of the SEC as watchdog of the capital market.[23] Ensuring that the PSE meets its responsibilities as a self-policing institution becomes an important task of the SEC. Its primary function, however, is to prevent and punish fraud in order to maintain the integrity of the securities market.

[23] When the US Congress created the US Securities and Exchange Commission in 1934, stock exchanges had had a 140-year history of regulating their own members. The SEC was superimposed on this system of 'self-regulation' as an addition level of regulation. (Ilano and Mariano, 1995, p. 61)

The BW case brought out in the open long-standing weaknesses of the SEC as a regulatory institution. The watchdog of the capital market, it adopts a see-no-evil-hear-no-evil attitude in regulating the market. In its 50-year existence, no person has been convicted of insider trading or similar illegal trading activities, a fact that speaks more of the poor state of market regulation than the integrity of the stock market. Constitutionally independent, it has not been beyond the reach of politics and the influence of vested interests. As quasi-judicial body, it has not avoided charges of corruption from lawyers and litigants. As a collegial body, it has, during critical moments, failed to speak with a single voice, effectively undermining its authority.

Inaction on the part of the SEC was most auspicious in the BW case. The SEC issued its first official directive relating to the trading of BW shares on 30 September 1999, only two weeks before the stock hit its peak on 11 October. The SEC directed the PSE to inform the Commission within five days what surveillance measures the PSE was undertaking to ensure that no irregularities were being committed in the trading of BW and AHI shares. In late October after the stock has collapsed, the SEC sent two investigating teams to the PSE but recalled them two days later. On 25 November, it suspended all investigations related to the BW to avoid duplication of effort.

Constitutionally independent, the SEC was subject to intense pressure coming from the highest office of the land. Preparatory to the manipulation of the market, EO 63 issued on 13 January 1999 put the SEC under the direct supervision of the Office of the President. On 6 September, the President issued Memorandum Order 73 which required 'investigations of any transactions or entity under the supervision or regulation by the SEC shall not be conducted … except by authority of the Commission en banc.' Likewise, the order provided that no care or matter being handled by any hearing officer, auditor, investigating officer or examining officer shall be reassigned to another without the consent of the Commission en banc. The order effectively clipped the powers of the SEC chief who was then at odds with Malacanang.

At the height of the BW crisis, the President issued a gag order on the SEC Chairman. The order directed the Chairman 'to refrain from issuing public statements and policy declarations affecting the securities market… without prior clearance or approval of the Office of the President. Finally, there was the series of calls from the Office of the President to SEC officials, including the Chairman, to influence the ongoing investigations. Malacanang's intervention took a heavy toll on the effectivity and integrity of the SEC. A SEC order issued March 7 suspending trading in the PSE was set aside the following morning by another order signed by four commissioners, not including the SEC chairman. At a most critical period, the SEC could not get its act together.

To its credit, the SEC conducted its own probe of the scam and in the process came up with three reports. The reports served as the basis for the filing of charges against the parties involved. Issued after the PSE report on the scam, they improve on the PSE report and offer comprehensive documentation of the build up of the bubble until it burst in October 1999.

The emasculation of the regulatory mechanism did not end with the SEC. Likewise, Malacanang's influence was only too apparent as the case reached the Department of Justice (DoJ). After months of stalling, the DoJ finally issued the result of its preliminary investigation into the complaint filed by the SEC. In the midst of the impeachment process, the DoJ agreed to file charges against Tan but only with the lightest offense – nondisclosure of significant ownership of a listed company. It cleared all the brokers on the ground that one cannot possibly arrange a wash sale or matched order given that trading at the stock exchange is done through a computer system. This despite documents showing that such illegal trades were done – and done many times over.

5.4 Concluding remarks

The change in government following the aborted impeachment trial changed the course of the BW case. The new administration has taken the first steps to close this dark chapter in the history of the stock market. The SEC filed a new complaint with the DoJ against a dozen brokers and close to 50 individuals led by Tan and other Estrada cronies, accusing them of market manipulation and other violations of the securities law. Moreover, charges of graft and corruption against Estrada on the basis of the BW scam have been filed with the Sandiganbayan.

Beyond the legal battles, the more difficult task of reforming and strengthening the stock market and its regulatory framework lies ahead. The current structure of economic interests that underlie the stock exchange and the market's governance mechanism renders it vulnerable to market manipulation. The major obstacles to promoting transparency of transactions and therefore fair price formation is the dominance of small, family-controlled brokerage, high ownership concentration among listed firms, control by brokers of the PSE leadership reinforced by informal networks and channels of authority, and the lack of independent regulators. Poor regulation is less an accident of history than a product of the balance of interests that has dominated the market. It is these weak institutions within the exchange that allowed political corruption as exemplified by the BW price manipulation scandal to work way through the market.

Our discussion of the BW case carries several implications. One, corruption is not the monopoly of the state. Corruption also afflicts the market. What produced an explosive case like the BW crisis was the combination of state and market corruption. While ultimately related, these two processes are to a large degree independent of each other. It did not take the exercise of state prerogatives to manipulate the price of BW shares, although such manipulation referred to state franchise and contracts with government.

Two, the need for strong regulation in the financial and capital markets. Financial markets, in particular the capital market, present a special case because these markets are inherently prone to fraud. It should not be a surprise that the most sought after stock exchange in the world – the New York Stock Exchange – is also the most regulated. In the absence of an effective regulatory framework, we should be very cautious about developing the capital market.

Three, the importance of institutions within the market and the link between interests and institutions. Most crucial at this point is the ownership structure and control of the PSE. Reform in this area is critical if self-regulation, which is adopted by the new securities code, is to become meaningful. SRO or not, market regulation is implemented by or filtered through the workings of the PSE. That is why it is necessary to restructure the Exchange.

Many of the issues brought out by the BW scandal have been addressed by the Revised Securities Act of 2000. Reforms, however, has met vigorous opposition from affected parties. Reforms such as demutualization of the PSE which aims to separate ownership and management of the Exchange, the removal of the broker-dealer rule, increased power of the SEC to examine the books of brokers, have been effectively stalled and opposed by affected brokers.

What makes the task doubly difficult is that domestic brokers who dominate the PSE have been regaining lost ground in terms of market share as a result of the prolonged weakness in the market. The weak market recovery since the crash of 1997/1998 has been propelled mainly by local players. A strong resolve combined with creativity will be needed to sustain the momentum of reforms so far.

6. Changing the governance structures and values system

This paper in various respects shows how weak our institutions and governance structures are and how they somehow failed to withstand the pressures of a particularly vicious type of paternalistic patronage politics that have gained authority and power. The Estrada administration had replaced key formal authority lines and rules with informal personalistic ties, favors and vested interest cuddling.

Nowhere was this more obvious than in the successful attempt of eleven senator judges to blatantly disallow (using an illogical technicality of 'irrelevance and immateriality' to the articles of impeachment) conclusive evidence of ill-gotten and unexplained wealth on the evening of Jan. 16, 2001. This was a clear case of the complete breakdown of the institution of the Senate and of the impeachment process itself. It implies an initial condition of bias in favor of the President by a majority despite overwhelming evidence of guilt. This is remarkable given that the Senate had been viewed most of the time as having more integrity than the Lower House. Again this subversion of the institution of the Senate did not happen overnight as some people may think. It had been going on as cultivation of friendships (some literally using the 'godfather' relation), personal favors and as Cardinal Sin calls it 'envelopmental' arrangements between the patron and his clients occurred over time and finally paid off when the final crunch and crucial time came. It is also illustrative of how laws (no matter how well formulated) have arbitrary interpretations. Rulings by the justice system, more often than not, depend more on mere technicalities (even wrong ones) rather than on the real merits of the cases. We have to view this as part and parcel of clientelism and how it sabotages formal authority and formal rules and institutions. It is indeed intrinsic to the system of clientelism and the patronage system.

The rendering of the Senate as a 'damaged institution' (as Senate President Pimentel would call it before tendering his resignation) finally doomed whatever possibilities the state institutions, governance structures and constitutional processes could have had in using the impeachment process to correct the rotten system that was developing. Extra-constitutional processes had to take place. This important fact was completely lost on the Lee Kuan Yews, Time and Newsweek magazines and International Herald Tribune that followed the American obsession of law above humanity, constitutional processes before morality. They saw on television what seemed to be a fair impeachment trial, ignored the backroom deals and patronage system, and claimed that it was the Filipino people, and not the Estrada administration, that subverted the constitutional processes.

The institutions and governance structures, even if weak and helpless in many respects, did allow some free flow of information, and did allow some freedom of expression and dissent, thanks to no small respect to the first people power revolution against the Marcos dictatorship. The strong counter-force and resistance to the Estrada administration was made up of a powerful coalition of big business and a sizeable portion of the elite, the established Catholic Church, most Protestant churches and Muslim groups, former Presidents, and practically the entire organized sector of trade unions, people's organizations and non-government organizations, including the entire spectrum of the left. This coalition, as in 1986, provided the strongest pressure for change in the system, and delivered the extra-constitutional processes needed to overthrow the corrupt government.

One thing will have to be emphasized. This is the often overlooked but important role of culture and the values system. Decades (and perhaps centuries) of clientelism and patronage systems, both inside and outside the state, have bred among many of us a value system that tolerates patron-client and personalistic relations even as they subvert national interests and thus views corrupt and unfair practices more acceptingly than we would admit. This point of view was the biggest ally of the Estrada administration since it either blinded people to the unfairness of corrupt practices or justified them on the pretext that everybody else (including past regimes) is practicing corruption. This view had been caricatured as one that tolerates corruption by a patron as long as the winnings are shared by the patron with his clients ('balato')[24]. It allowed the established order to be able to organize its own mass rallies as long as favors and gifts were given. Together with the massive funds channeled to radio stations and other media outlets catering to the masses, this value system allowed the Estrada administration to attempt and succeed temporarily to gather enough mass support, which some opinion poll surveys lavished on the media.

But history provides important moments and conjunctures when events happen and the people and masses are forced to rise above vested, partisan interests and fight for the common good and national interests. These are the moments of the Chavit Singson revelation, the Clarissa Ocampo and Edgardo Espiritu testimonies, and, finally, the Senate vote not to open the sealed envelopes. When this happens, the moral conviction of the citizenry that decides to go to the streets and fight for a higher good would be far stronger and committed than any patron-client and 'exclusive boys' club' sentiment. Thus the number of people in the streets announcing their disgust of the Estrada administration,

[24] This is not helped at all by the 'exclusive boys' club' and fraternity mentality which absolves influential wrongdoers of any punishment or ostracism simply because they are one of the boys.

should be weighted – in terms of potential impact and effectiveness – much more than those who chose to stay in their homes. (This is not a one-vote one-count situation. The opinion poll surveys therefore gave a wrong assessment of the political will of the people and a wrong reading of the political situation, which caused the Estrada administration to miscalculate the situation completely.) They would be able to stimulate the nationalist and patriotic sentiments as well as moral indignation from among even the staunchest friends and clients of the established order[25]. This was how both the 1986 revolution and people power 2001 succeeded.

7. Political and institutional reforms: A necessary condition for economic development

7.1 Mea culpa from economists

It is finally dawning to us economists that extra-economic forces are important factors that make and unmake economies. Fortunately the trend in theoretical economics and new institutional economics talk of important needs to provide clear property rights, competitive and fair play, to tackle 'market failures' and to ensure correct and enlightened governance and regulations, as we discussed in the first half of this paper. The old conservative school of economics had preached for many a decade that markets and private sectors, on one hand, and the state and its intervention, on the other, are competing entities that are incompatible. Hands-off policy by the state on economic matters had been the prescription for decades.

Now a more enlightened environment allows us not to blame all economic woes on state interventions per se but to scrutinize good interventions from bad interventions, good governance from bad governance and good states from bad states. Equally important is the realization of the need for good governance and institutions as a precondition for economic development. Instead of making state / market and state / private dichotomies and promoting anti-statist policies, a more open and flexible model of state-market and state-private partnership and cooperation, not in production as economists fear, but in regulation and governance can now be adopted. Furthermore, economistic beliefs that economic

[25] Again this is what the Lee Kuan Yews, Time, Newsweek and International Herald Tribune fail to see, so much so that they cannot distinguish genuine people power from plain 'mob rule'.

liberalization, deregulation and privatization on their own automatically result in the rise of better institutions, governance structures and value systems have been refuted by the case of the Philippines[26] and most other countries[27]. Thus economists would have to work in a more interdisciplinary spirit and finally respect the other less 'exact' social and political sciences since human, social and institutional frailties, bounded rationality and outright irrationality (from an economistic viewpoint) are more the norm than the exceptions. In the end, we economists need the other social sciences more than they need us.

7.2 The need for rules, regulations, and proper incentive structures: But who will do it?

The more enlightened new institutional economics theories would try to come up with rules, regulations and incentive structures to tackle the requirements for 'market failures', regulatory needs, property rights ascription, and provision of a competitive and fraud-free environment and to ensure performance and merit-based criteria in order to reduce patronage and personalistic relations. If done well, these would be major contributions. One can have good policy papers on what programs to adopt to stop money laundering in the financial institutions, or what laws and procedures would be beneficial so that chances of identifying and punishing corrupt public official will be enhanced. One can even focus on important enforcers, regulators and instruments of justice such as the Office of the Ombudsman, Commission on Audit, the Securities and Exchange Commission and the judiciary. But there is something more basic than these.

First, no matter how good rules, regulations and incentive structures are, they will come to naught if the particular regime in power is captured by vested interests that subsume national interests under theirs. This is illustrated in the cases that we had taken up in this paper. The *jueteng* scandal precisely broke clear rules and laws that prohibit top officials from participating and partaking of the fruits of illegal gambling. The laws broken were clearly mentioned in the impeachment proceedings against ex-President Estrada. It also involved inappropriate granting of a gambling franchise. Similarly the air war with Taiwan was a questionable abrogation of an already existing bilateral agreement and executive order and goes against the spirit of a very clear executive order. Thus in both cases there were clear rules and regulations, and existing regulators and enforcers. The bad policy was breaking or arbitrarily changing the rules in favor of dubious interests.

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[26] i.e. the weak and negative impact of governance structures in the post-liberalization administrations in the eighties and nineties

[27] The case of Russia wherein the shock treatment of market liberalization, deregulation and privatization without the corresponding institutions and governance structures would be the most striking example.

This brings to fore the related question as to who will choose, regulate and veto the regulators? A bad regime representing vested interests that are incompatible with national interests will obviously nullify the effects of good rules and incentive structures and neutralize good regulators and enforcers[28].

Second, new institutional economics tells us that the dominant atmosphere countries face is one of uncertainty, 'market failures' and bounded rationality. We cannot foresee all possible problems, volatilities and dangers that confront the country and its economy. Thus good governance includes proper discretionary policies to meet unforeseen circumstances, which existing rules and regulations may not be able to tackle and deal with. Regimes captured by narrow vested interests will no doubt manipulate current problems and volatilities in the system for their own benefits, and not to the national interest.

7.3 The need for a relatively autonomous state with a development vision

Because of the two points (the need for a relatively autonomous state not captured by narrow vested interests and the inadequacy of existing rules and regulations to solve national problems), important questions such as "Will clipping the powers of the executive branch be beneficial?" or "Will a switch to a parliamentary system of government be good for the country?" cannot be independent of the type of ruling coalition that is emerging in the country. Thus, they are secondary to the more important question: "Is there the possibility of a political force and coalition committed to reform and economic development which can win power and eradicate patronage and personalistic relations and politics in government?"

The histories of economic development of countries all point to the need for the ascendance of a ruling coalition that has a developmental and long-run vision for the country. These may be as varied as the originally imperialist and colonial ruling powers of the developed countries (which are now mostly made up of liberal democratic governments) to the strongly right-wing authoritarian People's Action Party of Singapore, to the Communist-led government of China (which is strongly committed to a market economy). How these coalitions eradicated or neutralized the powers of vested interests are themselves the stories of development of these countries. They were achieved through means as varied as revolutions, civil wars, democratic elections, and elimination of rival groups in the same parties or coalitions. Not all the governments are likeable ones and many are still

[28] This affects not just 'corrupt' policies but also controversial policies that break social cohesion, such as the recent banning of 'Live Show', which effectively nullified decisions by the regulators by top officials.

authoritarian and repressive. But what they do have is some recognition of national interest, a relatively autonomous state that punishes vested interests that go against national interests. Some have been horrendously tyrannical governments – such as the Pinochet government of Chile and the Park Chung Hee government of South Korea – which over the decades were eventually replaced by more liberal and democratic regimes.

7.4 In the Philippine context, a reformist, pro-poor government and genuine political parties are needed

In the Philippine context, since we want this done democratically and with as little repression as possible, the only option is to ensure a reformist government voted in strongly by the electorate for a substantial period of time[29]. This is of course easier said than done. To be effective the reformist government will have to be strongly developmental in the sense of having a long-run vision of economic development for the country, free of inimical vested interests and strongly pro-poor in orientation. This is almost asking for a miracle since all past governments of the Philippines in our less than six decades of independent rule had been narrow and short-term in vision, and controlled and manipulated by powerful interest groups (from landlords to business cronies to Mafia-type syndicates).

Most importantly, the poor majority of the populace have not been included and have never participated in the political, economic and social life of the ruling governments. This has led to their cynicism and suspicion of the ruling elites. Nowhere is this more clearly demonstrated than in the refusal of many poor sectors of the population to cooperate with the new Arroyo government and their continuing strong support for the populist Estrada. Many have argued that this is due to lack of information, lack of education and wrong value systems of the masses. All these may have partial contributions to the phenomenon. But the constant answer one gets if you ask the Estrada supporters their view is that: 1) all governments without exception have been corrupt, 2) the poor have never gained anything from any of the governments, 3) except the respect, sympathy and identification they get from Estrada. This points to one important point: that a democratically elected reformist government will have to win the support of the poor majority and make them feel that they are respected participants and beneficiaries of the developmental process of the country.

[29] This allows the reformist government to change the rules of the 'game', incentive structures and political practice (in short, institutions and governance structures) permanently so that succeeding governments will inherit a system of conducive and viable set of economic and political institutions.

The need for a reformist government capturing power in a democratic context implies the hard task of building genuine political parties with clear and serious political reform platforms with party members committed to these reforms. This is an arduous task for us as a people since historical forces have made political parties in the country convenient venues for diverse politicians to compete for political positions and posts. No genuine political parties with clear interests and stands on issues have yet emerged.

7.5 Positive factors towards a reformist party and government

History provides conjunctures and opportunities for a people to irreversibly change their destinies for the better. The EDSA revolution in 1986 was one such occasion, which in many ways brought us forward, but unfortunately (as partly discussed in section 3.2) did not change things drastically enough to improve our governance structures and development prospects. People Power II of 2001 should provide another such opportunity which we can ill-afford to waste.

Today in April 2001, there is a strong feeling from a large section of society -- the business sector, the intellectuals, the media, a sizeable portion of the youth and the middle class, and practically all organized people's and sectoral organizations -- that the most important current issues are corruption and governance. Although the current political parties are still traditional and operate through political favors, lobbying, connections and wealth, the lines are pretty clear as to which parties and political candidates cater to strong vested interests (and their attempts to parry off corruption and other criminal charges), and which ones are more open to political reforms and better governance. This coalition of People Power II, if politically astute and unified, must be able to effect the electoral victory of politicians who will be more cooperative in starting the difficult task of rebuilding political and social institutions as well as governance structures.

Another bright spot is the eagerness in which people's organizations and civil society organizations (including left-leaning ones) are now joining the electoral processes (and party list system), and their determination to effect changes and reforms in government and civil society. These organizations need not just be watchdogs and fight for cause-oriented issues, but can become potential partners of the state in the development process, especially in the difficult task of including the poor and disadvantaged in the political processes and economic benefits of the country. Indeed the genuine reformist political party we are envisioning to take over power in the country must be in alliance or partnership with organized sectors representing the peasants, the workers, the urban poor, the indigenous peoples, women and other sectors of civil society.

In concrete terms, political empowerment of the masses via these organizations cannot be successful without economic empowerment. The anti-poverty struggle in the current economic liberalization context must be interpreted as ensuring the capacity and ability of the poor and disadvantaged sectors (let us call these the people's sector) to effectively become productive and compete in the economic and business arena. This concretely requires them access to resources (infrastructure, skills, education, capital, market outlets, input sources) which the state can more effectively provide with the help and cooperation of the various people's and civil society organizations.

7.6 Negative factors to change and reforms

Although we are faced with a positive environment for change, we must be aware of the even stronger negative forces deeply entrenched in our society which will oppose moves for reforms and positive changes in governance. The most obvious forces are those vested interests that have good access to top government posts and positions. Even the main political party of the new government includes factions and individuals who have joined the political processes for their own narrow interests. With the patronage and personalistic system still dominating, the dangers of the new dispensation falling into the same traps as its predecessors are very real. This has become very apparent with the political favors given to some government appointees, which gained access to their posts not because of better qualifications and abilities but because of access to the main political party and powerful forces.

These dangerous forces have, as in the post EDSA revolution in the second half of the eighties, succeeded somewhat in instilling in the mainstream political thinking that the only flaw in our political system was the greed and evil of one man or one family who gained power, not the pervading dominance of vested interests and patronage and personalistic culture in government and civil society. This view, as we mentioned in section 3.2, led previous governments to forego necessary political reforms and go back to the old ways of allowing alternating factions of the elite to take over government via elections and sham political parties without platforms. It is so much easier to get rid of a bad government than to build a genuinely good one.

The biggest enemies are not the existing vested interests but the dominant culture and values system that permeates after centuries of patronage and personalistic systems in

Philippine politics and governance. One can see this in the lack of concern of the general public concerning genuine political issues in the current electoral campaign, and the fascination with personalities and celebrities. While this is largely due to the lack of community and national consciousness (over and beyond family and clans), it must be emphasized that this is also due to the frustration and cynicism with government we have discussed earlier.

Indeed rising above personal and familial interests – to interests that concern the community and the nation – requires a change in the educational and values systems which a reformist government will take decades to implement. A short-cut to deriving national interest from the populace is to make them feel that they have a stake in the government that takes over power, and that they and their families will benefit from this government. This is a miracle which the cause-oriented groups, together with reformist political parties and a little help from committed and charismatic leaders, may be able to do within our lifetime.

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