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**The Inability of the Philippines to Use its Bargaining Power
Effectively to Attract Foreign Direct Investment (FDI) for its
Economic and Social Development**

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Abstract

In recent times, developing countries have accelerated their policies from protectionism to more open economies to achieve higher rates of economic growth. The implementation of economic reform measures together with offering tax breaks and additional incentives aimed at attracting foreign direct investment (FDI) have gained momentum as countries compete with each other to attract further investment from multinational corporations (MNCs). It has been observed that many developing host nations lack negotiating skills when dealing with MNCs for effective implementation of relevant investment projects.^{1 2} The process of bargaining and negotiations between individuals and groups from MNCs and host governments to achieve the best possible deal is an important feature of the relationship and interaction between these parties.

Raymond Vernon's 'obsolescing bargain theory' adds to the literature in explaining the relationships between MNCs and host governments, and this thesis links Vernon's theory to the Philippines' case. Case studies and interviews were significant, particularly in analysing two recent cases of government intervention to existing investments. The expropriation by the government of the Ninoy Aquino International Airport Terminal 3 built by Fraport AG and the termination of mining activities as a result of a mining disaster in Marinduque caused by Marcopper Mining Corporation were both cases that were referred by the Philippine government to the Philippine Supreme Court. The study emphasises that the Supreme Court's decisions in both cases had both negative and positive implications for the Philippines' bargaining power. Along with the above cases, three other case studies highlighted the significance of the relationships between the host country and the MNCs. These were of two corporations; Samsung Electronics Philippines (SEPhil), and Nestle Philippines; and the other the Philippine Economic Zone Authority (PEZA).

¹ Morton, Kathryn & Peter Tulloch. 1977. *Trade and Developing Countries*, Overseas Development Institute, Croom Helm, London, England, p 240.

² Anderson, Jean & Patrick Macrory. 2008. Helping the World's Poorest Nations Benefit from Global Trade, *World Trade Magazine*, August 4, 2008, available from http://www.worldtrademag.com/Articles/Column/BNP_GUID_9-5-2006_A_1000000000000394048

The overall study, therefore, explores the extent to which the MNCs and the host government (in this case, the Philippines) use their bargaining power to gain advantage over the other in the bargaining and negotiation process. More specifically, the study analyses the bargaining power of the Philippines. The thesis explains why the country is ineffective in using its bargaining power to achieve its economic and social development objectives, attributing its inability to do so to the weakness of the government in addressing its many internal problems.

Statement of Originality

This work has not previously been submitted for a degree or diploma in any university. To the best of my knowledge and belief, the thesis contains no material previously published or written by another person except where due reference is made in the thesis itself.

Daniel J. Ringuet.

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List of Abbreviations

ADB	Asian Development Bank
AMCHAM	American Chamber of Commerce
ANZCHAM	Australia and New Zealand Chamber of Commerce
AO	Administrative Order
ARC	Agrarian Reform Communities
ARMM	Autonomous Region in Muslim Mindanao
ASEAN	Association of South East Asian Nations
ASG	Abu Sayyaf Group
BCDA	Bases Conversion Development Authority
BETP	Bureau of Export Trade Promotion
BIR	Bureau of Internal Revenue
BOC	Bureau of Customs
BOI	Board of Investments
BOT	Build Operate and Transfer
BSP	Bangco Sentral Pilipinas
CARP	Comprehensive Agrarian Reform Program
CDC	Clark Development Corporation
CDC	Continually Developing Country
CEO	Chief Executive Officer
CFNU	Council of Filipino Nestlé Unions
CIP II	Carmelray Industrial Park II
CPP	Communist Party of the Philippines
CPW	Cereals Partners Worldwide
DAR	Department of Agrarian Reform
DENR	Department of Environment and National Resources
DFAT	Department of Foreign Affairs and Trade
DHA	United Nations Department of Humanitarian Affairs
DOLE	Department of Labor and Employment
DOST	Department of Science and Technology
DTI	Department of Trade and Industry
EDA	Export Development Act
EMG	Estate Management Group
EO	Executive Order
EPZ	Export Processing Zone
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FTAA	Financial and Technical Agreement
GCR	Global Competitive Ranking
GDP	Gross Domestic Product
GTEB	Garment and Textiles Export Board
HG	Host-government
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
IE	Industrial Estates
ILO	International Labour Organisation
IMF	International Monetary Fund
IPE	International Political Economy
IPP	Investments Priorities Plan

IT	Information Technology
IUF	International Union of Food Workers
JTCI	Jurong Town Corporation International
JV	Joint Venture
LDC	Least Developing Country
LGU	Local Government Unit
MBC	Mindanao Business Council
MNC	Multinational Corporation
MNLF	Moro National Liberation Front
NAIA IPT 1	Ninoy Aquino International Airport Passenger Terminal 1
NAIA-IPT 3	Ninoy Aquino International Airport Passenger Terminal 3
NEDA	National Economic and Development Authority
NPA	New People's Army
ODD	Optical Disc Drive
OECD	Organisation for Economic Co-operation and Development
OMS	Optical Media Solution
PBEC	Pacific Basin Economic Council
PCCI	Philippine Chamber of Commerce and Industry
PD	Presidential Decree
PDG	Placer Dome Giant
PEZA	Philippine Economic Zone Authority
PIATCO	Philippine International Airport Terminal Company
PIDS	Philippine Institute for Development Studies
PLDT	Philippine Long Distance Telephone Company
PNR	Philippine National Railway
RA	Republic Act
R&D	Research and Development
RIRR	Revised Implementing Rules Regulations
RP	Republic of the Philippines
SBMA	Subic Bay Metropolitan Authority
SC	Supreme Court
SEC	Securities and Exchange Commission
SEPhil	Samsung Electronics Philippines
SEZ	Special Economic Zone
SME	Small and Medium Enterprises
UNCTAD	United Nations Conference on Trade and Development
UNCTC	United Nations Centre on Transnational Corporations
UNEP	United Nations Environmental Program
US	United States
WHO	World Health Organisation
WTO	World Trade Organisation
WB	World Bank

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I particularly want to also thank my dear parents for giving me life, even though it was a life often in transit away from my dear island Mauritius, which I have always missed – my mother for her efforts with raising so many children and showing me that in life you can get by with very little, and my dear father, your passing from this earth has left a huge gap in my life, and to you, the most intelligent man I have known, I thank you for showing me the meaning of learning. I remember sitting by your side that one special night as you told me how much I looked and did things like you, and that I should never stop following the path of knowledge. Well, I am still learning and I miss your words of wisdom, particularly, “to stop writing would end my life”.

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“The justification for many major actions could only be explained as a hedge against the murky future or as a commitment to a learning process” (Vernon, 1971:117).

Chapter 1 Introduction

1.1 Introduction

This thesis is a study of the bargaining power of host governments and multinational corporations (MNCs)³. The study was based primarily on the interactions between MNCs operating in the Philippines, with their aims to maximise the profitability of their investment, and the Philippines as a host government, with its aims and objectives for the economic and social development of the country. This first chapter of the thesis presents the background of the study, specifies the problem of the study, describes the argument of the thesis, details the methodology and gives an outline of each chapter.

1.2 Background of the study

The bargaining power of a host country and a MNC is very important to both parties as they come together to negotiate the potential investment. Both the host country and MNC negotiators will seek to gain the best possible outcome and in the process have to factor in the potential benefits or perhaps even the losses to either party. According to Stern and Tims, “bargaining is a process in which parties with different interests and conflicting objectives attempt to reach an agreement which benefits the parties in rough proportion to their strengths” (1975:225).

Many governments in developing countries such as the Philippines are interested in attracting and engaging MNCs because of the ability of MNCs to raise and provide capital, and to provide technology, information and managerial skills. In effect, MNCs are viewed as catalysts of sorts (Chan, 1995). MNCs are very important participants in

³ For the purpose of this thesis the international corporations engaging in FDI will be referred to as Multinational Corporations (MNCs). In the literature they are also referred to as Transnational Corporations (TNCs) and Multinational Enterprises (MNEs).

most nation-states' economies and have been more so particularly in the post-World War II era. However, competition is fairly strong and governments use their various attributes as bargaining chips to indicate to potential investors that their country has the necessary features to attract and sustain MNCs' operations. As such, it could be argued that developing countries have an obligation to their constituents to work collaboratively with MNCs in their quest to achieve a higher living standard similar to that of the developed Western economies and countries like Japan and Singapore.

Furthermore, many emerging, developing and the least developed countries are highly reliant on MNCs to further explore, process, ship, market and distribute their countries' raw materials and to export manufactured goods. This gives the MNCs some bargaining power. On the other side of the spectrum, MNCs are interested in tapping these countries' raw materials, low labour costs, domestic market potential, as well as any incentives that may be associated with locating processing plants in Special Economic Zones (SEZs). The more of these that a host country has the higher its potential bargaining power. This suggests that both developing countries and MNCs can gain from foreign direct investment (FDI) projects and each has bargaining power.

To assist in the process of their developmental goals, many governments seek the resources provided by MNCs. Of particular interest is foreign direct investment (FDI) in the form of joint ventures, acquisitions and new businesses – Greenfield investments – that offers these countries access to capital that might otherwise be unavailable (Holder, 2000). However, it could be argued that governments need to monitor the use of this capital to ensure it reaches areas that they have specifically targeted to achieve their objectives for economic development and in the process increase the social and living standards of their constituents.

The bargaining power of both the host government in the developing country and the MNC will be analysed in more detail to ascertain the commitment of both parties to each other, particularly during the negotiation process. Hence, the failure to overcome certain barriers during negotiations can often mean that many potential good agreements may not be realised (Mnookin, 1993). Often what is good for the government is not necessarily good for the MNC, and vice-versa. As will be indicated

and accepted throughout this thesis, firms “expect their investment will lead to higher returns” (Moon and Roehl, 2001:202) because they need to promote the economic interests of their shareholders, whereas the host government needs, for example, the additional capital and technology to increase employment prospects, build much needed infrastructure and promote more export-oriented manufacturing that will lead to the generation of positive economic growth and social development.

The effect of FDI, particularly in its early stages has shown clear benefits to host countries and is viewed to be very important. For example, when an investor enters a country, it allows the host country access to the investor’s modern technology and that of others linked to it (Holder, 2000). In addition, it produces enhanced employee training and multi-skilling, managerial expertise and accounting practices, as well as access to foreign markets that are most valuable to developing countries. As such, this thesis concurs with Holder’s (2000) argument that many proponents of FDI consider MNCs to be one of the most important institutions of interdependence in regional and world trade. However, it is not the most important, because there are several other factors that can enhance a country’s economic growth in combination with FDI. In the host country, FDI projects can assist in raising living standards and provide more and even improved employment for those displaced by the migration of older activities to other countries (Holder, 2000). In addition, Holder argues that there are also strong arguments against FDI in developing countries and concerns about the use of inappropriate technology, the repatriation of profits to the MNC’s home country and the belief that MNCs aggravate the already unequal distribution of wealth in developing countries. However, whilst this may be the case in some countries, not all MNCs operate this way, and many are very responsible corporate citizens who most of the times abide by the laws of the host nations (Holder, 2000). However, even though they may be responsible corporate citizens, the cumulative effects of MNCs may not necessarily see effective transfer of technology and equal wealth distribution to the host country.

The history of FDI has been characterised by periods of conflict. In the 1950s and especially in the 1960s and early 1970s, large numbers of foreign owned investments were nationalised in many developing countries. Holder (2000) indicates that particularly hard hit were investors in plantations, public utilities, mining and

petroleum. Many other foreign investors were forced to take on local partners in their overseas subsidiaries through joint ventures.

1.3 Statement of the problem

The Philippines⁴ possesses a very well-educated and skilled low labour cost workforce that is very proficient in the English language, which translates as a bonus to investors who would normally have to train staff in the local language. In addition, the country possesses abundant mining resources⁵ that are now available for mining since changes to the Mining Act took effect with the recent Supreme Court decision to allow for the re-entry of foreign investment in that sector. As well, on the positive side, the Philippines has much to bargain with based on the number of procedures and authorities necessary to establish an investment. For example, to further promote much needed foreign investment, the country passed laws to create the Securities and Exchange Commission, the Board of Investments and the Philippine Economic Zone Authority (PEZA). Incentives available as a result of the Omnibus Investments Code of 1987 (Executive Order No. 226) to companies willing to locate their plants in PEZA locations are generally fairly competitive. These incentives have been a major drawcard for investors in the country.

On the negative side, however, the Philippines shows high levels of political instability and political risks, which are causes of concern for potential investors. The difficulty in gaining the confidence of investors, however, is that there are several factors that can impede the ability of the government to negotiate with and attract MNCs to the country as it competes with other surrounding nations for much needed FDI. The thesis recognises that there is not one single factor which can be blamed for the lack of confidence investors show, rather there are a number of factors such as corruption, a highly influential and powerful oligarchy, political instability, threats to foreigners, risks of government interference with investments, as was the case with Fraport AG, and the threats of expropriation and renegotiations of existing agreements

⁴ See Appendix 1 for a Map of the Philippines

⁵ The major principal minerals that are abundant in the Philippines include copper, gold and nickel. The copper deposits are similar in quantity to Chile. During the 1970s chromite and manganese were mined extensively in the Philippines

between MNCs and the government. All of these factors combined can be and are used by MNCs to demand more concessions, more ownership preferences, more trade-offs between equity and non-equity benefits, and less control on export performance which effectively places them in a better bargaining position than the host government regardless of the government's bargaining power.

The problem is that in comparison to neighbouring countries in East and South East Asia, the Philippines has not been capable of effectively bargaining with and attracting the more powerful and larger MNCs. In addition, when considering that the Philippines has managed to liberalise its FDI policies, particularly in the last 25 years, in an environment that has had the necessary investment policy and incentive measures following extensive reforms which have now been implemented, FDI inflows to the country are still very limited. The reason, therefore, that the Philippines lacks the ability to attract the larger corporations to invest in the country is due to a combination of issues. Firstly, the inability of the government to address the influence of a powerful oligarchy on the political, economical and societal front sends signals to potential investors that the government is ineffective and weak in dealing with such a problem and appears to be reluctant to do so. In addition, the combination of factors such as political instability, corruption, poor collection of taxes, insurgencies and high levels of poverty has the effect of diminishing its bargaining power.

1.4 Argument of the thesis

This thesis argues that the Philippines does have bargaining power, but it is not using this effectively to achieve its objectives. As indicated in the statement of the problem, this is because of the weakness of the government in dealing with its internal environment, which clearly inhibits the Philippines' ability to attract substantial FDI from larger MNCs⁶ for its economic and social development.

⁶ Definitions of FDI and MNCs – as will be further shown in Chapter 2 – are important to make clear the importance of both to a host government in determining how it approaches potential investors for entry into the country. FDI serves as an important stimulus to the expansion of the export sector in many developing countries. It generates foreign exchange, employment and taxable income in the host country. However, despite substantial inflows of foreign investment, many countries still face severe balance of payments difficulties, rising urban unemployment and rural underemployment.

FDI is important for the Philippines in that, as the literature suggests, the gains from FDI to the host-countries have been particularly significant in the area of economic and social development. In recent years, governments such as that of the Philippines have become increasingly more receptive towards FDI. However, in the scramble for more FDI, it appears that the country allows MNCs to venture into the Philippines regardless of the type and size of the investment. As will be shown in Chapter 5, the Philippines needs to consider FDI critically and ensure that they only enter into agreements that would be of benefit to the country. For this to happen, the Philippines would need to be able to maximise its bargaining power. Furthermore, once the government decides to enter into an FDI agreement, they need to ensure that there is a clear and detailed agreement that cannot be overridden by other parts of the government, thereby providing much needed certainty and stability. Nevertheless, as will be demonstrated in the course of this thesis, parts of the government still interfere in ways that are seen as unfavourable by MNCs. In addition, governments change, which can lead to expropriation, cancellation or re-negotiations of contracts or investment approvals that were reached at the point of negotiations or at the point of entry of the MNC in the country of investment.

To avoid such potentially severe consequences, the initial bargaining and negotiations need to go through a process that revolves around issues such as the terms of the project, particularly those of ownership, management, range of products and services, location, profits and incentives, all of which are important components of the final agreement and decision. However, several other issues are instrumental in swaying MNCs whether to enter or not. Aside from other competing neighbouring countries, these also include political instability, political regime and conflicts between factions such as religious and ethnic groups. Lack of resources and a domestic market are also factors that influence an MNC's decision. Negotiations and bargaining are processes in which parties with different interests and conflicting objectives attempt to reach an agreement. This can be analysed by an investigation of the bargaining and negotiation processes between the MNCs and the host governments that can demonstrate the potential gains to both parties from managing negotiations effectively because the bargaining process needs to be conducted fairly to boost each party's bargaining power.

Particular attention will be given to Raymond Vernon and his theory of the “obsolescing bargain”, a phenomenon he founded, established and explained. The study will demonstrate that the “obsolescing bargain theory” can be further explained and expanded by researching more into the relationships between MNCs and host governments by focussing on the bargaining process. The debate about the theory’s relevance is dealt with in chapter 2 and in particular section 2.5. The author recognises that while the “obsolescing bargain theory” was initially developed by Vernon for a study of the mining industry, it will be proposed and argued that the theory can be applied in several other sectors of investment and the economy. Of particular mention here is the Fraport AG case, which is an infrastructure project. In more recent times the obsolescing bargain theory has proven to be valid where some new governments nationalised certain utilities and services when it became apparent that privatisation had not been fully successful in certain sectors.

This study examines the bargaining power of the Philippines with that of multinational corporations who have either set up or are intending to invest in the Philippines. It is argued that, although the Philippines does possess bargaining power, it is not fully able to utilise that power, mainly because of political instability and the political risks that MNCs confront when seeking to invest in the country. The argument gives a thorough examination of the current investment climate of the Philippines and some of the historical features of FDI in the Philippines that have either weakened or strengthened the country’s bargaining power. Particular criticism is aimed at the Marcos regime and the weakness of the Philippine state under his administration. The Aquino and Arroyo administration are also partly analysed to highlight how they have dealt or deal with internal issues that may have contributed to scepticism about the potential of the Philippines as an investment destination. The thesis also analyses the objectives of the Ramos administration which had begun to improve the economic environment, but this was somewhat short-lived under the Estrada administration.

The task of identifying the bargaining power of the Philippines is made even more difficult because the question itself is only indirectly addressed in the literature, as will be demonstrated in the literature review. However, it was generally agreed

throughout interviews conducted during field studies in 2004 that the country did have bargaining power but lacked the ability to use this effectively to attract the larger MNCs.

Furthermore, the argument for or against a country's bargaining power is difficult to determine, because the MNCs appear to be the party which possesses more bargaining power. It will be shown by this thesis, however, that although both parties have the capacity to bargain for the best possible outcome, the Philippines does not use its bargaining power to its advantage. As a general concept, bargaining power is found in a vast area of literature. For the purpose of this thesis, bargaining power relates to the transactions between MNCs and the host government in relation to FDI. Whilst the most recognised definitions of bargaining power are found across various sectors of labour and industrial relations (for example, trade unions and their negotiations with employers and government agencies), this thesis recognises that the process is fairly similar, as each party seeks to dominate or get the better deal out of the bargain.

However, there are certain areas of concern which the government needs to address in order to meet its perceived or required development policies. In order to enhance the employment opportunities of skilled and unskilled workers, the government will broaden its goals to attract MNCs that have a strong business support base who will look at employing a great number of people, that is, companies who provide management skills, transfer of technology, expansion of exports and, most importantly, capital. The infusion of capital into the country will help with the balance of trade, increase tax revenues and assist the government in addressing areas that will enhance national security and national interests whilst at the same time ensuring that there is no loss to its sovereignty.

The MNC will also want an investment environment where set-up difficulties are minimal, so culture and language are important prerequisites. Other important factors are the size of the market, tax incentives, incentives to improve the skills of the workforce and absence of labour unrest that could impact on the company's production activities. Infrastructure support is also of extreme importance as the MNCs will need access to unlimited reliable and cheap power, water, transport routes etc.

The MNCs will also endeavour to seek a strong research and development support base. Moreover, what the MNC wants from the bargaining process must be consistent with their vision. Most importantly, however, the corporation will look at ownership and will seek to determine from the host government the limits of Foreign Equity participation and in what sectors as this could impact on competition within the industry and between local industries.

This thesis shows that as far as MNCs are concerned, their bargaining power lies in the firm-specific advantages they command in product and process technology, manufacturing, marketing, capital, management skills, firm size and worldwide commercial intelligence. Of these they need to retain in-house control, but governments have to be accommodated in their national economic and non-economic goals if the MNCs are to be able to function effectively wherever they operate, particularly where their expertise exceeds that of the host country. However, Alburo argues that “there may be even cases, where Filipinos’ expertise is better than the MNCs” (Alburo, 2004), and the Philippines should maximise and capitalise on such a situation.

All the interviewees for this thesis agree that technology transfer from MNCs has been beneficial to the Philippines. Technology from MNCs gives the Philippines the opportunity to compete in a technology-driven world economy. As stressed by Greg Domingo (2004): “where one does not have the right technology means one will miss out on trading”. Greg Domingo (2004) argued, however, “that there are some corporations that never transfer technology, despite all attempts by government to obtain information”. However, there is always some benefit to the Philippines because, even if the MNC does not transfer technology, they are somehow transferring management techniques, good management practices and quality standards. Greg Domingo insists that “One cannot expect a company that has invested millions of dollars in a particular technology to just give it to anyone because it is natural for corporations to keep some of the most sensitive technology for themselves” (Domingo Greg, 2004).

On the issue of the appropriateness of technology brought into the Philippines, respondents argued that technology for everyday use is never an issue. The technology brought in by Samsung is in fact helping Filipinos specialise in the IT industry. Nestlé brought food and beverage production facilities that allow Filipinos the capacity to manufacture and meet the demands for certain products in their country and overseas. Technology brought in by the mining industry has been criticised because of the environmental damage from mining operations. However, it can be argued that the technology brought in by mining companies is suitable for the Philippines because it allows Filipinos easy access to economically viable mineral resources that profits the economy. The issue is not the mining technology but how the managers accommodate for better waste disposal strategies.

In consideration of both the MNCs' and the host government's needs, it is highly important to look at many factors that influence the outcomes. For instance, one has to establish what sort of political pressure there is on host government negotiators, whether applied at the domestic or MNC level. In addition, in facilitating the bargaining process, what sort of time period is involved and are there obvious shifts in the bargaining positions?

Furthermore, it should also be pointed out that the experience of the teams involved in the negotiation process is important as is their preparation. For example, how informed are both parties? Besides the demand for renegotiation of original agreements (Vernon's "obsolescing bargain"), other issues of importance in the negotiation process are how the possession of bargaining power can be turned into success and how conflicts may be avoided during negotiations when there are such issues as the influence of local and political groups and their interplays; parent company influence on representatives; potential risks and/or removal of risks; the size of investment; control and management of the investment; and ownership and locational advantages (Dunning, 1993).

Other issues that will be touched on are the host country's policies (intervention, ownership, incentives etc.), host-country level of economic development, cultural/social and political risks, market size, infrastructure, technology transfer, effects on local industry, sustainability of investments and political resources. Whilst

it is not possible to look at all these factors within this thesis, it is the intention of the author to discuss several of the most important issues.

1.5 Methodology

This study contains qualitative and some quantitative research methods. A communication and case study approach was used. These are further explained below. The study focuses on two main groups, MNCs and host government. Whilst the study engaged current MNC management and host government (HG) negotiators, it was also necessary to interview various other groups in order to gain a more comprehensive analysis of the bargaining power of the two parties.

1.5.1 The communication approach

The main objective of the “communication approach” (Cooper and Schindler, 2000) is to obtain the views, expertise and experiences of individuals as primary sources. The approach requires that people be questioned or surveyed and their responses recorded for analysis. One of the most important features of ‘questioning’ as a primary data collection technique is its versatility. For example, the availability of information about past events may only be obtainable from the person being interviewed/questioned who can recall past events. Moreover questioning can be more efficient and economical than, for example, an observation approach.

One of the difficulties that may be encountered during the course of data collection can be viewed as a shortcoming of the questioning approach. That is, the quality and quantity of information that may be secured is highly dependent on the willingness and abilities of participants to co-operate. They may feel there is no value in participating, they may have fears for personal reasons, or they may see the interview as too intrusive or problematic. Van Hook argues for example that “intensive and intrusive [interview] methods could prove problematic, where the necessarily voluntary participation might well become more of a cultural measurement of a participant’s proclivity to volunteer, yielding culturally skewed results” (2003:13).

Extensive interviews were conducted to formulate an understanding of the processes in the negotiations, the bargaining power, the intentions, the priorities and the real outcomes both parties expect or aim for. All interviewees were informed prior to the interviews being conducted that the researcher had taken all measures possible in line with Griffith University's Office for Research Ethics Committee on Human Research Project Proposals.

The focus groups were categorised into levels of importance; for example, a Chief Executive Officer (CEO) was placed on the same level as a Senator and/or a Member of the Philippines government. The study indicates clearly the impartiality of the researcher; this was needed so as to appease any tensions that may have arisen in the course of the interviews.

The research participants⁷ were all briefed on the need for doing the interviews and surveys. They all received written communication well before and in anticipation of agreeing to be interviewed. However, several of the representatives of the companies and/or organisations/institutions made their own selection of who was to be interviewed, and in some cases this person only became known to the researcher on the day or the eve of the interview. They were informed as to why the study was being conducted. By preparing the research participants effectively for the interviews and surveys, this ensured that the study's main aim of finding the bargaining processes would be achieved. Several of the participants elected to remain anonymous and requested that their names not be shown in the content of the thesis. As a result of maintaining their confidentiality, these participants are shown within this thesis as Interviewee 1, Interviewee 2 and Interviewee 3 (see Appendix 3 (Confidential)).

In this way the thesis has been further developed to explore in more depth the projected outcomes and benefits to both the MNCs and the host country. Many of the concerns raised during the interviews came about as a result of discussions on other important issues such as corruption, law and order, lack of governance, the influence of the 'rich/elite families' – as some would refer to them – the Catholic church, the poor and high levels of poverty.

⁷ See Appendix 2 for a List of all Interviewees.

Collection of data and information was done in 2004 over a period of six months, during which time three and a half weeks were spent doing field research in the Philippines. The field research in the Philippines was done in person predominantly in Manila, Quezon City, Laguna and particularly Makati City, and in several cases by telephone to business communities in Mindanao. Some follow-up to the original field research was made on another trip in 2006 to Makati City.

The selected interviews are of a particular focus group consisting of individuals such as managers, government representatives, local institutions, business group representatives and agents. The most appropriate and relevant samples are of people who had been or are engaged in the negotiations. Telephone interviews were carried out during a two-month period, and written requests for information were conducted to the end of 2005.

Face-to-face interviews⁸ were conducted and timed according to the level of importance of the interviewee. Face-to-face interviews involve direct contact between the researcher and respondent. This form of contact arose through approaches made by the author of this thesis in preparation for the interviews. One of the real advantages of personal interviews resides in the depth of information and detail that can be secured.

As well as interviews, the study conducted surveys to give respondents the opportunity to give their opinions of the expected outcomes they would prefer to see. The surveys and interviews were conducted mainly in the Philippines; however it was necessary to do some of the interviews within Australia with representatives of Australia-Philippines business organisations.

Dunning contends “the setting up of a foreign or domestic subsidiary requires a new team or network of decision makers who not only have to relate to each other, but also to those of the parent company. It is at this point that the locus of decision taking becomes an important issue” (1993:223). In order to further explore bargaining power

⁸ See Appendix 4 for a List of Questions used during the interviews.

and Vernon's "obsolescing bargain" it was necessary to obtain the views of the interviewees. It is further emphasised that Vernon's theory is dealt with and expanded on in this thesis due to the political situation in the Philippines.

1.5.2 The case-study approach

It will be the contention of this thesis that the main benefit of using a case study approach is that the focus on one or a few instances allowed for the research to deal with the subtleties and intricacies of complex political, corporate and social situations. In particular, this approach enabled dealing with political and social processes in a way that is denied to the survey approach. The case study approach allowed for the use of a variety of research methods. More than this, it more or less encouraged the use of multiple methods in order to capture the complex reality under scrutiny, the bargaining process.

The case study approach is particularly suitable because it gives the researcher little or no control over events. Because the approach is concerned with investigating phenomena as they naturally occur, there was no pressure on the researcher to impose controls or to change circumstances. However, there are some disadvantages; the point at which the case study approach is most vulnerable to criticism is in relation to the credibility of generalisations made from its findings, some of which can be soft data, which can often be viewed as lacking the depth required for effective research. However, generalisations, whilst at times controversial, can also enable the effectiveness of critical analysis and, in many instances, can assist the interviewer in informing the participants that there may be some misinterpretations, misimpressions of events and issues, and to some extent people and/or organisations.

Another important factor to consider is that negotiating access to case study settings can be a demanding part of the research process. As well, it is hard for case study researchers, for example, to achieve their aim of investigating situations as they naturally occur without any effect arising from their presence. This is where it is important for the researcher to have access to the research location for an extended period of time.

In the process of determining the bargaining power of the Philippines and MNCs, five case studies were conducted. One of the case studies on infrastructure was done on Fraport AG; a German enterprise engaged and contracted in the building of the Ninoy Aquino International Airport Terminal 3 Extension. The condition at the Manila International Airport was of concern, particularly in the areas of traffic flow and security. This project was named NAIA Terminal 3. Fraport AG and Philippine International Air Terminal Company (PIATCO) were the main stakeholders in the building of the terminal. Fraport AG sought compensation from the Philippine government as a result of the government being pressured to take over the project by other contractors and a Supreme Court ruling that the contract was null and void. In this particular case, as indicated in many parts of the thesis, infrastructure is undoubtedly an important area that the Philippines needs to and must improve.

Another case study was done on mining, and this was on Marcopper Mines, a company that was set up by a Canadian firm in agreement with the Philippine government to mine for copper in Marinduque. A leak caused a major tailings spill which severely affected the environment. As a result the government was pressured by groups within civil society such as anti-mining campaigners, indigenous communities, NGO's and religious organisations to prevent any other mining contracts being awarded to Foreign Mining companies until a Supreme Court ruling.

Since the debate from several sources within this thesis clearly demonstrated the importance of mining in the Philippines, a ruling in favour of allowing foreign investors to engage in mining activities was of utmost importance. Because of the debacle and the subsequent pending ruling from the Supreme Court, no foreign mining firms were permitted to operate in the Philippines. As a result, the Supreme Court ruled in December 2004 that the Mining Act be changed to permit the re-entry of foreign mining companies into the Philippines. The Philippine economy will be markedly improved as it relaxes the laws for entry in this particular area. However, these companies will now be subject to stringent environmental monitoring.

The information for both Fraport and Marcopper was obtained from interviews of government officials and representatives of business groups. In addition some secondary information was obtained from government internet sites and press

releases. A third case study was done to highlight the importance and involvement of the Philippine Export Zone Authority (PEZA) in the promotion of FDI into the Philippines. Within this case study, reference is made to two Special Exporting Zones, one public and the other private.

Two further case studies were done on manufacturing, dealing with, firstly, Samsung Electronics Philippines (SEPhil), a leader in innovation and technology and an MNC that has been one of the successful companies to be given incentives and priorities within a PEZA Export Zone. As will be demonstrated in the PEZA case study, Samsung is seen as one of the success stories of the Philippine government's FDI policies. The second case study, in food and beverages, is Nestlé Philippines, a subsidiary of Nestlé Switzerland, and an MNC that has been in operation in the Philippines since the early 1960s. This company demonstrates how a foreign company successfully operates in the Philippines and its impact as one of the major employers and contributors to the Filipino community.

Even though Nestlé's reputation in Africa has suffered enormously due to the infant milk formula problems in many LDCs, the company's representative in the Philippines acknowledged that it would strive to ensure a recurrence of this magnitude did not happen in the Philippines. Although China has now become the major destination of most MNCs for manufacturing, this thesis recognises that the Philippines has for many years been fairly competitive in manufacturing. Through its competitiveness and skilled labour, it has become and still is one of the hubs of manufacturing in the region. However it needs to become much more focussed – as will be discussed in more detail in the following chapters – on seriously improving the overall infrastructure of the country, particularly in the Metro Manila region, as is evident with the seriousness of the problems with the transport system.

This research recognised that, in light of its World Trade Organisation (WTO) membership and the bilateral agreements it has with several other countries, the Philippines is still viewed cautiously by investors. Adding to the main thesis, it is recognised that both MNC and host government need each other no matter who has the more bargaining power. There are many issues to consider for both parties and additionally, when the bargaining process is in place, there is a need to understand the

factors that can and will influence the outcomes. On the basis of the case studies conducted, the thesis will establish the motivations behind the negotiations and the outcomes for the host countries and the MNCs.

The empirical research and studies of the interactions between MNCs and host governments highlight the bargaining power and/or structure of negotiations. However, the lack of a decisive explanation of the processes of bargaining demands this thesis take a concerted approach to a very important and fundamental process. This research contributes to the theoretical and empirical knowledge of the bargaining power of MNCs and host governments. The thesis also adds to the current knowledge on FDI, which it does by focussing on a developing country, the Philippines, and the conceptual framework that will be developed will examine the effects of negotiations on the bargaining interaction between the host government and the MNC. The thesis will also further expand on Vernon's "obsolescing bargain theory", and explain the link between bargaining power and MNC/host government performance.

1.6 Structure and outline of chapters

Chapter 1 identifies the main contending views of the author of the thesis and the reason for this research. The introductory chapter highlights the statement of the problem and the argument of the thesis. The chapter also explains the methodology, which details the reasons why a communication approach as well as a case study approach were the best selections for this particular study. This section also looks at the data analysis and the research participants; it also focuses on the motivations behind the negotiations between MNCs and host governments.

In **Chapter 2** an extensive and systematic review of the literature pertaining to this thesis is undertaken. This literature review is highly focussed on critically examining the processes that occur between MNCs and host countries. Included also is an explanation of the importance of negotiation and a detailed overview of aspects of negotiations that are critical to both the MNCs and the host governments. The literature review also incorporates the sources of bargaining power, the theoretical framework, and explains Raymond Vernon's "obsolescing bargain theory" and its

relevance to this thesis. Other theories are also considered since they do fit within the framework of the thesis; these are analysed but not, however, to the extent of Vernon's theory. Particular focus is given to the contributions of Theodore Moran in the study of MNCs and these entities' impacts on developing countries. This chapter also highlights host governments' investment environments, particularly in reference to their bargaining potential.

Chapter 3 deals with the importance of FDI and economic development in the Philippines. In this chapter there is an evaluation of the progress the Philippines has achieved since the removal of protectionist policies by the Aquino and Ramos administrations, and the role that FDI and MNCs have played in the Philippines. The chapter highlights the effectiveness, commitment, or lack thereof, of the Philippines in promoting the country as a foreign investment destination and how it uses the benefits of FDI in promoting its economic and social development. In addition, the chapter analyses the political aspects of the country and the impact of political decisions on the economy. The chapter also gives a historical overview of the country in its quest for economic development. Furthermore, the chapter provides several figures indicating performances of the Philippines in the process of its economic development.

Chapter 4 reflects an analysis and assessment of the Philippines' bargaining power and its use of or inability to do so. This is done by an analysis of current politics and historical factors that have influenced decisions that have impacted positively or negatively on economic planning. Most importantly, this chapter analyses the many important views and responses of the in-country studies and interviews undertaken during the writing of this thesis. This chapter incorporates the findings from these interviews conducted from field research in 2004. The chapter also focuses on the advantages and disadvantages that can affect the bargaining power of the country.

Chapter 5 focusses on five important case studies which highlight the bargaining power of the Philippines in attracting or deterring MNCs in their decisions whether or not to invest in the country. Four companies' activities are analysed, these being Fraport AG, a German company engaged in infrastructure development, building and management; Samsung (SEPhil), a subsidiary of Samsung Korea specialising in

manufacturing electronics; Nestlé Philippines, a subsidiary of Nestlé Switzerland, involved in food and beverages; and Marcopper Mines, a company owned and operated by Placer Dome, a Canadian corporation. In addition, the chapter includes a case study of the Philippines Economic Zone Authority (PEZA) to explain the significance of the authority in promoting Ecozone sites for potential investors and the importance of or relevance of this authority in adding to the bargaining power of the country. The thesis also analyses the Philippines' approach, experience and expectations in relation to foreign investments. These case studies confirm the main argument of the thesis that the Philippines has bargaining power but lacks the ability to use this to its advantage.

Chapter 6 summarises each chapter of the thesis and indicates the contributions and significance of the research. This section will also expand on a result of the findings prior to clearly demonstrating how effective or not the Philippines is in attracting FDI and the country's ineffectiveness in using its bargaining power. The conclusion highlights the implications of the weakness of the Philippines in not using its bargaining power to its advantage in the promotion of the country as a worthy destination for investors. The chapter concludes by making a contribution to how the country could use its bargaining chips better as it strives to bring into the country larger MNCs that could be more valuable in the promotion of its economic and social development.

Chapter 2 Literature Review

2.1 Introduction

This chapter draws on various branches of the literature dealing with bargaining power, negotiation between MNCs⁹ and host governments, and FDI. Both theoretical and empirical literature was reviewed and some of the gaps within each are highlighted. The theoretical framework is developed to facilitate the understanding of the phenomenon under study and to enable the bridging of gaps in the existing literature. It does not look at determinants of FDI; rather it examines the bargaining power of MNCs and host countries. The chapter reviews Vernon's "obsolescing bargain theory" and explains the relevance of it to the bargaining power of MNCs and host governments. A lot of emphasis is also placed on the work of Theodore Moran and other work by Raymond Vernon as both authors have made considerable contributions to the study of FDI, MNCs and host governments.

This literature review indicates that a host country's overall investment environment and its bargaining potential can be divided into two subgroups – the political group (the government) and the business group (the MNCs). In dealing with the approaches used within this thesis it is recognised that these two subgroups interact with each other constantly, where changes within one subgroup have an immediate impact on the other subgroup. Therefore it is critically important to understand the investment behaviours of both the host government and the MNC. It can be further added that these two sub-groups co-exist and depend on each other for their functions.

Domestic firms for example examine carefully the changes in the political environment of the country. However, in the case of an MNC, both the political environment of the host country and the bilateral relationship between the host and the home countries need to be considered. It has to be recognised that any given country's policy makers have different conceptions and understanding of economic development as each are influenced by not only their own assumptions but also the

⁹ Throughout this thesis the abbreviation MNC has been used for the sake of consistency. All citations that used different abbreviations, such as MNE, TNC etc., have been amended.

environment within which they have to work. It is the contention of this thesis that in order to attract more FDI, the Philippines needs to achieve sustained economic growth and stability, for a number of reasons as have been stressed for e.g., the instability in the south, and also the continuous threats of political uncertainty. The country has significant bargaining power but does not use that strength to its advantage.

The chapter is divided into various sections. The first part of the chapter reviews the concept of foreign direct investment (FDI) and its importance to developing countries, MNCs and host governments, and analyses the links between each of these. This is done through an analysis of the literature that defines the roles each has in economic development and in the possible development of the Philippine economy. Secondly, the chapter reviews the bargaining power and bargaining theory literature to explain the sources of bargaining power and the interactions of MNCs and host governments highlighting the dynamic nature of this process, and some of the political issues involved. Thirdly, the chapter focuses on the negotiations between the MNCs and the host governments. This section identifies the types of bargaining power that emerge from the negotiation processes. And lastly, the review analyses Vernon's 'obsolescing bargaining theory', emphasising clearly the relevance of this theory; even though states have several means of protecting investors from activities such as expropriation, many still engage in the practice. This section highlights the different kinds of risks that could potentially lead governments to renege on contracts and even expropriate assets of MNCs. The literature is also analysed to partly identify the Philippine state and its role in the process and promotion of or inability to attract FDI. However, this process will be elaborated on more in Chapter 3. Whilst the focus of this thesis is on the bargaining power and negotiations between the MNCs and host government, other related issues are also examined in order to compare the differences in influences that occur between the two.

2.2 The nature and importance of foreign direct investment to developing countries

FDI is defined by the United Nations as "investment involving a long-term relationship and reflecting a lasting interest of a resident entity [individual or business] in one economy [direct investor] in an entity resident in an economy other

than that of the investor [host country]” (United Nations, 1992:45). According to Dunning (1993), FDI has the following features: (1) the investment is made outside the home country of the investing company; (2) control over the use of the resources transferred remains with the investor and (3) it consists of a ‘package’ of assets and intermediate products, such as capital, technology, management skills and access to markets and entrepreneurship. It is commonly thought to be an important engine of economic growth, job creation and technological upgrading, which in turn leads governments to bid for more FDI. This section of the chapter stresses the importance of an effective relationship between the foreign investor and the host government, arguing that with any investment there will be difficult issues that both parties will encounter during the course of an investment.

Commonly seen by economists and policy makers as a premier agent, not only of globalisation, but also of economic growth and development, FDI is now treated as the capital flow of choice in Asia and South America in light of financial crises that caused such severe economic downturns in both Latin America and most recently in Asia. As a result of past protectionist policies and governments’ insular policies, particularly towards import substitution industries, Mnookin suggests it became clear to policy makers that a shift to export-oriented industries provided much needed capital to most economies that showed more openness and liberalised their economies, therefore permitting unrestricted inflow of FDI. The topic of an enormous amount of research and debate concerning its nature and impact and the object of enormous investments of time and resources by policy makers who want to attract it, FDI has thus become one of the most sought-after commodities in the global economy (Mnookin, 1993).

While reviewing and discussing a number of cases of FDI in developing countries and economies in transition, Moran (2001), one of the most acclaimed academics on MNC and host government interactions, noted that the benefits of foreign investments dominated a large majority of the cases reviewed, and that policies, particularly policies regarding negotiations, often played a vital role for success. In particular, he emphasises the need for policies to overcome coordination problems. Governments in many developing countries often permit entry to FDI that may not necessarily benefit the country in terms of the skills required, which leads in many cases to the MNC

bringing in their own workforce and not employing local personnel for their operations. Therefore policy makers and negotiators need to be conscious of having a well-coordinated approach when bargaining with the MNC to ensure that the company will be prepared to employ and train local workers.

Moran, in one of his important studies 'Beyond Sweatshops', furthers the argument that has raised concerns that workers may be exploited in developing countries and discusses the growth of foreign direct investment (FDI) in manufacturing and assembly. He argues that, whilst "foreign investors ... offer ... integrated packages that include hard-to-replicate technologies, business techniques, management skills, human-relations policies, and marketing capabilities; these are often referred to, somewhat awkwardly, as intangible assets", they need to stop exploiting workers (Moran, 2002:108). He furthers this argument by stating that:

As they introduce these assets into the local economy, foreign investors may position the host country at the frontier of best practices in international markets ... Further, foreign investors may find that it is in their own best interest to develop local supplier networks and to supervise and help improve the performance of those networks (Moran, 2002:108).

However, Moran (cited in Navaretti and Venables, 2004:262) also points to several other negatives: effects of policy competition between both developing and developed countries, the danger of growing protection through local content requirements and anti-dumping measures enacted in many countries. Moran's work on host country and foreign investors (in his comprehensive 1974 study *Multinational Corporations and the Politics of Dependence: Copper in Chile*) highlights the very nature of the MNC and host-government interactions when dealing with FDI. In the study he clearly defines that relationship as it enters the dynamic areas of 'balance of power'¹⁰, national interest and economic nationalism. The term 'dynamic' is used here to highlight the changing nature of a government's policy and interests as governments change hands. The study looks closely at the "Chilean experience with copper within

¹⁰ 'Balance of power' in this context means the shifting strength of the bargaining power of either the MNC or the host government.

the framework of a more satisfactory model of the evolution of the balance of power between foreign companies and underdeveloped countries” (1974a:154).

By examining “how actual policy toward the foreign companies is determined”, Moran (1974a:154) argues that:

despite clear instances of exploitation in the Chilean case, however, the balance of power model accurately predicts that the domestic perception of the costs of economic nationalism will decline over time – even among those most ideologically allied with the foreign corporations. In addition, [the Chilean] model indicates that the sense of injustice in the host country is likely to be more acute in the case of large natural resource concessions (1974a:156).

In addition, Moran further demonstrates that:

Foreign direct investment and the globalisation of industry, consequently, not only allow a host economy to do what it already does more efficiently, but make it possible for the host country to transform the set of activities that can be performed within the country’s borders (2002:109).

Moreover, Moran explains Romer’s (cited in Moran, 1998) observations of the Mauritius textile experience in which it was clearly pointed out that:

foreign textile investors helped transform the host economy not simply because they brought in capital ... or ... new technology ... but because they brought in a package – production techniques, contacts with external retailers and style centres, and experience in manoeuvring in the complex terrain of textile quotas in international markets – that transformed the economy.

Moran credits the FDI with the change in the Mauritian economy by indicating that “the Mauritian economy shifted from slow-growth agricultural activities and high unemployment to high-growth garment-export operations, a tight labour market, and rising wages” (Moran, 2002:109). Moran explains that “there is a long-held belief that would-be host-countries that adopt an energetic approach to investment

promotion are much more successful in attracting foreign firms than are those that do not” (Moran, 1998:37).

Moran suggests that “the challenge of utilising FDI as part of the development process is much more complicated than conventional wisdom suggests. The direct and indirect benefits from well-constructed FDI projects are substantially greater than commonly assumed, but they do not come easily” (1998:153). This notion therefore lends support to the main view of this thesis that, in order to be effective in the bargaining process, a host government needs to carefully engage and monitor how it negotiates with an MNC to ensure that the country is well served by the new investor. Moran emphasised that “[t]he debate about the need for foreign direct investment in the Third World has changed dramatically in tone and substance – partly in response to the dire economic conditions of the debt crisis” (1986a:3). In effect, when analysing Moran’s argument here it is clear that countries looking at FDI as part of their development planning need to take into account investment that will have a long-term positive effect on the economy and focus more on attracting the much larger MNCs.

Therefore, according to Moran, FDI can be seen to be of great value to less-developed countries. However, the generally accepted view that friendly investment climates and larger investment flows will automatically help solve developing countries’ problems has to be carefully qualified. In actual fact, to ensure the greatest contribution to their own development, host governments may at times have to refuse granting the kind of treatment that many international companies want most (Moran, 1986a:7). This lends support to the argument of this thesis that stresses the importance of ensuring that the negotiation process is purposeful for both parties involved. Host governments need to ensure that MNCs meet their end of the bargain, particularly in terms of environmental issues, as many MNCs have been known to cause serious harm with high levels of pollutants.

Before proceeding, it is worth mentioning that the author of this thesis acknowledges Raymond Vernon’s product life cycle theory, John Dunning’s eclectic theory and David Ricardo’s theory of comparative advantage, because they offer important insights into how firms function and interact anywhere. This includes all MNCs,

without exception. However, these theories somehow fall short of focussing on the distinguishing characteristics of operating in different nations and the bargaining processes by which agreements have been reached.

The international product cycle described by Raymond Vernon (1966) probably was the first major theory of the movement of production overseas, rather than just to explain international trade and FDI (Grosse and Behrman, 1992:94). Central to MNC practices and analysis are government interventions. Any theory of MNCs must be a theory of policies, interactions and activities with governments, in conflict and cooperation. Although there have been many studies of “MNC/government relations, there is still disagreement over the scope of the interactions” (Grosse and Behrman, 1992:94). Because the focus of this thesis is on the bargaining power of MNCs and host governments, it does not deal with theories of international business. However, it is important to accept that many of these theories are linked to MNC and host government interactions.

Any theory of international business, therefore, should give details of how the issues of government concerned with MNC activities are defined, how they are negotiated, what trade-offs are involved, how differences are resolved, what adjustments are made over time and why, and who possesses more bargaining power. The real meaning of the theory must clearly explain differential barriers and incentives to foreign business imposed by sovereign governments in an effort to change the distribution of benefits, and the effects of those policies on MNC decisions and operations. In addition, it must centre on the impacts of MNCs on government policies (Grosse and Behrman, 1992:97-98).

Governments are still the sovereign and ultimate legislators for activities such as investments and trade coming into and within their jurisdictions (Grosse and Behrman, 1992:95). Adding to this statement, Vernon argues that:

in deciding how to exercise their influence, MNCs face powerful but often conflicting demands. National governments, for instance, persistently pressure such enterprises to provide more markets, capital, and technology, even if such demands can only be satisfied at the expense of other countries (1995:26-30).

Accordingly, governments are not going to let the market make major economic decisions or let business alone set the rules of market behaviour. If they did, Grosse and Behrman point out, the result would not be free markets, for it is generally accepted that no business in the world likes competition for itself or prefers to operate in a classical free market. That is because the purpose of governments is to seek growth (efficiency) and a distribution of benefits (equity), both internally and with respect to outsiders (1992:96).

2.2.1 Multinational Corporations (MNCs)

It has been proposed by several authors that “the early literature on multinational corporations saw MNCs as firmly tied to their home countries, and often utilised as instruments of national policy and in the national interest” (Apter and Goodman, 1976; Bergsten, Horst and Moran 1978; Vernon, 1971, 1977, cited in Bruchey, 1999). Moreover, Bruchey points out that “controversy most typically arose in connection with the impact of multinationals on, and their behaviour in, developing countries” (Bruchey, 1999:21).

For some governments and investors, MNCs are an invaluable dynamic force and instrument for the wider distribution of capital, technology and employment; for others, such as NGOs and civil groups, they are monsters which our present institutions, national and international, cannot adequately control, a law unto themselves which no reasonable concept of the public interest or social policy can accept (ILO, 1973:ix).

Whilst some effort has been made to define MNCs in the introduction of this thesis, it is accepted that, according to the International Labour Organisation (ILO):

There is no agreed definition of the multinational [corporations]. Some find its determining characteristic in the organisation of its activities, that is the extent to which its operations in different countries are actually co-ordinated by a corporate centre, or the degree of “global outlook” to be found in the

enterprise's decision making. Others use as criteria the number and type of its subsidiaries, the number of countries in which these subsidiaries operate, and the proportion of foreign sales, assets and employment in the enterprise's total sales, assets and employment. Still others look to the nationality mix of its management or to its ownership characteristics (ILO, 1973:3)

The definition of MNC that is accepted by the Organisation for Economic Co-operation and Development (OECD) and the United Nations Centre on Transnational Corporations (UNCTC) is "an enterprise that engages in foreign direct investment (FDI) and owns or controls value-added activities in more than one country" (Dunning, 1993:3). Mourdoukoutas (1999) defines an MNC as "an international business organisation of corporate colonialism in which the home (parent) company treats each national market as a separate market, setting up subsidiaries to handle its entire product and business lines in each of those markets" (1999:115). Furthermore, Mourdoukoutas contrasts the MNC with the global corporation, emphasising that the latter has a "business strategy that [views] national markets as integral parts or regions of a single regional or global market to be handled by product divisions or corporate alliances often with former competitors" (1999:117).

According to Navaretti et al., "the general public and policy makers around the world have mixed feelings about MNCs: they see them as either welcome bearers of foreign wealth and knowledge or unwelcome threats to national wealth and identity" (Navaretti et al., 2004:1). On top of this, the debate on MNCs is hardly ever grounded in economic debates and there is only a modest understanding of what MNCs are, and what the actual reasons for liking or disliking them are. Furthermore:

MNCs are often different from purely national firms and some of the concerns raised are legitimate. They are relatively large, they have competitive power in the market place and bargaining power in the policy-making arena, particularly in smaller developing countries ... [some] are footloose, able to move activities between their plants at relatively low cost, removing benefits as rapidly as they deliver them (Navaretti et al., 2004:1).

The literature highlights that multinational corporations (MNCs) have also been variously described as “multinational, transnational, global, international, stateless, worldwide, inter-territorial and footloose” (Barnet, 1994; Hu, 1992, Bruchey, 1999). In many cases they are viewed as “nearly synonymous with FDI” (Bruchey, 1999:18).

In further identifying the MNC, Dunning (cited in Stopford and Dunning, 1983:56), drawing and extending from Behrman (1972), explains that there are four types of MNC activity: resource seekers, market seekers, efficiency seekers, and strategic asset or capability seekers. Resource seekers are prompted to invest abroad to acquire particular and specific resources at a lower real cost than could be obtained in their home country. Market seekers are enterprises that invest in a particular country or region to supply goods or services to markets in these or adjacent countries. Efficiency seekers are motivated to rationalise the structure of established resource-based or market-seeking investment in such a way that the investing company can gain from the common governance of geographically dispersed activities; and the strategic asset seekers comprise those which engage in FDI, usually by acquiring the assets of foreign corporations, to promote their long-term strategic objectives.

For the thesis it may suffice to assume that the essential nature of the multinational corporation lies in the fact that its managerial headquarters are located in one country (referred to, for convenience, as “the home country”) while the enterprise carries out operations in a number of other countries as well (“host countries”) (ILO, 1973:3).

One authority on the subject of multinational corporations, Raymond Vernon, presents an overall view of research he undertook by arguing that one way of providing a definition is through “induction and inference”. Vernon notes that MNCs are invariably large in size, that they operate in a large number of countries, that they have access to a common pool of human and financial resources, and that they control their widespread activities rather than serving merely as exporters or licensors of technology (Vernon, 1971a, cited in ILO, 1973:4). And in many respects, the MNC is viewed as a very powerful entity.

Furthermore, Penrose adds that:

today the problems created by the power of the very large firms do not relate so much to the cruder form of coercion or deception, the ruthless elimination of competitors, or even collusive restrictive practices (although all of these, and perhaps particularly the last, are at times important); they relate more to the way in which firms, in their normal investment and operating policies use resources and influence the distribution of income (1976:53).

This explains, then, why some firms do have leverage in dealing with host governments when considering Penrose's view that:

partly because large firms do possess great economic power of this kind, governments have increasingly thought it desirable, and perhaps especially in the developing countries, to negotiate directly with foreign firms over the terms on which they are allowed to operate (1976:51).

However, whilst it is recognised that since 1976 a lot of work has been done on MNCs, this thesis concurs with Penrose, who further argued that:

Economic theory has never comfortably digested the large diversified firm. The theoretical system which provides the economic justification of a competitive economy takes grossly inadequate account of these great administrative organisations, and the theory of international trade and investment virtually ignores them, in spite of the fact that a very important part of both is carried on within the [scope] of their administrative framework because of the large international firm, the flow of international trade and investment, the structure of international prices, and the international distribution of income are subject to forces that are at times very different from those presumed in ruling economic theory. Yet it is to this theory that even the great international corporations openly appeal in demanding their independence from government 'intervention' (1976:25).

In addition to Penrose's view, Vernon (1995) argues that "given the significant role of MNCs in international relations, the query on their importance is almost transcendental. Some of these MNCs dispose of resources that exceed those of many

sovereign governments". In addition, Vernon (1995) explains that MNCs control the production of a large percentage of the world's industrial output, because they control such industries as "automobiles, electronics, pharmaceuticals, chemicals, etc." Furthermore, MNCs play a large role in international trade, managing over two-thirds of the world's trade in industrial products. The temptation when analysing their significance is "to describe MNCs as a handful of industrial giants securely in control of the economic relations among nation-states" (Vernon, 1995). Furthermore, Vernon (1995) contends that:

the roles that MNCs typically play in international relations, as it turns out, are very diverse. While at times inciting governments that they are in a position to influence, MNCs often play the opposite role. They frequently try to deter their "home" governments from taking some threatening action against another country, fearful that the other country will hassle one of the MNC's units in return.

The early literature on MNCs distinguished them as strongly attached to their home countries and frequently utilised as mechanisms of "national policy and national interest" (Vernon, 1971, 1977, cited in Bruchey, 1999). Alleged abuses and exploitation of developing countries by MNCs were highly publicised; however, examinations today point out that relations between host governments and MNCs have grown less confrontational as both institutions seek to find and manage their interactions better (Dunning, 1994, cited in Bruchey, 1999). According to Bruchey (1999:24), some onlookers point out that nation states are downgraded to being little more than "global platforms" (Porter, 1986, cited in Bruchey, 1999) for production, "artefacts" of previous centuries (Doremus, et al., 1999; Bruchey, 1999) without even the power to manage economic activity within their own borders. Rather than encouraging wealth creation, nation states are "dysfunctional ... engines of wealth destruction" (Ohmae (1995:120), cited in Bruchey, 1999).

It is argued by Lall and Streeten that many MNCs may be better able to extract 'concessions' and favourable terms from host governments than local firms for two substantial sets of reasons:

First, in many cases they may possess some scarce resource, such as capital or technology, which most local firms do not have ... Second, they may in fact have greater political leverage, either because of constant pressure exerted by the government of their home country (by means of 'aid', military or otherwise, diplomatic and political links, and so on) or because of pressure promoted by interested groups such as officials or business people within the country (1977:27).

As firms seek to extract concessions from their selection of entry modes, ownership and location advantages then become fairly important because, according to Cantwell, "the greater ability to shift production between alternative locations strengthens the bargaining power of firms in negotiations over wages and conditions of work" (Cantwell, 2000:18). The location of affiliates worldwide can also be seen in the context of diversification strategies by a country or company because it gives scope for alternative sources of supply and/or it allows companies to utilise specific locational advantages. Such a strategy may also turn out to be a good bargaining strategy towards governments as the existence of alternative locations – whether actual or potential – will strengthen the company's bargaining power in asking for favourable conditions from host countries' governments. However, it is also a strategy that impacts on labour and the bargaining power of the MNC and that of its rivals (Antonioni and Ietto-Gillies, 2002:2).

Agarwal and Ramaswami's (1992) evaluation of the effects of the interrelationships between a firm's ownership and location implied that firms more often than not establish a market presence in foreign countries through FDI. The results of Agarwal and Ramaswami's study showed that firms use investment modes only in markets with high potential. They also suggest that the larger MNCs often focus on investing in relatively lower potential markets. However, according to Beamish and Banks (1987), firms are careful in entering markets that are considered risky.

In addition to the preference for investment modes by large MNCs in lower potential markets, a number of interesting issues surfaced from the study. Firstly, small firms with "limited multinational experience were found to have an inclination for entry into markets that were recognised to have high potential through a joint venture"

(Agarwal and Ramaswami, 1992). One rationale behind this policy is that the sharing of costs and risks permits such firms to reduce the long-term uncertainty more efficiently. Secondly:

firms that have a higher ability to develop differentiated products are apprehensive about the possible loss of their advantage in countries that are identified as having higher contractual risks. They show a strong dislike for the exporting mode, but are willing to choose investment modes in such markets. Thirdly, the results disclose that while firms are interested in entering markets that are perceived to have high potential, the existence of investments risks leads them to withdraw from such investments. In such countries firms prefer to simply export. These results imply “an inclination to avoid entry through exporting when the potential returns through other modes are high, and prefer entry through exporting when the potential risks for other modes are high (Agarwal and Ramaswami, 1992).

To compete with host country firms in their own markets, firms must possess better-quality assets and skills that can earn economic rents that are high enough to counter the higher costs of servicing these markets. A firm’s asset power is reflected by its size and multinational experience, and its skills are assessed by its ability to develop differentiated products. When a firm possesses the ability to develop differentiated products, it may run the risk of loss of long-term revenues if it shares this knowledge with host country firms. This can be because the latter may acquire this knowledge and decide to operate as a separate entity at a future date.

Firms interested in servicing foreign markets are expected to use a selective strategy and favour entry into more attractive markets because their chances of obtaining higher returns are better in such markets. The attractiveness of a market has been characterised in terms of its potential and investment risk (Agarwal and Ramaswami, 1992:4-5).

Market potential (size and growth) has been found to be an important determinant of overseas investment (Forsyth, 1972; Weinstein, 1977; Khoury, 1979; Choi, Tschoegl and Yu, 1986; Terpstra and Yu, 1988; Agarwal and Ramaswami, 1992). The

investment risk in a host country reflects the uncertainty over the extension of present economic and political conditions and government policies which are vital to the continued existence and profitability of a firm's operations in that country. Changes in government policies may cause problems related to repatriation of earnings and, in extreme cases, expropriation of assets (Root, 1987). Certainly within the last 30 years changes within the political sphere in the Philippines, for example, suggest that it may be correct to assume that the lack of FDI coming into the country in more recent times may be attributed to investment risks suggested by the above authors.

2.2.2 Host countries and the regulatory environment

The MNC, as a socio-political institution and ongoing operational entity, must be studied within the framework of a host country's expectations (Sethi and Holton, 1974:1). Many groups within host countries such as for example, local and international NGO's, indigenous rights groups, environmental organisations etc., do not necessarily look upon the MNC as a welcome visitor and have in many cases shown much opposition and distrust towards such companies. Meanwhile, the MNC too frequently reinforces this approach by tending to extend in a foreign country the policies applied successfully in the home country, with little consideration for the socio-economic intricacies and the cultural sensitivities of the people involved. The result of this, according to one argument, has been restrictions on the resource-allocation process as host countries have put constraints on the movement of resources, frustrating the development of maximum efficiency in worldwide production (Sethi and Holton, 1974:2).

A large part of the misunderstanding, distrust and confusion may be attributed to ignorance and misinformation on the part of host countries and the MNCs. But perhaps a more important reason is that policy planners and executives lack a conceptual framework to develop a proper approval of the possibilities of this most distinctive institution, to predict its likely behaviour and to specify the possible courses of action necessary to improve the worldwide benefits to be drawn from the MNC (Sethi and Holton, 1974:2).

Globerman and Shapiro (2002) argue that a country's economic performance is determined largely by its political, institutional and legal environment. The authors highlight that governance infrastructure attributes of countries have a strong link with the foreign direct investment that flows into and out of the economy. Furthermore, good governance is an important aspect and increases investor and developer confidence in the country and eliminates regulatory risks (Globerman and Shapiro, 2002).

Jamison, Holt and Berg consider the various instruments that can be used to mitigate regulatory risk, especially with regards to electricity issues. They highlight the importance of transparency and describe the steps that governments and investors can take to mitigate regulatory risk. The authors note the importance of investment to developing countries, and the fact that developing countries will need an additional \$550 to \$600 billion in infrastructure by 2010. Unfortunately, it is unlikely that the countries will meet this investment aim as new investment has declined steadily since 1997 (2005:37).

Furthermore, Jamison, Holt and Berg (2005) outline that there are three basic approaches to mitigating regulatory risk:

1. Institutional instruments that limit the possibility of government opportunism;
2. Financial instruments that decrease financial risk; and
3. Managerial strategies, such as choosing technologies that may not be cost-minimising but that have lower "sunk" costs than more traditional alternatives.

Jamison, Holt and Berg also note that:

new regulatory [bodies] in developing countries might not have their 'independence' explicitly guaranteed in law. Moreover, regulators do not operate in a vacuum: their effectiveness can be strengthened or diminished by what we call the regulatory system, which includes the host country's governmental checks and balances (included the judicial and legal) systems for regulating the financial sector, environmental policies, country's conflict resolution mechanisms, political resolution mechanisms, political system, and

relationships with other countries and with multi-lateral institutions. Because these factors are different for each country, there is no one-size-fits-all 'ideal' regulatory framework (2005:37).

In considering the above, Jamison, Holt and Berg outline the importance of transparency to countries wishing to mitigate regulatory risk. They argue that there are "absent compelling circumstances, no information should be withheld from public view" (2005:38). On the other hand, the authors highlight the harm of corruption as a concern for policymakers and investors (2005:39-40). The way to combat these issues, they suggest, is for countries to develop policies to ensure political sustainability (Jamison, Holt and Berg, 2005:40).

There are also several tensions present that complicate risk mitigation and risk allocation:

1. those between the benefits of adaptability and the benefits from certainty;
2. during times of crises, the dependence on government institutions that are themselves either involved in or the source of the crisis; and
3. requirements for national sovereignty and the gains from international support (Jamison, Holt and Berg, 2005:41).

Bhargava and Bolongaita (2004) reinforce the themes discussed in Jamison, Holt and Berg (2005) and outline the negative impact that corruption has on the delivery of public services, developing countries' growth and investment opportunities. Their finding is however based specifically on the Philippines and considers the issues in light of its turbulent history.

Bhargava and Bolongaita outline that governance in the Philippines has received reasonable marks, and it was rated as "fair" with an index of 44 on a scale of 0 to 100 (2004:79). Unfortunately, according to the authors, the country's administrative capacities are weak and principal interests are not well specified (2004:81), which undermines the country's ability to maximise its potential with investors. However, on a positive note, the country's weakened institutions have prevented it from returning

to arbitrary power, and Filipino citizens have more rights and freedom than previously (Bhargava and Bolongaita, 2004:85).

Bhargava and Bolongaita (2004:89-91) also distinguish between political and bureaucratic corruption, and grand versus petty corruption. The authors note that the Philippines have a number of major weaknesses including:

1. The effort of the bureaucracy in combating corruption suffers from lack of organisational coherence;
2. There are gaps in the wider executive action needed to complement initiatives focused on combating corruption. These discontinuities include a lack of consistency, inadequate audit procedures and inactive case referral systems, weak enforcement of regulation and a lack of regulatory framework for civil society; and
3. Parallel legislative remedies not moving fast enough in certain cases (Bhargava and Bolongaita, 2004:109-110).

Whilst filling in these gaps appears almost impossible, determined leadership can overcome the difficulties that currently exist (Bhargava and Bolongaita, 2004).

Hutchcroft (1997) supports the themes considered by Bhargava and Bolongaita regarding the negative aspects of corruption and clientelism in the Philippines. Hutchcroft brings to light the negative aspects of corruption in undermining investment and development. Hutchcroft does however consider that corruption can, at times, circumvent import and export regulations and promote the functioning of the market. However, overall corruption and clientelism has been most influential in restricting competition in the Filipino markets and promoting the growth of “cartels and monopolies” that continue to detrimentally impact on the essential parts of the political economy (1997:12).

Hutchcroft outlines that:

To the extent that corruption inhibits the achievements of these vital foundations of *laissez-faire* capitalism, opportunities for sustained growth will

be impaired. If one expects that promotion of late, late industrialisation requires an even more extensive role for the state, quite clearly, it will be necessary to build up to an even greater degree of capacity throughout the bureaucratic apparatus (1997:13).

Carino's work suggests that regulatory governance at the national level is inconsistent. This applies particularly to foreign investment. On the one hand, there has been deregulation that favours foreign investors through the reduction in the number of sectors reserved for Filipino nationals and through Acts which ease restrictions on FDI in telecommunications, oil, electric power and retail trade (Carino, 2002:14). On the other hand, there is a preference for Filipinos in certain sectors deriving from interpretations of the Constitution by the Supreme Court and monopoly rights handed out by Congress to various individual firms (Carino, 2002:17). Thus, a confusing picture emerges at the national level regarding the Philippines' regulatory stance on FDI.

Legaspi (2001) focuses on the *Local Government Code* 1991 that was passed by Congress arguing that the Code altered the power relationship between national and local governments, providing local governments with basic services and functions that were traditionally delivered by the central government.

Whilst this move was designed to allow for more effective community governance, there are a number of issues that detract from improved governance including:

1. the financial capacities of local government - a number of governments are rural based and do not have large and broad tax bases;
2. many local governments have remained conservative in their resource-generation approaches and continue to depend largely on local taxes and government allotments;
3. local governments also have difficulty in recruiting technically trained and competent personnel at a local level and a number of positions remain unfilled (Legaspi, 2001:137).

Holden, focusing on the mining of resources in the Philippines, argues that the Philippine government has been attempting to encourage mining-based development through a number of initiatives, but the mining industry continues to be underdeveloped. Holden outlines that one of the ways that this can occur is through the strengthening of civil society in the Philippines, stating that “not only are Filipino NGOs potent, they are also plentiful” (Holden, 2005:226). Accordingly, strengthening civil society might improve the regulatory regime.

Concurring with several authors Holden argues that the Marcopper tailings spill has created a fear of mining in the Philippines which has acted as a barrier to increase development and investment in the country. Furthermore, in light of the significant adverse environmental effects inherent in mining, it is very important that mining is subject to a thorough regulatory framework. This raises questions about whether the Filipino system is too corrupt to be able to handle an activity as detrimental as mining, stating that a number of people “adopt the view that the corruption is too extensive to allow an activity with as many potential deleterious effects as mining to occur” (Holden, 2005:241).

Holden and Jacobson (2006), focusing on issues surrounding mining development in the Philippines, note that the country is naturally abundant in a number of valuable minerals and this provides it with a comparative advantage for FDI and development. Unfortunately, this advantage has not been utilised as effectively as it could have been. Adding onto their discussion regarding the Marcopper tailings spill incident as an example of a conflict between local governments and mining companies, the authors note that in response to this incident a number of local governments passed resolutions opposing mining and signalling no intention to consent to mining projects in their jurisdiction (Holden and Jacobson, 2006:192). As a result the Philippines government’s reaction was a serious impediment to the mining industry and also the economic development of the country.

Noting the importance of information-sharing Holden and Jacobson discuss that a vital precondition to local government consent is adequate information from the investors and developers. The information-sharing is not adequate and the lack of

information is a continual problem for Filipino development (Holden and Jacobson, 2006:194).

The political leaders of host countries may fear that they no longer have command of their own destinies if they allow the MNCs to operate in their territories. Very often they overreact by instituting protective measures that have the effect of heavy-handedness, thereby causing unnecessary suffering on the citizens of their own countries. The MNCs' fear of the host-country governments also exists and can yield similar results.

Whilst a host country recognises that "openness to international trade accelerates development"¹¹ the issue is not whether the MNC is good or bad, but whether the benefits from the MNC are worth the economic and other costs. Although empirical testing would be incredibly difficult, the host country according to Sethi and Holton should consider the following suggestions in evaluating foreign private investments "1. Whether the MNC subsidiaries are indeed contributing their maximum to the local economy and 2. whether those gains can be obtained through some other alternative" (Sethi and Holton, 1974:3).

Even though in most MNCs the daily ongoing operations of a local subsidiary are left to the local people, the decisions these people are allowed to make are generally low-level and pertain primarily to that country. This produces two types of problems. The first has to do with creating incentives for foreigners who have only limited access to the top corporate positions. Instituting corporate objectives and developing long-range plans under these conditions assume critical importance and call for a fundamental change of approach (Sethi and Holton, 1974). Not only must the MNC deal with a large number of legal and political entities, it must also "assimilate into the process a whole host of diverse, often unsuited and conflicting, objectives of the foreign subsidiaries and executives" (Sethi and Holton, 1974:6). The ensuing institutional dynamism is more like a "union of interests than a single being with unified purposes and centralised course and control" (Sethi and Hogle, 1972, cited in Sethi and Holton, 1974:6).

¹¹ Dollar, David & Aart Kraay. 'Trade Growth and Poverty', *The Economic Journal*, Volume 114, Issue 493, Pages F22-F49.

Hymer proposes that the second predicament is more important from the host-country's standpoint. Although the local executives in an overseas subsidiary may formulate decisions only within a narrow collection of alternatives, their companies are in most cases often among the largest in the country. The executives' experience in making broad decisions is likely to be limited, yet they may exert considerable influence in the policy-making circles of their own countries. Therefore, the country controlled by foreign investment can easily develop a branch-office attitude, not only regarding economic matters, but right the way through governmental and educational decision making (Hymer, 1969, cited in Sethi and Holton, 1974:6).

The role of government in a host country, it can be argued, has decreased in most developing countries, as most have shifted from protectionist policies to more liberal and free-market approaches. Lack of recognition by an MNC of the importance of a host government's role in economic matters can result in often serious mistakes in negotiations and the bargaining process. One role of host-country governments is the need to develop their economy to advance and improve the welfare of their constituents and to develop the talents of indigenous entrepreneurs. These and other considerations have prompted host governments to recognise their role in planning for the economic development of their countries as fairly significant. The planning process that includes the need to attract FDI is often highly detailed and based on both economic and political considerations, and the MNC wishing to set up in the host country has to fit into such a context.

Whilst recognising there are challenges that confront MNCs at the dawning of the new millennium, it is necessary to take into consideration that an understanding of globalisation and strategic policy issues be properly interpreted. In light of the changes in foreign policy forced upon nation-states as a result of September 11, the economic environments in which MNCs and host governments find themselves have been drastically altered, lending support to the notion that security issues are now a necessary component of the interactions between both parties. To explain this further, a host government's political and social stability is fundamental in ensuring continued growth and interest in the promotion of FDI. In the case of the Philippines, there is cause for concern, particularly with the threats of "mutiny" by renegade soldiers, as

was the case in late July 2003 in Manila, and the continuous problems of secessionist movements as well as the NPA's activities. At the same time, not enough attention has been given to firm-level behaviour of MNCs and their new agendas (Young, 2000:4). Added to that, as argued by Young (2000:12), is "the evidence that the world economy is experiencing a period of enormous corporate 'shake-up' and 'shake-out', much of it global in nature and driven by global imperatives", for example the "dismemberment or break-up of corporations, with corporate sell-offs, spin-outs and divestments, and redefinition of corporate missions" (Young, 2000:14) which could lead to host country's attitudes to MNCs becoming increasingly negative. The global financial crisis may have increased those negative attitudes as evidenced by increasing levels of investment protectionism.

Whilst enhancing development is primarily the responsibility of host governments, MNCs play a central role in the process. Their presence enhances productivity and stimulates economic growth. Enhanced productivity serves the wealth-related goals of the multinational as well as the economic needs – tax revenues, employment and potential balance of payments effects – for the host government. Alternatively, national governments have a much broader range of social and developmental objectives and find the multinational with its size and sophistication to be a delimiting factor on their freedom to pursue many of these broader goals. Developing-country host governments have tended to view MNCs with suspicion, partly because of their size, which connotes power (Vernon, 1971a).

Defining the size and shape of MNCs is not easy. Trying to determine their effects on developing countries is even harder. The objective of most developing countries is economic development, improvement in general welfare, increased production and employment, better income distribution and the alleviation of poverty; however, in the case of the Philippines, the impression is that the government may not be sufficiently interested or strong enough to achieve these goals. These are all basic considerations in determining not only policy toward MNCs but also development policy in general. Zimbabwe is no doubt one of the prime examples of a host state that has failed in that respect.

The nature and the relative variety of the constraints of the host states, primarily the dependence¹² on FDI and the degree of competition among countries for the investment, has increasingly intensified the phenomenon of competitive bidding for investment among states as well as among communities within a certain state (Jarblad, 2003:25). One indication of the importance of attracting FDI is the extensive implementation of investment promoting authorities in states throughout the world (Jarblad, 2003:25).

2.3 A theory of bargaining

The literature does not clearly identify the bargaining power of the Philippines or any other country for that matter. As a result, the task of identifying the bargaining power of either the MNCs or the host government (the Philippines) was made even more difficult. As will be indicated in Chapters 4 and 5, the process of identifying the bargaining power of either party was achieved through interviews conducted and the analysis of responses to these. This was much more reliable as an identifying process rather than searching through a multitude of material that showed very little information about the Philippines' ability or non-ability to use its potential bargaining power. This then explains the heavy reliance on the literature which identifies the issue of the bargaining power of either the MNCs or the host governments.

Nizamuddin argues that a country has to be more open and use its bargaining power to catch the attention of new actors into the host market. Liberalisation always creates strategic opportunities and enables countries to pursue alternative sources that may not exist in a very protective economy. To enable ease of entry for new entrants into the economy, structural adjustment of the economy is a necessity, as this results in the availability of other alternatives, reduces dependence and increases the bargaining position of the state (Nizamuddin, 2001:71-72).

¹² If we argue that most MNCs are mainly from the developed countries, it is important to note Gunder Frank's argument that "development and underdevelopment are two sides of a world process by which the First World has developed at the expense of the Third World and having got the upper hand uses its economic power to keep the Third World poor, in debt and dependent" (A.G. Frank 'Dependency Theory cited in Martin Slattery, 2003. *Key Ideas in Sociology*, Nelson Thornes, Gloucester, UK.

Dunning furthers the argument that:

some host countries may be at a disadvantage in bargaining with MNCs even where there is no competition for their resources and capabilities from other countries. In extreme cases, MNCs may be able not only to extract the entire economic rent arising from their activities, but also to use their leverage to engage in organisational and operational practices which, under other conditions, would be unacceptable. This lack of government bargaining power may be a result of ignorance, lack of experience or inappropriate policies. Alternatively, it may reflect the monopolistic control exerted by MNCs over the resources and capabilities they provide or the markets which they serve (1993:575).

The theory of inter-organisation bargaining has been used to characterise and analyse business and government negotiation, policy-making and behaviour. That theory in broad terms focuses on the relative bargaining resources and the stakes of each participant in a bargaining situation, drawing both political and economic/commercial conclusions from the analysis. When focussing on what the bargaining parties bring to negotiations such as assets, interests and capabilities, it is very clear then that this entails economic, political and social objectives (Grosse and Behrman, 1992:98-99).

Grosse and Behrman argue that when considering that:

any enterprise is involved in power relationships with rival firms; bargaining theory would include in MNC/government negotiations the potential response of other MNCs or even domestic enterprises. Important phenomena such as the obsolescing bargain, trade restrictions and performance requirements are illuminated by analysis using bargaining theory. In principle, bargaining concepts could be used to examine relations between competitors or negotiators, and several empirical studies do so, but the theory has not been extended for use in explaining the purposes of government intervention in foreign business activities and MNC responses (1992:98-99).

In addition, policies of MNCs and governments are filled with power relationships leading to concession and cooperation, as well as competition. Those results, it is argued by Grose and Behrman, are based on negotiations involving psychology, ideologies (philosophy), law, politics and ethical/moral systems. Decision-making and policy structure require more complex theory than economic analysis permits. The bargaining theory approach appears well suited to include those considerations. While several authors have utilised that approach in their analyses of MNC/government relations, as noted above, a concise and testable theoretical structure remains to be developed (Grosse and Behrman, 1992:98-99).

Haslam (2004), for example, argues that:

the bargaining model assumes that there is a potential economic rent (both profits and non-tangible benefits called externalities) from any individual investment by a foreign firm. The [MNC] and the state determine how they will share the expected rent by bargaining over the terms of the investment.

Each determines its bargaining position by assessing what it wants from the other party. Bargaining power is conferred by having some assets that the other party wants and for which it cannot easily find an alternative. For example, the firm may possess capital, technology, managerial expertise and proven access to export markets, while the state may possess human capital, internal market or unique natural resources. The bargaining outcome that results should be a compromise based on strategy (wants) and structure (power resources and constraints) of the actors (Dunning, 1993; Kobrin, 1987, cited in Haslam, 2004).

Haslam (2004) pointed out that Moran (1974a), assumed that the original bargain granting the firm access to the country would favour the firm, which received a risk and scarcity premium for its investment. With the passage of time, once the firm had sunk its investment, and the government progressively improved its ability to regulate and even run the industry, the pressures to renegotiate the investment terms in favour of the government increased.

Theorists such as Vernon, Moran and Dunning explain the richness of types of FDI and bargaining that are observed in the interactions between MNCs and host countries. For example, Dunning's 'Eclectic Paradigm,' which according to Moon and Roehl (2001) needs to be slightly modified by focussing on ownership, and location advantages as well as disadvantages. Therefore the argument proposed by Moon and Roehl (2001) is that a host government's motivation for FDI is not focussed on the disadvantages but rather the drive to fix deficiencies that exist within the country. Therefore a firm's FDI decision also depends on its ownership advantages because the firm needs a minimum level of resources necessary to go abroad. This is a form of imbalance, something for further study. One of the aims of this thesis is to focus more on the ownership and local aspects of the interactions between the MNC and the host government.

According to Kobrin, characteristics of the MNCs that aim to invest in developing economies determine the extent to which these corporations have bargaining power in the negotiation with the country's host government. The agreement among authors is that the bargaining power of an MNC depends on what resources the firm brings to the internationalisation process (Kobrin, 1987; Yan and Gray, 1994). However, the bargaining power of the MNC is not just a function of the intensity of all the resources a company has. In other words, each of the resource factors must be analysed relative to the host country capabilities. For example, if an MNC offers access to scarce resources to a country that desperately needs such resources, the company may have the upper hand. The MNC's bargaining power is likely to be even stronger if there is no other competitor with a similar offer that is interested in investing in the host country (Kobrin, 1987).

Both MNCs and developing economy governments are interested in obtaining something the other party can offer. The more that developing economies are interested in the resources an MNC can provide, the more it will be willing to allow the MNC to set the terms of the entry agreement. Thus, governments from developing economies ultimately play one of the most vital roles in relation to the strategic options and decisions that are made by the MNCs (Voican Bolino, 2002:10).

2.3.1 Sources of bargaining power

Some of the main views on bargaining power indicate the types of interactions between MNCs and host governments in relation to FDI. Accordingly, there are several contending approaches that either explain or try to explain the phenomenon of the bargaining power of either. However, most views seem to reflect a general assumption that is strongly focussed on the MNC and maintain that their influence has been beneficial to the host countries, particularly in the developing world, but very little has been discussed about the actual processes that form the basis of this assumption.

Nizamuddin points out that “the bargaining dynamic is an inherent feature of foreign direct investment since the MNCs have local subsidiaries in various host-countries and a parent company in the home market” (2001:2). “Both sides cooperate because of the gains from mutual cooperation and since neither can achieve separately what they can attain together” (2001:2). However, during the initial stages of the bargaining process, MNCs have strong bargaining power, whilst towards the latter end of the relationship the host government appears to have more bargaining power (Vernon, 1971; O’Faircheallaigh, 1982; Nizamuddin 2001).

It is interesting to note the various arguments that have been put forward in the literature on bargaining power, MNCs and FDI. Theodore Moran writes, “What gives dynamism to the bargaining process, Vernon argued, is the evolution of risk and uncertainty over the life of a (successful) [M]NC investment. This produces a dynamic phenomenon which he named the ‘obsolescing bargain’, whereby investment contracts that are initially favourable to the foreign firm (reflecting early risk and uncertainty) may be renegotiated on terms more favourable to the host country, as risk and uncertainty dissipate” (Moran, 1993:4-5). Fagre and Wells (1982) argue that in a bargaining model, for example, the deal that is eventually agreed upon between foreign investors and host governments reflects the need for and the scarcity of the resources offered by the two parties as well as, perhaps, their bargaining skills (Fagre and Wells, 1982).

However, government actions can create a high level of uncertainty in international planning and are often fairly costly to the foreign investor (Poynter, 1982). And in terms of benefits to either party, it is argued that the actual distribution of benefits depends on the terms of the agreement (Kobrin, 1987). Therefore, as explained by the UNCTC (1991), “only through constant vigilance can the host country derive the development benefits that it hoped to gain from MNC participation”. Moran (1998) argues that the “direct and indirect benefits from well-constructed FDI projects are substantially greater than commonly assumed, but they do not come easily”. That is because a host government’s intervention policy can be interpreted to impose severe constraints on an MNC’s strategies and operations within the host country (Moon and Lado, 2000). As well, the terms of the multinational’s involvement in local manufacturing are continually subject to negotiation with the host government (Vachani, 1995).

Vernon proposes that “the creation of a foreign-owned subsidiary is the signal not only for a transfer of resources across international boundaries but also – and more importantly – for the regrouping of resources within the local economy” (Vernon, 1976:154). Furthermore, Vernon argues that “Once acquired, the local resources are put to work alongside the imported capital and labour” (1976:154).

In theory, foreign direct investment involves a capital flow from countries with more adequate resources to those with less satisfactory resources (ILO, 1973:18). For the home country, investments abroad are of some concern because of their effects on the country’s balance of payments. For a host country, the capital flow associated with a multinational firm’s new facility provides an immediate gain, with continuing positive effects arising from increased exports and/or reduced imports. However, the benefit from increased exports to the host country’s balance of payments may be considerably reduced by capital outflows for imported raw materials and equipment necessary to produce the goods for export. Earnings repatriation may also have an adverse effect (ILO, 1973:19).

Moran stresses that “the most familiar frameworks for analysing foreign investor-host country relations rely on game theory and bargaining models (especially the bilateral monopoly model)” (1974:157). As explained by Levy and Prakash (2003:140-141):

The bargaining model of MNC–host country relations focused primarily on bilateral regulatory regimes with domestic locus of authority. This model was developed in the context of the polarized debate in the 1970s between those who saw foreign direct investment (FDI) as a manifestation of the growing power of multinational corporations and fundamentally antithetical to host country interests (Barnet and Muller, 1974; Evans, 1979) and those who argued that the power of MNCs had been exaggerated and their economic benefits ignored (Gilpin, 1975; Johnson, 1970). The bargaining model represented a pragmatic approach in which the benefits of FDI to the host country would be contingent on the specific contractual arrangements of each deal. MNCs and host countries would bargain over the distribution of benefits from each instance of FDI, and the bargaining power of each side was determined by the possession of rare or unique assets (Vernon, 1971).

Whereas it is generally accepted throughout the literature, Moran adds that “the foreign investor has the skills, experience, access to markets, and finance that the country needs to develop its resource base” (1974:157). In retrospect, Moran notes that “the country has the ore-bodies, the labour force, and the control over taxation [or lack of as is the case in the Philippines] that can be mixed in some proportion to produce an attractive opportunity to the investor” (1974:157). Furthermore, Moran argues:

both the foreign investor and the host government try to increase their returns from the industry, each side has threats to make and benefits to offer. The struggle centers on the relative distribution of revenues that are being generated or that potentially could be generated in the industry (1974:158).

In effect, according to Moran, “the host government must weigh the benefits of demanding a larger share of the existing revenue ... [and] the foreign investor must weigh his prospects for further profits on the original investment” (1974:158). And in order to “understand the fundamental trends or cycles in the bargaining relations between [the two parties] one must add considerations about the role of uncertainty” (Moran, 1974:158-159). As an example of this notion Moran suggests that:

The foreign investor starts from a position of monopoly control over the capacity to create a working operation out of a potential ore-body ... There is always a great deal of uncertainty about whether the investment can be made into a success and what the final costs of production and operation will be. The government would like to see its natural resource potential become a source of revenue and employment, but the government cannot itself supply the services needed from the foreign investor and is even less qualified than the investor to evaluate the risk and uncertainty involved (1974:159).

The analysis of bargaining strengths is highly intricate and many of the factors at play can only be assessed subjectively (Bacharach and Lawler, 1981). Bargaining, according to Stern and Tims:

is a process in which parties with different interests and conflicting objectives attempt to reach an agreement which benefits the parties in rough proportion to their strengths. When applied to relations between industrialised and developing countries, complications arise since the countries of the world are not neatly divided into two such groups (1975: 225).

Examples of this very issue are enumerated by many scholars throughout the literature on MNC and host-government relations; one particularly important, some 13 years after this notion was proposed by Stern and Tims, is demonstrated in an article by Narula and Dunning (1998). Narula and Dunning stressed that “Globalisation has changed economic realities ... [in] that economic globalisation [now] refers to the increasing cross-border interdependence and integration of production and markets for goods, services and capital” (Narula and Dunning, 1998:2-3).

Furthermore, Narula and Dunning contend that “globalisation has influenced both the nature of the location specific advantages of countries and the ownership specific advantages of firms, and the opportunity sets facing the governments of the former and the managers of the latter” (Narula and Dunning, 1998:4). In making their point clearer and in agreement with the literature, Narula and Dunning added that:

the economic relationship between MNCs and democratic national governments is governed by a fundamental difference in the objectives of each. The MNC, as with most private economic entities, desires to maximise the welfare of its owners – wherever they may be located – while the national government wishes to do the same for the constituents (or some of them) within its jurisdiction. Although not a zero-sum game – even where the relationship is not confrontational – the failure to find common ground often results in a sub-optimal outcome for both parties (1998:5).

2.3.2 Bargaining power and political issues

Bargaining power is very important in the negotiation process between MNCs and host governments. And to further add to its definition, some of Chamberlain's views need to be stressed. To understand bargaining power when using the term in a negotiating relationship, one needs to analyse Chamberlain's definition of power (cited in Rubin and Brown, 1975), which is characterised as the ability for a party to cause a degree of controlled change, in the direction wanted, in another group. Chamberlain focussed on the process of bargaining and has produced an even more set definition of bargaining power by arguing that it is the ability to secure another party's agreement on one's own terms. In relative terms, the bargaining power of the Philippines, for example, will depend on the MNC's opinion of the Philippines, that is, the Philippines' reliance on the MNC in terms of the existence of other sources to obtain what the country needs from the MNC and in terms of how much it values the result of the negotiation.

The central insight of the traditional bargaining power perspective is that the balance of "resources controlled by one party and demanded by the other" (Kobrin, 1987:617) influences the distribution of profits between investors and the government. Investor bargaining power is posited to be at a maximum prior to investment, when the government needs access to scarce capital or technology, and then decline severely once an investor sinks capital in the ground or its technology or expertise diffuses (Poynter, 1985; Vernon, 1977). As its bargaining power declines, an investor faces

increased political risk as a result of the government's incentive to redirect its returns to a broader set of interest groups (Fagre and Wells, 1982; Kobrin, 1987; Lecraw, 1984; Svejnar and Smith, 1984; Henisz and Zelner, 2003:3-4).

According to Newfarmer (1983:183), a strong argument can be made for the idea that the era of nationalism and MNC–host government conflict has passed. But some authors (e.g., Frank, 1980) have suggested that bargaining power in the bilateral negotiations between states and MNCs has swung irreversibly in favour of host governments, producing a new, more equitable distribution of gains – and within it a new stability. Indeed, several studies of the natural resource industries show that after the huge fixed cost of investments in resources installations are sunk, the host government can in effect “hold the company hostage”. Bargains made at the entry point become obsolete as power shifts from the companies to the state (Vernon, 1971; Moran, 1974, 1977).

As Alan Rugman (1980) comments, “the very nature of the MNC makes conflict with governments inevitable”. The MNC's objective is to maximise its return – profits, market share – on its firm-specific advantages through international operations in trade, foreign investment and licensing. As was indicated earlier, sovereign governments, on the other hand, regard the MNC in the broader economic, political, social and cultural goals of the nation-state (Sally, 1995). The problem arises, though, when states begin to entice or poach MNCs by offering better incentives than those available from other states that may be in the market for FDI.

The case in point here is China and the way FDI has been so unevenly distributed throughout not only East and Southeast Asia during the last 15 years or so, but of concern to the rest of the developing world. Apart from Vietnam, which seems to be attracting foreign investors, most of the other states that have been major destinations of FDI are now struggling to say the least. The Asian Financial crisis of 1997 is partly to blame for this change; however, China's ability to produce in great volume and at lower cost reduces the potential of competing nation. In the process, countries like the Philippines will always be required to demonstrate an effectiveness in bargaining with MNCs that is strong, unmatched and sufficiently promising. However, it will need to

do so in an environment where the struggle to establish itself as a legitimate destination is made that much harder by the continuous debt burden the country faces.

Sally argues that “the interests of the two sets of actors can be complementary when MNCs and governments agree on measures which contribute to national competitiveness; or they can conflict, when the global interests of firms diverge from the national priorities of governments” (1995:215). MNCs, it can be argued, have most often considered the fulfilment of their obligations that were negotiated during the bargaining process fairly well, that is, if there had been a need for negotiations. In many cases, however, some MNCs gain entry to a state’s market and location simply by going through the processes that permit fast and easy entry as long as the MNCs register their corporation and activities. In the Philippines for example, this is done through the Securities and Exchange Commission (SEC) and the institutions which require the MNC’s registration. Sally further points out that:

for both governments and MNCs, the agenda of their interaction has shifted with changes in the international political economy. Governments are losing the power to pursue independent policies; they, like firms, must master the ‘new diplomacy’ of bargaining, testing the intellectual skills and administrative capabilities of both sets of actors within government bureaucracies as well as within MNC organisations (1995:217).

Traditionally, MNC–host government relationships with regards to the bargaining model have been determined on the economic resources of both the MNC and the host government. However, progress in the literature on the view of bargaining power has highlighted the need to incorporate political resources as an asset in the bargaining process. Ramamurti (2001), for instance, campaigned for a two-tier bargaining model in which negotiations in the upper tier, between governments of the host and home countries, have a direct effect on negotiations in the bottom tier between the MNC and the host government. However, to gain the upper hand in the bargaining process, the MNCs are encouraged to apply the political resources available in their home country in order to take advantage of their home country’s bargaining ability.

Similarly, Eden and Molot (2001) proposed a trilateral bargaining relationship between the host country, the first-mover MNCs, and the latecomer MNCs. Both the first-mover and latecomer MNCs are viewed as political rivals by their host governments as they engage in political activities in the host country directed at altering public policies, and they take action to question the host country's perceptions of legitimacy when favouring one group over the other. When competing for the same resources, the MNCs take the time to discredit each other's business practices in the hope of gaining the upper hand in the bargaining process.

Moreover, these political activities also require the exploitation of political resources in the host country. Vernon (1971, 1977) agrees that the positive management of an MNC's political resource may also reduce or eliminate the rate of ineffectiveness of an MNC's bargaining power over host governments. Jenkins (1986) suggests that host country governments should also be mindful of an MNC's political resources and its ability to influence and manipulate public policy in favour of its operations in the host country. However, it must be noted that MNCs will, in many cases, aim to influence politicians not only to favour their activities but also to gain knowledge of potential areas of expansion and future privileges for location advantages; however, they are not intent on political control, but merely seek to influence it.

The issue of businesses and business leaders associating with politicians is not a new phenomenon brought in by MNCs; local businessmen also have a certain high level of association with politicians as well. One must keep in mind that some politicians may have been businessmen before entering the political arena and thus continue to maintain those close ties with the business community. However, the exploitation of valuable political resources is needed in order to develop an effective corporate political strategy. Hence, the ability to predict bargaining outcomes between the MNCs and host governments will be increased if factors that influence the value of political resources are clearly identified.

Thus, it is evident that the bargaining theory literature offers a wide range of possible models and outcomes, some of which are sensitive to a particular structure of the bargaining process. However, the foreign investment literature offers little in the way

of useful guidance in the structure or likely outcomes of host country–foreign investor bargaining (Mash, 2000:10).

For example, Penrose put forward the view that MNCs as large firms have “great power”, thus explaining that “partly because large firms do possess great economic power ... governments have increasingly thought it desirable, and especially in the developing countries, to negotiate directly with foreign firms over the terms on which they are allowed to operate” (1975:51).

The interrelated themes of bargaining power and attractive offers bring into view Jenkins’ (1999) argument that the capability of governments to bargain successfully is related not only to the attractions that they have to put forward to MNCs, but also to the consistency of their policies and institutions and the skill of the negotiators. In this respect, the ever-increasing experience of negotiations with MNCs has led to a possible increase in bargaining power.

The larger the capital mobility of an MNC the stronger is its relative power and bargaining power over the host government. Kenneth Thomas (1997) proposed that:

The ability to cross borders in the production process gives firms an important tool in their bargaining with governments. To a large extent, it does not even matter what kind of border it is; city, state, or national. As long as different jurisdictions are competing to land new economic activities, or keep existing ones, companies have the potential to improve their outcomes in these bargaining games by using auctions among governments.

Thomas (1997) asserts the state’s structural dependency on capital, citing the neo-realist idea of the state as an economic actor. In doing so, he furthers the view that, in order to reach the highest benefits from foreign investors/manufacturers, states look strongly at minimising costs. In essence, it is argued that MNCs have a remarkable advantage because of competition between states for similar investment projects. This is regardless of the efforts of governments to control the MNCs. This leads to a situation, according to Thomas, of competitive bidding in which MNCs agree and

accept with government negotiators the proposals and counter-proposals of various States, bidding the former with the latter.

Although bargaining power will also depend on the degree of competition between MNCs, experience in these types of negotiations will favour the MNCs in the process. However, it is likely that the learning curve would be more rapid on the government's side. There is strong evidence to suggest that intense competition amongst MNCs that weakened their bargaining power vis-à-vis host governments in the 1970s abated somewhat in the 1980s (Jenkins, 1999:503-504). However, firms have the ability to move across borders (capital mobility) giving them a better bargaining power, one that the host country does not yet possess (Nizamuddin, 2001:30).

According to Narula and Dunning (1998), in general, the balance of bargaining power can be argued to have shifted in favour of the MNC. However, some governments are beginning to look for closer supervision and control over activities of corporations. As a result, it can be argued that in many developing countries, political and economic ideologies favour an increasing role for the government as controller of incoming investment. Almost customarily the host governments decide if, when, and on what terms the foreign company can enter the country. This requires superior interaction and negotiation between the [MNC] and host governments (Kapoor, 1975).

2.4 Negotiating and controlling negotiations

Ikle (1967, cited in Kapoor, 1975) suggests that negotiation is an art developed through study and practice and that effective negotiation requires an understanding of the social, cultural, political, and economic systems, as well as an expertise in technical, financial, accounting, and legal analysis. Negotiation is here defined as the use of common sense under pressure to achieve goals. However, reaching clear agreement on all points is not necessarily the only objective of negotiation; in fact, agreement may be reached on only some of the clear proposals being negotiated. Even then agreements vary widely in their specifics and in the extent of disagreement which is left unsettled. The result of negotiations is more than merely an explicit agreement (Ikle 1967, cited in Kapoor, 1975).

Negotiating involves the recognition and assessment of a counterpart's bargaining position. The relative 'needs' of the buyer and the seller are really what determines who holds the upper hand. First and foremost, negotiators must understand where the company they represent stands in terms of international commercial perception.

Many negotiators from developing economies come to commercial discussions with handicaps that they willingly turned into strengths. Their economies are in most cases considered to "need" practically everything – from capital, to infrastructure, to clothing, to employment, to roads to telephones. They very often have taken to be inexperienced and uneducated negotiators with little to offer except a polite "thank you" to their backers.

Selling a product or investing in a new country will be met with some suspicion by locals, even when the target nation has a high demand and everything to gain by the deal. This fear of exploitation is inversely proportional to the level of economic development, while the ability to quash potential exploiters is directly related to the affluence of the target market.

Companies, having learned of the existence of what they see as potentially profitable projects from one of their sources, may then send representatives to the host country with proposals for their participation in the projects. There are, however, some basic facts that should be known about any company with which a relationship is being considered.

The first has to do with its familiarity in carrying out the particular activities foreseen for the project and its competency in carrying them out. If a host country knows there is a lack of competence, it will certainly use that as a bargaining chip. Many companies whose business is described in a directory or directory database as petroleum exploration may never have explored for oil in off-shore waters or in desert terrain. Many others may have such experience but may have failed to discover potentially rich deposits that were later found to exist (UNCTAD, 1991:72). The second has to do with its financial resources, the ways in which it uses them and its motivation to commit them to projects in developing countries. Such projects are sometimes kept alive by the host country pumping unforeseen resources into them.

The third has to do with its reliability and honesty. This is always an important issue, but it becomes urgent in cases where host country participants receive unsolicited proposals from companies. From time to time companies misrepresent their capabilities and have no history of engaging in the kinds of projects in which they claim to have expertise. While even the most experienced business entity can be duped by clever dissemblers, it appears to happen more frequently to governments and local enterprises of the countries that can least afford it (UNCTAD, 1991:73).

A host country party can begin to establish a strong negotiating position long before negotiation starts. In addition to being firm about the project in which the local partner wants MNCs to be involved, it should know the value to an MNC of the assets it will bring to the project and the costs it will incur in providing them. It should know the value of the water and electricity that would be consumed and of the market to which the arrangement would provide access. It should know the value of the infrastructure already in place, or the contribution it would have to make to the building of the additional roads, railways, power equipment and pipelines that would be needed.

Bacharach and Lawler (1981) explain that, when a representative of a host country meets a representative of an MNC at the bargaining table, both have resources and face constraints embedded in the social, economic and historical circumstances surrounding the relationship. It can be argued that bargaining is a process of developing tactical action from motives and intentions that are, in turn, grounded in the bargaining context. Motives and intentions are important because bargaining is goal-directed.

Two questions come to mind then. How do bargainers adjust or relate their own intentions and actions to those of the opponent? And how does the context of bargaining determine the motives, intentions and action of the bargainers? These are not only theoretical questions but also practical questions confronted by bargainers themselves. To answer these questions there are three possibilities to consider. First, bargainers must convert the resources and constraints of the bargaining context into objectives and actions to be pursued at the bargaining table. Second, they must make sense of and interpret the motives, intentions and actions of the opponent. Third, to

maximise the achievement of their objectives, they must present their own motives, intentions and actions to the opponent (Bacharach and Lawler, 1981).

It can be argued that bargaining power is the key to the three answers and to the interrelationship of bargaining context, bargaining process and bargaining outcomes. A theory of bargaining must place power at its centre and offer a framework for analysing how bargainers themselves come to understand and act within their bargaining situation. Bacharach and Lawler (1981) assume that “bargaining power” is not merely a part of the bargaining context or environment; it is not just another variable to be included in predictive models; it cannot simply be equated with payoffs or utilities. Bargaining power pervades all aspects of bargaining and is the key to an integrative analysis of context, process and outcome. So it can be justified to mention that a theory of bargaining must begin with the notion of bargaining power, must treat both the subjective and objective sides of bargaining power, and must examine tactical action in the context of bargaining power (1981:42).

It is apparent and argued by Bacharach and Lawler that nearly all theories of bargaining commence with a familiar representation of the bargaining dilemma – specifically, that bargainers have to reach some agreement but, at the same time, aspire to settle on terms more in favour of their own interests (1981:4). Somehow this scenario produces the mixed-motive nature of bargaining relationships. Bargainers have some incentive to reach an agreement and, therefore, to cooperate with each other; they also have some incentive to push for a settlement consistent with their own interests and at least somewhat inconsistent with the other’s interests and, therefore, to compete with each other. If they had no incentive to cooperate, they would probably not bargain at all; if they had no incentive to compete, they would not need to bargain. Theories of bargaining, Bacharach and Lawler point out, begin with the simple and obvious notion that bargainers compare the costs and benefits of no agreement with the costs and benefits of particular settlements (1981:4). Accordingly, “these costs and benefits presumably establish the concession behaviour of the parties and also the nature of the definitive settlement. This basic intention depends partly on how they conceptualise the bargaining problem” (Bacharach and Lawler, 1981:4).

Power, according to Bacharach and Lawler (1981), is a central feature of bargaining and negotiation. They regard "bargaining" as a process of managing impressions and manipulating information. Bacharach and Lawler have developed a challenging and comprehensive theory of power in bargaining and negotiation.

Bacharach and Lawler's theory involves the following assumptions: firstly, power is the essence of bargaining. It is the key construct of bargaining:

This assumption emphasises that (a) power is the central organising device of a bargainer's reality, and (b) power is multidimensional: Power as an outcome; Power as potential; Power as tactical action; the use of power. Secondly, bargaining is a process of tactical action, where tactical action links potential power and bargaining outcome. And thirdly, bargaining power is subjective power. Power in negotiation does not exist apart from bargainers' perceptions of it (within the bargaining situation and relationship). (a) Power has an objective component (e.g., money, status, knowledge, reward). The subjective component (bargainers' power perceptions and judgments), though, is more important to understanding potential power and tactical action; (b) objective power influences bargaining through the actual interaction of the negotiators; and (c) manipulating perceptions of power is a critical bargaining tactic (Bacharach and Lawler, 1981).

Based on these assumptions, Bacharach and Lawler (1981) present a "dependence" theory of power. Dependence refers generally to the degree that parties have a stake in the bargaining relationship. The dependence relationship is not constant or fixed. Negotiators bargain about the nature of their dependence on one another. Dimensions of dependence include:

Firstly, alternatives - the extent to which parties have alternatives via which they can gain similar outcomes; Secondly, commitment - the extent to which a party is committed to outcomes the other bargaining party controls; thirdly, bargaining power reflects (in bargaining between Party A and Party B): (a) A's alternatives to dealing with B; (b) B's alternatives to dealing with A; (c) A's commitment to outcomes B controls, and; (d) B's commitment to outcomes A

controls. Fourthly, bargaining power involves the parties' comparative dependence: (a) the greater A's alternatives, the less B's power over A; (b) the fewer A's alternatives, the greater B's power over A; (c) the greater A's commitment to outcomes B controls, the greater B's power over A; and, (d) the less A's commitment to outcomes B controls, the less B's power over A. Fifthly, power is influenced by manipulating perceptions of alternatives and commitment; and, lastly, persuasive argument is a primary way of manipulating perceptions of alternatives and commitment (Bacharach and Lawler, 1981).

As a result, Bacharach and Lawler identify three forms of bargaining power. Firstly, absolute power – power of an individual irrespective of the other party's power. A's absolute power is determined by B's alternatives and commitment. Secondly, relative power – the dependence of one party compared to the dependence of the other party, that is, the ratio of A's dependence on B to B's dependence on A. And thirdly, total power – the sum of the parties' dependence upon one another (Bacharach and Lawler, 1981).

According to Goldman and Rojot, “when negotiating, each party’s bargaining power is based on his opponent’s perception of the cost of agreeing versus the costs of disagreeing with the other’s approval” (2003:46). Bargaining power can be influential in changing the course of negotiations between the host government and the MNC. For example, the Philippines government might decide to use its bargaining power towards its own objectives by constraining the MNC. And some critics would argue that they are within their rights to do so since they are the legislators. This can then have a fairly decisive effect on the overall negotiation process that could ultimately favour the Philippines, which ultimately is interested in fulfilling its economic objectives. On the other hand, the reverse effect might apply in favour of the MNC, because if the MNC felt it was not gaining advantage in the bargaining process, it may even threaten to pull out of the negotiations.

Negotiations in the Philippines, according to Curry (1999:161), “are conducted in a very formal manner. Company titles are very precise and are used to maintain the hierarchy. Locals will take on a very rigid manner when dealing with foreigners in an

effort to preserve what they believe is a professional appearance”. Furthermore, Curry stresses that the Filipinos are strong advocates of forging relationships and “maintaining *pakikisama* (smooth relations) at all costs. Confrontation is unthinkable and a sign of disrespect. Part of this process is the *utang na loob* (reciprocity) system whereby one business (or political) connection leads to other, more lucrative, deals” (1999:161).

Both the MNC and the host government respond to the interests of those they represent, such as the shareholders in the case of the MNC and the constituents in the case of the host government. However, the MNC’s interest is boosted because it also becomes a player that is in many ways supported by the state it operates within, in some cases more so than the local companies or corporations, who most often do not obtain the incentives that are offered to the MNC which, for example, chooses to operate within a government sponsored economic zone. So the role of the state becomes rather a difficult one, and it is certainly a clear indication that, in this era of globalisation, states have not lost the power referred to in much of the literature surrounding states’ influences in managing their internal and external activities. The role of the state has simply altered, and one can argue that this is not the same across the world, since states usually operate differently within and across geographical regions.

Whilst the bargaining process may in some way indicate one party being more influential leading to that party gaining more of an advantage, it is clear, however, that the gains in the long term usually favour the state, given that that state advances its economy and political objectives positively, within a free market and democratic environment guided by a responsive government that is persistent in dealing with such major impediments as corruption and cronyism.

An interesting point was raised by Henisz and Zelner (2003), who argue that:

despite the potential for mutual gains, the relationship between foreign investors and host governments is characterised by divergent interests resulting from the distributional process through which the policymaking apparatus allocates the costs and rewards of investment among various interest

groups. While investors are interested in maximising returns, governments have more complex preferences shaped by multiple interest-group pressures.

Moreover, in the process, people in government more often than not become part of interest groups after they are decommissioned and from that point onward can have relatively strong impacts on both the investors and the government.

An interesting point raised by UNCTAD (1991:71), and an important one when negotiators come together, is that:

the negotiating process itself is perhaps the most difficult and risky part of dealing with MNCs because, at this stage, the terms are set that will determine the future relationship between the local and foreign partners and the success or failure of the enterprise. Multinational corporations have access to skilled negotiators and sophisticated lawyers. They can secure terms that will result in profits for the corporations, perhaps at the expense of the local partner. After negotiations are completed and MNCs have become established in a country, they will need to be monitored to ensure that they are following the laws of the country and adhering to the terms of the agreements that were reached.

2.5 The “obsolescing bargain” theory

Traditionally, the bargaining relationship between MNCs and states has been considered an obsolescing one. Even though MNCs initially had the upper hand in the bargain, the investment would eventually lead to a commitment by the firm to the production site, with a resulting power shift advantageous for the host. However, due to the theoretical reasoning and the empirical evidence in this thesis, the author asserts an altered structure of the interdependence between these two main actors in the global political economy.

Given that MNCs now pursue global strategies for their activities, and given the processes of the globalisation of the world economy discussed earlier, the bargain does not obsolesce, since the firm becomes increasingly less bounded to the state it invests in. Additionally, development has made it possible for the corporation to keep

the host more or less dependent on it, and thus maintain the upper hand in the bargain. Given that there is a relative scarcity of major FDI projects, state competition for these has also increased, which furthermore leaves the state with less ability to renegotiate the bargain to its advantage, since the relative importance of the specific FDI project increases and, the cost of losing it therefore increases. In other words, according to Jarblad, the obsolescing bargain model may very well be increasingly inaccurate (Jarblad, 2003:40-41). Host countries face the dilemma that MNCs' strategies can change over time, often the result of cost-savings, take-overs, and higher levels of production. New locations strategies particularly aimed at low labour cost nations, such as China, can potentially lead to investments shifting from host countries that under perform or are unable to meet the requirements of the MNC.

Vernon explains, in response to his earlier publication of *Sovereignty at Bay*, that "Meanwhile, the themes of *Sovereignty at Bay* (Vernon 1981, Vernon cited in Moran 1985:248), if they were ever learned were half-forgotten in the heady pursuit of more vulnerable quarry. Only the author and a few of his more attentive students would remember the argument of his final chapter, which concluded somewhat lugubriously".

Furthermore, according to Vernon the basic asymmetry between MNCs and national governments - that is, the capacity of the enterprises to shift some of their activities from one location to another, as compared to the commitment of the government to a fixed piece of national turf - may be "tolerable up to a point, but beyond that point there is a need to re-establish balance ... If this does not happen, some of the apocalyptic projections of the future of multinational enterprise will grow more plausible" (Vernon, cited in Moran, 1985:248).

Because *Sovereignty at Bay* (1971), according to Vernon, "was one of the earlier works in a stream that would soon become a torrent, much of the book was devoted to chronicling and describing the phenomenal growth and spread of multinational enterprises" (Vernon, 1981; Vernon, cited in Moran, 1985:248).

Vernon further explained that oligopoly was recognised as a near-necessary condition for breeding MNCs, a conclusion that simply reaffirmed a point made ten years earlier

by Stephen Hymer (1976). Vernon (1981:518) explains that “two kinds of oligopoly that seemed particularly relevant in explaining the spectacular growth of U.S.-based MNCs in the post-war period for example were explored with special attention”. Firstly, the oligopoly is founded upon the special technological proficiency of the participating firms. Secondly, the oligopoly is based on the absolute size and geographic spread of the operating firms concerned, as in the oils and metal industries. Moreover, Vernon adds that “the most widely known of the hypotheses that were elaborated was called the product-cycle hypothesis which was particularly applicable to the technology-based oligopolies” (cited in Moran, 1985:248).

Clear threats to MNCs are that there are strong initiatives on the part of the governments of less-developed countries to control the key factors in the exploitation of their raw materials, which are likely to continue. And as they do, according to Vernon (1971:64):

the capacity of host governments to participate in management will increase. It is another question, however, whether the host countries will feel that their ‘dependence’ on the outside world has declined simply because their management role has increased. As long as the product requires marketing in foreign countries, dependence will presumably continue in some form.

Vernon adds that, as one reads the raw materials chapter written in 1981 with the necessary observation, the argument for the increasing limitation of the oil companies is all there, carefully laid out under a heading dubbed “The Obsolescing Bargain” (Vernon, 1981; Vernon cited in Moran, 1985:251). Furthermore Vernon stressed that:

What prevented [him] (and practically every scholar at the time) from fully applying the lesson of the obsolescing bargain to the situation of the oil companies was [their] inability to appreciate that a profound shift in the supply-demand balance was taking place, which might reduce the need of the oil-exporting countries to rely on the marketing channels of the multinationals (cited in Moran, 1985:251).

Vernon confirms that most people took the persistent weakness of oil prices during most of the 1960s to mean supplies were more than sufficient. Accordingly, it was hard to consider that demand would soon grow so rapidly that the oil-exporting countries would feel free to cut their lifeline to the international oil marketers. Vernon further highlights:

that many analysts in the oil industry itself were aware of the dangers of an oil shortage at the time. To be sure, by the latter 1960s, some thoughtful executives in the industry were deeply worried. Some were expressing anxiety over the deterioration in their negotiating position (cited in Moran, 1985: 251-252).

One of the conclusions, founded as much on other raw materials as on oil, Vernon argues is that the theory of the obsolescing bargain does have a definite utility in analysing the shifting position of the MNC engaged in any given product line. Accordingly, wherever the conventional shrewdness of any market turns from an expectation of scarcity to a probability of excess, Vernon anticipates this is in accordance with the obsolescing bargain concept that the position of the MNCs will be somewhat weakened (cited in Moran, 1985:252).

The “obsolescing bargain model”, developed by Vernon, explains the interrelations between MNCs and host countries as a function of goals, power resources and constraints of each party. This model makes the assumption that each party possesses assets valuable to each other, and each party is able to withhold these assets. Each party is also constrained in its exercise of this power, and the party with the larger actual bargaining power gains a larger share of the benefits. This theory, which has been used extensively in International Political Economy (IPE) studies of MNCs, implies that MNC/host state relations are dynamic and evolve over time. Before the MNC has established in a country, the host government’s bargaining position is assumed to be weak. Since investments in a new country are always related to uncertainty (Kobrin, 1987, cited in Jarblad, 2003:4) and given the reality that the MNC is likely to have other potential investment sites available, the host will be forced to offer concessions in order to attract the FDI project.

According to the model of the obsolescing bargain, this power shifts once the investment has been made, due to dissipation of uncertainty, commitment of immobile resources and an increasing independence of the host on the MNC for capital, technology and access to markets:

once invested, fixed capital becomes 'sunk', a hostage and a source of bargaining strength. The high risk associated with exploration and development diminishes when production begins. Technology, once arcane and proprietary, matures over time and becomes available on the open market. Through development and transfers from FDI the host country gains technical and managerial skills that reduce the value of those possessed by the foreigner (Kobrin, 1987, cited in Jarblad, 2003:5).

As the overall local economy develops due to FDI, the host government is thought to gain relative power according to the theory of the obsolescing bargain. However, the host country is considered to have additional incentives to renegotiate the bargain in order to achieve more of the potential benefits. As a result, the MNC needs to try to keep the host reliant on it for new technology, products or access to export markets. The alternatives are obviously to exit or give in to state demands (Eden, 1991, cited in Jarblad, 2003:5).

The theory of the obsolescing bargain predicts that the passage of time will result in erosion of the multinational's bargaining power (Vernon, 1971). At the outset, the MNC enjoys a high degree of bargaining power since the host country may want to attract it to the country on account of its capital, technology or marketing expertise. However, Vernon suggested that, once the MNC has sunk its assets in a developing country, its vulnerability immediately increases. If the MNC's operations are highly profitable, the passage of time may reduce the government's appreciation of the up-front risks assumed by the company at entry (Vachani, 1995).

Once the MNC has settled negotiations and begins to operate in the host country, the ownership, location and internalisation factors begin the process of MNC/host country relationship. However, as the host country begins to gain from technology transfer, the process of acquiring knowledge assists it to find ways of capitalising from its

interactions with the MNC and to recognise that it may have the potential to renegotiate the terms of the original agreements. This is what Vernon terms 'the obsolescing bargain theory'.

In terms of theory, the prime model that economists have used when looking at the relations between foreign investors and host countries has been one of bilateral monopoly: the foreign investor has control over the capital, technology, management and marketing skills needed to launch the project successfully; the host country has control over access before the investment is made and over the conditions for operation afterward. The early attempts to look at foreign investor–host country relations within the framework of bilateral monopoly suffered from being too static and too indeterminate.

To add more dynamism to the analysis, Raymond Vernon introduced the idea of what he called the “obsolescing bargaining”. Central to Vernon’s formulation was the role of risk and uncertainty. The dynamism of the obsolescing bargain that accounts for a shift in power from the foreign investor to the host country springs from the dissipation of risk and uncertainty. Moran (1986) argues that the obsolescing bargain framework constituted a breakthrough in several respects. In effect not only did it provide a dynamic understanding of the evolution of bargaining relations between a host country and foreign company over the life of a project, it also provided a realistic expectation about how favourable to the foreigner new investment concessions would have to be to attract investment. On the other hand Moran (1986) argues it provided a promising perspective about the eventual strengthening of the hand of third-world authorities in renegotiating the initial agreement to capture more and more of the benefits from foreign investment (Moran, 1986:5-7).

However, Jenkins argued that this theory of “obsolescing bargain” can be criticised for its simplicity and insufficient capacity to identify the variables that might explain differences in the development of bargaining power at the company level (Jenkins, 1986). As a result of this criticism, the empirical research has focussed on illustrating the power certain variables may possess over a period of time and their potential impact on a firm’s bargaining power (Fagre and Wells, 1982; Lecraw, 1984; Gomes-Casseres, 1985 and 1990; Kobrin, 1987; Contractor, 1990). Similarly, there are certain

points of contention on whether bargaining power actually shifts to companies or the host governments over time. One of the aims of this thesis is to further expand on this issue.

Vachani tested the existence of the obsolescing bargaining theory by formulating and testing hypotheses about the primary variables on proportion of foreign ownership retained. Given that MNCs and hosts bargain over equity level and benefits, measuring foreign ownership therefore remains a useful proxy for bargaining success (Vachani, 1995:176). Vachani argues that a “critical component of multinationals’ strategy is their foreign ownership strategy, the formulation of which is complicated by the erosion over time, of multinationals’ bargaining power vis-à-vis host governments, a phenomenon described as the obsolescing bargain by Vernon” (Vachani, 1995:159). What Vachani fails to do is identify and categorise the foreign ownership laws within any given country. In conclusion Vachani (1995) argues that there has been practically no statistical research using longitudinal, firm-level data to test the obsolescing bargain theory. However, one has to question if this argument actually does dismiss the theory.

To answer this question, cross-sectional statistical studies provide insights into determinants of static bargaining power (Fagre and Wells, 1982; Gomes-Casseres, 1985, 1990; Nizamuddin, 2001). Lecraw (1984) found that countries became more successful in striking bargains over time, and most importantly over the lifetime of the given project, but did not attempt to measure the evolution of bargains over time. A possible reason for the lack of this attempt is the lack of continuity of many governments, particularly in liberal democracies. Kobrin (1987) used static, cross-sectional data to infer the evolution of the bargain, a dynamic phenomenon. He conceded that his approach was “obviously imperfect” (Vachani, 1995:160).

Perhaps one of the most intuitive characterisations of state–MNC relations has been termed by Joseph Grieco as the ‘bargaining school’, a type of learning process. It has a distinguished academic lineage that includes Raymond Vernon, Charles Kindleberger and Theodore Moran (Grieco, 1984; Nizamuddin, 2001). Without a doubt, credit is given to Vernon who initially developed its core notion of “obsolescing bargain” that captured the dynamic of a change in relative power to the

host country (Nizamuddin, 2001:22). First, the condition of entry and the allocation of benefits that accrue to the host country and the MNC are a function of the relative power of each. Second, in the early stage of a project's development, the power balance appears to favour the MNC. Grieco writes, "the [host] country may control access to its markets and resources, but the [MNC] has more important bargaining assets through its control of capital, access to foreign markets, technology, and managerial expertise" (Grieco, 1984:2).

However, Grieco does not elaborate much on the importance of these assets. The third and final phase is marked by a consistent and progressive reversal of power away from the MNC. This phenomenon is not only a by-product of the effects of learning by the host, but also a result of sunken investments from the perspective of the foreign firm. Grieco concludes by stating, "... prolonged contacts with [MNCs] afford the [host] countries the experience needed to manage these relations more effectively and to the greater benefits of the countries" (1984:3).

The wearing down of the MNC's bargaining power is reflected in lower bargaining achievement, which is a measure of how close the terms of the deal negotiated are to the MNC's objectives, as opposed to the host's objectives. Bargaining success is, in itself, complex to measure, and an MNC's level of foreign ownership in local subsidiaries is a widely accepted alternative for level of bargaining success (Vachani, 1995). MNCs and governments bargain over a diverse set of factors (Vachani, 1995; Encarnation and Vachani, 1985; Kobrin, 1987; Lecraw, 1984; Poynter, 1982; Weiss, 1990). With the passage of time, as the host government tries to revise its arrangement with the MNC, it may be willing to give companies benefits, such as permission to expand and diversify, in exchange for reduction in foreign ownership (Vachani, 1995; Encarnation and Vachani, 1985; Grieco, 1982); however, rather than generalising, this would depend entirely on what country Vachani refers to.

2.5.1 Applying the "obsolescing bargaining theory"

The theories discussed so far apply to all forms of uncertainties in investment returns, that is, market as well as public risks. In contrast, the "obsolescing bargain" models

stress the public risks that investors face due to the fact that the bargaining power between the host government and the investors changes with the phases of the investment project (Vernon, 1974).

The obsolescing bargaining theory was developed to analyse the situation of foreigners investing in natural resources projects, but the model can also easily be applied to private investment into infrastructure, as will be shown with the Fraport case study in Chapter 5. At the beginning of the investment project, the foreign investor has a stronger bargaining position than the host government (Weder and Schiffer, 1999:6-7; O'Faircheallaigh, 1982:3). While the government possesses valuable natural resources, these can only be exploited with the capital and expertise of the foreign investor. Applying this model to the infrastructure sector, the government possesses the right to decide which firms are allowed to act as providers in its utility industries and also has the power to regulate those firms. To induce the foreign firms to invest in an uncertain project, the host government must initially offer favourable terms to the private investor. Once the foreign firm has invested in the project and it turns out to be successful, the power structure between the investor and the host government reverses (Weder and Schiffer, 1999:6-7).

The host government, realising that the firm, now that it is clear that the investment is a success, makes high profits, will want better terms, that is, some share of those profits the firm earns. Because the firm's investment is irreversible and therefore sunk costs to the firm, the government is now in a very good bargaining position to renegotiate a more attractive contract, resulting in more profits for the government and less profits for the investor. However, the firm knows from the very beginning that its bargaining position will worsen as the investment project matures and therefore less private investment will be undertaken (Weder and Schiffer, 1999:6-7).

The general result from all these models is that both the investor and the government would profit from a more credible policy regime because it would induce higher levels of private investment (Weder and Schiffer, 1999:6-7). Unexpected changes in economy-wide laws and regulations governing foreign investment, taxation, labour, antitrust, environmental protection and other matters can reduce the profitability of an investment (Weder and Schiffer, 1999:9).

Kindleberger and Herrick argue that “the expropriation of foreign-owned assets is a dramatic event in poor countries. It may be accompanied by offers of compensation; although owners will always claim that the amounts are inadequate” (1977:316). And whilst “expropriation may be blatant and direct, involving seizure of assets”, it may possibly follow lengthened negotiation “and include carefully elaborated terms of payment. It may take more [restrained] but equally [useful] paths, such as withholding trading licences from the firms to be taken over” (Kindleberger and Herrick, 1977:316). The threat of expropriation is forever present, and goes together with the political instability that marks many low-income countries. Every so often expropriation is in the economic interest of people in poor countries. And every now and then it is not (Kindleberger and Herrick, 1977:316; O’Faircheallaigh, 1982).

Kindleberger and Herrick argue that usually expropriation is “exceptional but very observable. Its greatest economic impact may lie in its intimidation rather than in the act itself. And there is no doubt that the threat is double-edged. It may perhaps make existing firms perform at the same time that it frightens off potential newcomers” (1977:318). Furthermore, investors need to take into account the potential risks that may threaten their investments in countries that have political instability. In this regard, the investor can be viewed as having more bargaining power if the host country government is unable to prevent such risks from emerging or persisting. Of particular importance here are traditional political risks, expropriation risks, country risks and regulatory risks.

Whilst stability or for that matter political instability and their associated risks have a definite influence on foreign investors’ perceptions, what needs to be assessed from the literature is the extent, and more so, the outcomes of the relationship between political risks and FDI. Therefore, particularly in the Philippines’ case, an awareness its political risks is very likely to affect foreign investors’ tendencies about undertaking and investing into FDI projects in the country. When assessing the literature on political risks it is obvious that empirical studies on the importance of political risk for FDI are very unconvincing on the actual relationship between political risk and FDI. Furthermore, according to Kamga Wafo (1998) “the nature, intensity and magnitude of this relationship is not specified in most empirical studies”.

Poynter (1985) takes this view further by arguing that not only is the concept of political risk itself inadequate, but the connection between political instability measures to the firm as a whole is insufficiently understood (cited in Kamga Wafo, 1998). Kamga Wafo (1998) also notes that the same would be relevant to the relationship between governmental instability and any ensuing instability in the policies of host countries.

Prior to highlighting the different types of risks that foreign investors are faced with it is necessary to define what political risks are and expand on the concept. This is fairly necessary because a reasonable understanding of the impact of political risks on FDI could very well assist host countries to realise the “many possibilities and limits of their political governance upon the level and volume of FDI” (Kamga Wafo, 1998:6). Howell and Chaddick (1994:71) promoted the concept of political risk as “the possibility that political decisions, events, or conditions in a country, including those that might be referred to as social, will affect the business environment such that investors will lose money or have a reduced profit margin”. Whilst recognising that political risks are not usually the topic of frequent debates in academia, it is acknowledged that they have been around for many centuries. Furthermore, Howell and Chaddick point out that “political risk exists for both domestic investors and foreign investors and many of the techniques for assessment of risk are the same for both of them” (1994:71). In effect, Howell and Chaddick (1994:72) stress that the “best approach to understanding the concept of political risk and then assess its utility is to examine exactly what is at risk and what ‘risk’ means in applied business terms”.

According to Kamga Wafo evident in the economic literature are diverse ways of defining political risk. Certainly, the definition of political risk depends on the angle in which one views the political risk and on the importance one attributes to political risk. It can be debated that the very content of political risk definition is either extensive or restrictive. The exclusive definition of political risk incorporates in the “sources of political risk concept all kinds of politically motivated acts no matter where these are rooted. In this perspective, sources of political risk are seen in government instability as well as in societal instability” (Kamga Wafo, 1998:17). One example of extensive definition of political risk is put forward by Agmon (1985:7), who defines political risk as the “unanticipated changes in political factors ... caused

by the actions and reactions of governments and other political groups within and between countries” (cited in Kamga Wafo 1998:17).

A further description of political risk is presented by Robock and Simmonds (1973) who suggested that political risk in international investment exists when discontinuities¹³ come about in the business environment, when they are hard to predict, and when they are consequences that emerge from political change. Perhaps the most simple and practical definition of political risk is summed up best by Haendel (1979:5) who identifies the political risk encountered by foreign investors as “the risk or probability of occurrence of some political event(s) that will change the prospects for the probability of a given investment”. This thesis recognises that there are many political risks that are addressed in the literature, some of these being for example, political violence, societal instability, restrictions on entry by foreign investors, systems for controlling inflows of FDI, limits on foreign exchange transfers, government intervention, expropriation, government incapability, hostile attitudes of elites and society towards FDI etc. However, for the purposes of the arguments that the thesis addresses, the main focus will be on the political risks that impact the bargaining process between the host country (the Philippines) and MNCs.

The term political risk as proposed by Kobrin accordingly “appears overly constrained from both an analytical and operational viewpoint” (1979:71). Taking that into account and to have a better understanding of political processes in general, Kobrin argues that “what we are, or should be, concerned with is the impact of events which are political in the sense that they arise from power or authority relationships and which affect - or have the potential to affect, ... firm’s operations” (1979:71). In determining that a relationship does exist Kobrin further adds that “political factors are not a major determinant of FDI. To the extent that a relationship does exist, it is rather complex and depends upon the probability that instability or conflict will result in changes in policy rather than in direct effects upon investors” (1979:74).

¹³ See also Rummel R.J. 1966. ‘Dimensions of Conflict Behavior within Nations, 1946-59’, *Journal of Conflict Management*, Volume 10, Pp. 66-73.

In considering further assessments of political risks that arise from government actions that can severely impact on the profitability of a project Chermak (1992:167) posits that:

political risk is, or should be, a concern of any investor considering investment in a foreign country. Perhaps nowhere is this more true than in the extractive industries where a firm makes an upfront commitment to a high dollar, sunk cost investment. The potential of an obsolescing bargain (analogous to a hold up problem) exists.

Traditional political risks are risks relating to expropriation and political violence. Expropriation risk is the risk that the host government will nationalise assets or equity of an enterprise without paying fair compensation. Industries that have just been privatised and with this have probably switched from subsidised to cost-covering tariffs will be especially prone to this kind of risk. Infrastructure assets may also be particularly vulnerable due to their specific and immobile character. Political violence such as war, revolution, insurrection, civil strife, terrorism and sabotage may affect any investment, but infrastructure investments which are perceived as being strategic, such as those that provide energy or water supply, may be particularly vulnerable to certain types of political violence (Weder and Schiffer, 1999).

The classical political risk is the risk that the host government will nationalise the facility and simply expropriate private investors without offering compensation. Closely related is the risk that the government will repudiate part of the original agreement with the private investor. Both events are closely related to government instability, since significant changes in executive power are often accompanied by policy changes and by renegotiations of previous commitments (Weder and Schiffer, 1999:17).

In assessing political risk versus creeping expropriation, Weder and Schiffer (1999) examined a large number of indicators of political and regulatory risks, distinguishing two groups of risks: catastrophic political risks and risks of creeping expropriation. Catastrophic political risks include the traditional political risks such as the risk that the government will simply expropriate the private investor or renege on a contract. This risk is often associated with electoral and political uncertainty since after large

changes new rulers are likely to repeal obligations that were taken on by the previous governments. Catastrophic political risks are closely related to sovereign risks in financial markets (that refer to the danger that a government will default on its debt payments).

The second kind of risk relates to all actions or non-actions of governments that amount to creeping expropriation. They include regulatory risks, the risks of being surprised by new rules and regulations and the risk that returns on investment are reduced by red tape and corruption or more generally through non-enforcement of rules by the bureaucracy and the judiciary (Weder and Schiffer, 1999:3). Regulatory risks, which are risks from unexpected changes in laws and regulations, are of concern to all kinds of investment, but are often more important for private investment in infrastructure than for private investment in general. Creeping expropriation stands for all forms of unexpected changes in the institutional environment that gradually reduce the value of the investment. Creeping expropriation can come in many different guises and is much harder to capture and quantify than large catastrophic events. Thus, measures for creeping expropriation are less readily available. In particular, there are no measures of industry-specific regulatory risks (Weder and Schiffer, 1999:19).

A survey conducted by the US Chamber of Commerce established that “the risks to companies’ real or intangible property from direct or creeping expropriation are among the key considerations of U.S. businesses in decisions whether and where to invest abroad” (US Chamber of Commerce, 2000). The findings are also based on interviews from German senior managers who identified a good investment climate as a country where intellectual and physical property are protected. The interviewees identified most countries outside of Western Europe and Northern America to be a concern for investors, as they do not provide adequate protection for both physical and intellectual property. The danger of expropriation is another threat to physical and intellectual property. According to Wall Street Journal and Financial Times publications on expropriation cases, they tend to happen too often and send negative signals that threaten both current and planned investment into the country where the expropriation case took place. For example, the Russian government expropriated Japanese-owned Yukos stock in 2004, and by the end of 2004 the level of FDI declined as a result of investors fearing that the risk of doing business in Russia had

increased. Expropriation tends to take place in countries that most need to attract foreign direct investment for their economic development. Bolivia, Russia, Ukraine and Venezuela provide examples of countries that need a flow of FDI but take steps to frighten foreign investors away. In the case of the Philippines, the most recent case of this is with the Fraport incident, as will be discussed further in Chapter 5.

Moosa argues that country risk “represents a potentially adverse impact of a country’s environment on the cash flows generated by an FDI project. Country-risk analysis is important for a number of reasons” (Moosa, 2002:131). Firstly, the MNC can use it as a screening mechanism to avoid investing in countries with excessive risk. Secondly, it can be used to monitor countries where the MNC is currently engaged in international business. In this, a decision to divest (which may involve a change of the location of the production facilities) may be taken if it is felt that country risk has become excessive. Thirdly, the reason why the study of country risk is important for MNCs is the need to assess particular forms of risk for a proposed project considered for a foreign country. These forms of risk may be general, such as economic risk and political risk, or they may be more specific, such as the risk of a takeover by the host government (Moosa, 2002:131).

Furthermore, Moosa points out that country risk arises from political risk factors, and economic or financial risk factors. Hence, political risk is a subset of country risk arising from political risk factors. These include war, occupation by a foreign power, riots, disorder, attitude of consumers in the host country, attitude of the host government, changes in the rules and regulations governing FDI, blockage of fund transfers – by using capital controls as in the case of Malaysia during the Asian financial crisis of 1997 – currency inconvertibility, and bureaucracy. In general, political risk refers to potential losses to a firm resulting from adverse developments in the host country. Events whereby political risk materialises range from the outright expropriation of assets to unexpected changes in the tax laws that hurt the profitability of FDI projects (2002:132).

An investor that exports to a country or establishes a subsidiary in a country should be concerned about the demand for its products in that country (Moosa, 2002:132-133). Because the state of a country’s economy depends on several factors, an MNC should

consider all these factors. Some of the obvious ones are interest rates, exchange rates and inflation. High interest rates normally slow down the economy and decrease the demand for the MNC's products, while low interest rates have the opposite effect. Exchange rates determine the country's demand for exports as well as the domestic currency value of the MNC's costs and revenues. This is why MNCs tend to set up production facilities in countries where currencies are undervalued – a good example of this is China – and sell their products in countries where currencies are overvalued. The problem is that the state of undervaluation or overvaluation may change over time. The purchasing power of consumers is affected by inflation rates and this can be an undesirable factor for a country's economic growth and of course the returns an investor may collect (Moosa, 2002:133).

Therefore, a negotiator's objective along with the investor in measuring country risk that arises from these factors is to decide whether an investment in a country with these qualities is worthy of being embarked on, and if it is, what kinds of measures should be taken to reduce their potential disadvantageous effects. The assessment of country risk includes the assessment of political risk and economic risk that can influence cash flows. Furthermore, one has to bear in mind that political risk events are often generated by economic factors. Political risk is consequently not always entirely independent of economic risk (Moosa, 2002:134).

Political risk is the part of country risk that is normally more relevant to FDI. Most of the literature on FDI refers to political risk, and not to country risk. The concept of political risk has been around for some time. Baskin and Miranti (1997) suggest that attempts were made in the seventeenth century to deal with various sorts of risk, including political risk. The concept of political risk started to appear in the literature when it became important in the 1960s as newly independent countries tried to overcome their capital shortage problems by taking over the MNCs. Thus, expropriation and nationalisation became critical concerns in the 1960s for companies with foreign operations. After the ousting of the Shah of Iran in 1979, political instability was added to confiscation, nationalisation and expropriation as a source of political risk. For example, four months before the removal of the Shah, a country risk assessor for Gulf Oil detected severe political pressure building within Iran. As a

result, the company began planning to deal with the subsequent loss of Iranian oil, which at one time amounted to 10 per cent of its crude supplies (Moosa, 2002:148).

Political risk indicators are used to monitor political risk after a project has been taken. The political environment in any country is dynamic in the sense that it changes over time. Changes taking place over time include changes in the laws and regulations affecting FDI in general, or the underlying project in particular, as well as changes in public opinion. Monitoring political risk also means explaining the nature of the relationship between the host country and the investor. In this sense, FDI decisions are seen as resulting from negotiations between the host country and the investor.

One way to understand the nature of the relationship between the two parties is by resorting to Vernon's (1968) theory of 'obsolescing bargaining'. This theory essentially reflects the concerns of foreign investors in developing countries over the possibility that government policies might easily change ex-post (that is, after the implementation of the project) in ways that are detrimental to the profitability of the investment. The theory refers to changes in the relative bargaining power of the country and the investor over time (Moosa, 2002:154).

A variety of considerations suggest that the bargaining position of the host country generally strengthens over time relative to that of the investor. One explanation for this proposition is based on informational asymmetry, as the host country has access to all information needed by the investor, to which the investor does not have access. However, given the financial power of MNCs and their full control over technology transfer, any increase in the host country's bargaining power will most probably be marginal (Moosa, 2002:154). The management of political risk includes the identification and assessment of political risk, its quantification, the anticipation of losses and the prevention or reduction of the incidence of losses (Moosa, 2002:155).

One of the most important operating strategies is carrying out FDI via joint ventures with a partner from the host country, which could be a government body. This is the business form that is most frequently used in strategic alliances. The setting up of joint ventures with parties from the host countries is particularly useful when a firm (Moosa, 2002:155) wants to enter a country with a hostile government and/or

restrictive legislation (Moosa, 2002:156). Political risk can also be managed via bilateral agreements. These agreements can take two forms: bilateral government treaties and bilateral investment treaties. Bilateral government treaties are concluded with the objective of guaranteeing a commitment by the host government with respect to FDI. Bilateral investment treaties, on the other hand, are designed to improve the conditions for investment by firms of each signatory country in the other country (Moosa, 2002:158).

The flow of foreign direct investment into developing countries, which is a critical source of growth, varies greatly across countries and over time. International institutions like the IMF/WTO provide direct and indirect mechanisms for reassuring foreign investors about the treatment of their assets and the continuation of economically liberal policies. They enable governments to make credible commitments to foreign investors, because such international commitments are costly to renege on. Buthe and Milner (2005) “identify secure property rights as the key concern of the MNCs due to the obsolescing bargain”. Once a firm undertakes a foreign direct investment (which is by definition not perfectly mobile), some bargaining power shifts to the host country government, which has an incentive to change the terms of the investment to reap a greater share of the benefits (Vernon, 1971).

Governments wishing to attract inward FDI must therefore find ways to reassure private investors that their investments are secure and can prosper. Low barriers to trade, capital account openness and other economically liberal domestic policies may provide such assurances, but domestic policy can often be easily changed, especially if the change is at the expense of foreign private actors (Buthe and Milner, 2005:1). According to Buthe and Milner (2005):

Economic research further suggests that the size of the market in the potential host country matters for FDI, as well as levels of economic development and economic growth ... Countries with higher levels of economic development have been found to attract more investment, at least in part probably because of their better infrastructure and lower country risk.

Entrepreneurs that do business in developing countries often find that the most important source of risks and uncertainty their investment face comes from the government. Changes in government, for example, bring obvious risks of changes in policy and rules. A perfect example of an irreversible investment is a large-scale power project or a contract to exploit a natural resource. Most of the equipment and design is specific to the individual site and circumstances (Weder and Schiffer, 1999:5-6).

Typically a complex negotiation process precedes such large-scale projects and an involved net of contracts with the government is drawn up. However, because the investment is irreversible, once the capital is in place, the government may have large incentives to reject contracts and, in the extreme, nationalise the installation. In many countries these incentives are mitigated by the government's desire to attract further investment. A government with a long time horizon is more unwilling to alienate the private sector. But in an unstable political system such constraints are less binding. And if investors are apprehensive that they might get cornered, they will be unwilling to commit their resources in the first place (Weder and Schiffer, 1999:5-6).

Moreover political instability and violence may be expected to make a country less attractive to FDI, since they render the economic and political context less predictable (Basi, 1963; Brunetti, Kisunko and Weder, 1997, cited in Buthe and Milner, 2005:5). Empirically, political instability has been hard to define; many different definitions and measures exist. This lack of convergence around a common notion might explain why some studies find strong effects while others suggest that the relationship is insignificant (Delios and Henisz, 2003; Gelos and Wei, 2002; Jun and Singh, 1996; Kobrin, 1976; Nigh, 1985; Schneider and Frey, 1985, cited in Buthe and Milner, 2005:5).

Total expropriation of foreign investments has become less likely over time (though it remains a possibility, as in Bolivia's oil and gas sector today), but governments can cause far more subtle threats to property rights, all the way through to changes in regulation, taxation, tariffs and fees, as well as selective law enforcement. For instance, regulatory interventions of different types may force MNCs to buy inputs, borrow capital, etc. from particular domestic suppliers. While drastically obsolescing

bargains may be rare, such indirect threats to a foreign MNC's investments are real (Buthe and Milner, 2005:6-7). When reflecting whether to invest in a particular country, MNCs should have a preference for a surrounding where liberal economic policies – in particular, strong property rights protections – exist and can be expected to prevail. Most liberal economic policies imply a predisposition to use markets rather than government intervention (Buthe and Milner, 2005:7).

2.6 Summary of key issues

In summary, this chapter has reviewed the literature that encompasses FDI, and the interactions between MNCs and host governments. This was done to facilitate a clearer understanding of the bargaining power and processes that permit or facilitate entry into a host nation for foreign investors. In addition, this sets the scene for the following chapters of the thesis. The chapter analyses the importance of FDI to developing countries and the ability of both MNCs and host governments to deal with the potential investment with their own interests in mind. The chapter focuses on several academics' works, particularly those of Theodore Moran and Raymond Vernon in explaining the processes involved between MNCs and host governments before, during and after bargaining.

The chapter reviewed the bargaining power and bargaining theory literature to explain the dynamic and political processes involved in the negotiations between MNCs and host governments. As well particular focus was given to Vernon's "obsolescing bargain theory" and the potential risks to investors once an investment in a natural resources project has been sunk into a host nation. However it was highlighted that the theory also impacts on private investment in infrastructure.

Much attention was paid to government policies in regards to attracting FDI within a competitive environment for much needed investments by developing countries. Furthermore, the theories introduced in this chapter are important for the overall thesis as these facilitate an understanding of the phenomenon being analysed, and also they bridge some of the gaps that emerged from the empirical literature. In the process, the

chapter also highlighted the links between MNCs and host countries and the roles that each possesses in the overall economic development of the Philippines.

Chapter 3 Economic Development in the Philippines

3.1 Introduction

In a world where globalisation has been at the centre of discourse and many nations are struggling with the speed of change, the Philippines can be said to be one of the most globalised of nations.¹⁴ However, the Philippines still experiences an ongoing and continuous struggle to maintain political and economic stability. In its quest to be one of the most effective economies in the East and Southeast Asian region, the Philippines has sought to establish itself as a nation that prides itself on democratic values. It certainly prides itself on the fact that it has fought hard to be established as a democracy, and is certainly far ahead of other East Asian nations in that area. After the return of democracy and the demise of former President Ferdinand Marcos' regime in the late 1980s and years of martial law, the Philippines shows signs of a country that is slowly edging its way into political and economic recovery.

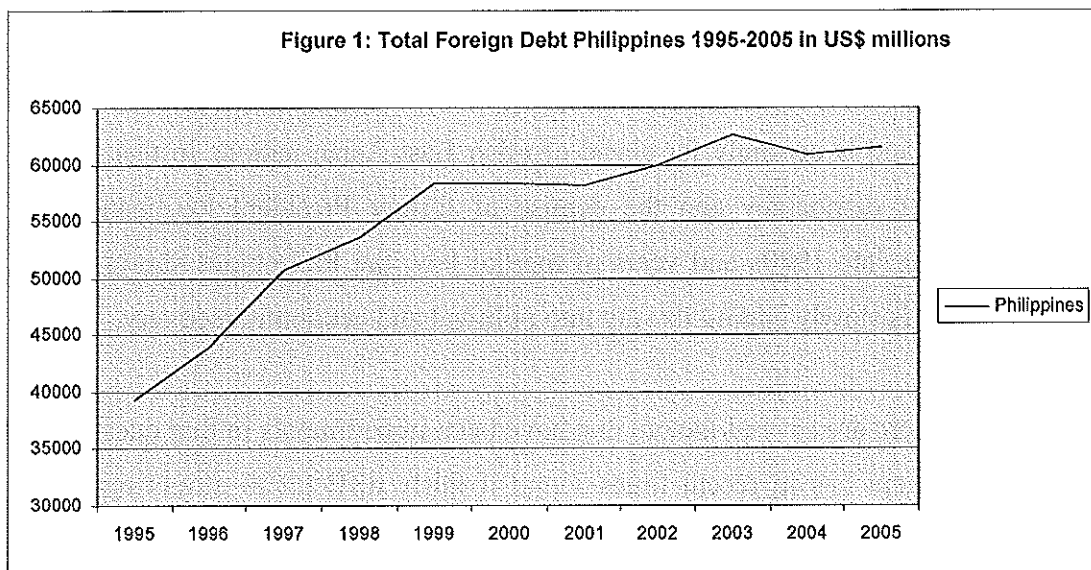
However, there are several factors that have been impediments in that quest, such that the government has in recent times found it fairly difficult to attract much-needed foreign direct investments to assist in the social and economic development of the nation. Some of these factors include, the Catholic Church, regulatory problems, high levels of continuing poverty, decentralisation, the assassinations of journalists, kidnapping of business people and tourists.¹⁵ Added to these are issues such as the ongoing war between the government and Islamic extremists and insurgents in the South who are determined to establish a separate Muslim state, the continuing problem of corruption at all levels of society and persistent elements of the military that threaten the government's authority.

There are also the problems of the communist movement and its military arm, the New People's Army (NPA). In addition to this, the government has a large foreign

¹⁴ The Philippines according to the Asian Development "has implemented a number of important policy reforms over the past three decades. Today, it is integrated with the rest of the world not only in trade in commodities but also in securities and foreign currencies. It has privatised many large government corporations and deregulated key industries" (ADB, 2007a:iii).

¹⁵ Whilst there is a free press in the Philippines it is also well known that journalists are very often intimidated and in several cases have been assassinated for expressing their views.

debt. Figure 1 below indicates the Total Foreign Debt in the Philippines in US\$ millions between 1995–2005. This level of debt certainly makes it even harder for the 30 per cent or so of the population that live below the poverty line. Another area of concern relates to the charges that were made against Arroyo in respect to the 2004 elections and the possibility that her government may have been thrown out of office. All of these issues combined certainly enter the mind of existing and potential investors as they contemplate the possibilities of investing in the Philippines.



Source: Asian Development Bank, *Key Indicators 2007*

In one of the most economically dynamic regions of the world, the Philippine state has not been able to achieve sustained economic development and has not realised the promise it showed in the 1950s, leading to a view of a country that is weak, sick and politically unstable. This very dilemma raises several contentious questions, the most important one being, simply, why? Why has this country with so much potential not attained full economic development, unlike Japan, for example, a country that had to restart all over again as a result of its actions during World War II? Why is this state still dictated by a political system that continues to be influenced by an oligarchy determined to look after its own interests?

This chapter looks at several aspects of the Philippines in its quest for economic development and how this process affects its bargaining power particularly for foreign direct investments. To begin with, attention is drawn to a few definitions of economic development. Secondly, the chapter analyses the complexity of the environment within which economic development is pursued in the Philippines. Thirdly, the chapter discusses an important historical period which includes the US occupation up to the early 1950s, highlighting how this period influenced and shaped economic development in the country and may have contributed to the weakness of the economy to be able to achieve strong bargaining power as the US retained remnants of Spanish landholdings. Fourthly, the focus is then projected into the 1950s through to the Asian currency crisis in 1997. Finally, the chapter analyses economic development in the post-Asian financial crisis period and the processes that the Philippines put into place for a recovery and to sustain economic growth.

Before proceeding, a definition of economic development is given as outlined by Kindleberger and Herrick (1977):

Economic development is generally defined to include improvements in material welfare, especially for persons with the lowest incomes; the eradication of mass poverty with its correlates of illiteracy, disease, and early death; changes in the composition of inputs and outputs that generally include shifts in the underlying structure of production away from agricultural toward industrial activities; the organisation of the economy in such a way that productive employment is general among the working-age population rather than the situation of a privileged minority; and the correspondingly greater participation of broadly based groups in making decisions about the directions, economic or otherwise, in which they should move to improve their welfare.

3.2 The complexity of economic development in the Philippines

This thesis maintains that, because of the weaknesses of past and current governments, the Philippines demonstrate a rather complex political and social environment. As a result, there appears to be a lack of commitment in stabilising its

pursuit of sustainable economic development, which could assist in strengthening the country's bargaining power. It is also recognised that the Philippines has suffered – and still does – all the factors of weak governments, military coups, poor management of the economy, a decaying urban environment that cannot cope with population growth and demands on housing, and a population more focussed on day-to-day survival. The problem is with the complete and obvious lack of consistency and continuity, and a government that lacks the will to guide its people, who are well equipped with the English language that can compete well with other Asian nations such as Singapore and Malaysia.

When researching for this thesis, it became evident that economists in the Philippines arguably were not very conscious of the lack of consideration given to “institutional and structural problems and to the power of historical, cultural, and religious forces in the development process” (Soedjatmoko, 1985, cited in Todaro, 1994:13).

This very lack of or interest in the abovementioned factors is still evident in the Philippines today, and the situation has further deteriorated in many aspects of government and in public, private and corporate activities.¹⁶ A striking example is in the damaging effects of corruption that is so widespread throughout the nation. However, it needs to be reaffirmed here that there have been some efforts by governments post-Marcos (apart from the Estrada regime) to address corruption. However, what is really needed is a sustained approach to reduce such damaging practices from destabilising an economic process that would place the Philippines above many of its Asian counterparts. Corruption is not just a word that highlights an issue; it is an issue that destroys economies and livelihoods, restrains progress and weakens nations and their connections with the broader regional or global communities.

¹⁶ However, certain steps to fight corruption have been taken in line with the World Bank Anti-corruption Program. For example, in mid-year 2005 “the Government of the Philippines and the World Bank signed a US\$300,000 grant for the Strengthening of Internal Audit Units for Effective Procurement Monitoring and Enforcement.... The grant, funded by the Institutional Development Fund (IDF) of the World Bank, will support Internal Audits Units of government agencies to perform their functions in conformity with international standards for the professional practice of internal auditing” (World Bank, 2005. URL <http://go.worldbank.org/4VG9KPX770>)

In a 1994 case study by Michael Todaro on Trade Strategy in the Philippines, the very idea of corruption is very evident. As noted by Todaro,

The collection of haphazard, mutually inconsistent and corrupt policies pursued by most developing countries is a third-best policy. The Philippines is a case in point. Despite [high levels of debt and] the much vaunted 'people power' revolt in the Philippines that led to the 1986 ouster of the Marcos dictatorship and the installation of President Corazon Aquino, less has changed in the Philippines than many observers expected. [Furthermore] to understand the causes and effects of an accumulated debt that was used in a way that made hardly any contribution toward its eventual repayment, we must understand the culture of corruption that nurtured it. Marcos decreed that a nuclear power plant would be built in Bataan province. The contract was awarded to Westinghouse, an American nuclear power plant builder, under conditions of blatant corruption and probable bribery. Huge cost overruns brought the construction cost to \$2.2 billion, financed by loans. The plant is located just 8 kilometers from a volcano, and known earthquake faults lie within 40 kilometers in three directions; consequently, the plant could not be brought on line. It is revealing to note the winners and losers in this fiasco. Any bribe money is long spent. The multinational corporation that built the plant has been paid. The banks that lent the money are being paid. Philippine taxpayers are footing the bill. The Aquino government ... sued Westinghouse for bribery, and in ... 1992 the suit was settled in a complex and controversial deal that proponents say will offset at least part of the damage. Westinghouse will pay the Philippine government \$100 million in cash and credits and will within 15 years compensate the Philippines for \$400 million in new loans it needs to pay to have the plant brought up to higher but still controversial safety standards—work to be carried out by none other than Westinghouse, which will operate the plant. One consequence of large debt-service burdens is accelerated natural resource exploitation and scaling back efforts to diversify manufacturing activities (1994:559-560).

The Fraport¹⁷ incident that followed the fracas of the Westinghouse issue certainly has lent support to this thesis' argument that the potential of expropriation is still a looming threat in countries such as the Philippines that continue to resist the necessary implementation of anti-corruption legislation. It is one thing to have the legislation but very much another to put it into practice. Soedjatmoko (1985) argues that the very problem of challenging an MNC is in itself a dilemma that exists within most nations, particularly when the MNC or a nation-state fails to abide by the rules of free trade as set out by the WTO, as well as honouring individual bilateral agreements with governments that they have signed Free Trade Agreements (FTAs) with.

To maintain a balanced approach to trade and investments and in increasing its bargaining power, the Philippines recognises some of the main issues that cause concern to foreign direct investors. Some of these areas of concern are explained by the Asian Productivity Organisation (2007:136) who point out that:

While it is apparent that business is taking voluntary actions to address its competitive interests, the interest of the wider society should not be relegated to the sideline. The other notion of corporate social responsibility is closely linked to the concept of 'sustainable development'. Many people think of industrial firms as the primary villain in environmental damage. The 1987 Bruntland Report found that the current model of economic development could not be sustained in the long term, as it depletes natural resources and harms society. It defines sustainable development as a 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'.

Furthermore, the Asian Productivity Organisation (2007:136), in explaining issues with labour standards, emphasises that:

In response to this [the Bruntland Report] the United Nations launched the Global Compact to engage corporations in the promotion of equitable labor standards, respect for human rights, protection of the environment, and anti-

¹⁷ This incident will be elaborated on further in Chapter 5 because of its significance to Raymond Vernon's theory on expropriation.

corruption. The Global Compact is a voluntary international corporate citizenship network initiated to support the participation of both the private sector and other social actors to advance responsible corporate citizenship and universal social and environmental principles to meet the challenges of globalisation. The Compact espouses human rights, labor rights, and environment and anti-corruption principles.

Interestingly the Philippines shows the qualities appropriate of a country that looks at problem areas and deals with these as effectively as possible, as demonstrated by the Asian Productivity Organisation (2007:137), who express that:

Within Asia, the Philippines lead other countries in terms of the number of corporate subscriptions to the Global Compact. When the Compact was launched in the Philippines in 2001, more than 115 corporations immediately signed up. Since then, conformance to the stated principles of the Compact has become the benchmark for measuring global corporate citizenship for many Filipino companies.

The Philippines, although perceived as a lost cause because of its inability to attain sustainable economic development, still attracts investors and in many ways has no problems securing loans to service the shortfalls the country faces daily due to its stagnant economy as a result of its lack of revenue from taxes within the country. For example, a report by Wayne Arnold of *The New York Times*, published in the *International Herald Tribune* in August 2006, highlighted that:

The Philippines has \$76 billion of debts, and its government has lost so much money in the past decade that its bonds are consistently rated below investment grade. But earlier this summer, as markets around Asia were still struggling to recover from a sell-off by global investors, the Philippines pulled off something seemingly unthinkable for a country known as the region's sick man: it persuaded international investors to lend it \$750 million ... and again this year Manila will hit investors up for roughly \$4 billion in new loans, almost half of it in foreign currencies, making the Philippines the biggest offshore borrower in

Asia – bigger than Japan (Arnold, cited in *International Herald Tribune*, August 2006).

Arnold (2006) further commented that:

Once considered largely hopeless, the Philippines and other emerging economies have become more skilful at managing huge debts, analysts say. Easy funding and high commodity prices have helped foster their balance sheets, smoothing out repayments and repaying debts from past crises. Though still heavily over-indebted, they have become so much more reliable that some economists now question the need for organisations like the International Monetary Fund, which has always been there to bail out the emerging markets.

Is it possible to accept the idea that, as Arnold puts it, “a lot of this newfound credibility also stems from an increased talent for smooth-talking investors, analysts say. Some borrower nations, including the Philippines, have even established dedicated investor relations offices” (Arnold, 2006).

The Philippines has recently gained a respectable sort of reputation as suggested by Agost Benard (associate director at Standard and Poor’s in Singapore), cited in Arnold (2006): “they’re very open and transparent and good at highlighting the positive”. Yet the debate is quite clear: MNCs are still very hesitant about engaging the Philippines due to a lack of stability (caused by insurgencies by communists and groups such as the Abu Sayyaf), the continued problems associated with the levels of corruption in the political and judicial systems and the manner in which the government is influenced by the oligarchy. Even though these issues are evident, they do not necessarily indicate that the Philippines lacks bargaining power, but rather that it does not use this to its own advantage.

As stressed by Paul Hutchcroft:

by most counts the Philippines should have all the ingredients necessary for development success: tremendous entrepreneurial talents, an enormously talented and well-educated workforce (readily conversant in the dominant

language of international business), a rich endowment of natural resources, and a vibrant community of economists and development specialists ... the Philippines may have everything going for it, but for most of the post-war period the country has been unable to go very far very fast. As such, it can be treated as a limiting case, one that greatly illuminates larger issues of the relationship between political and economic development in the modern Third World (1998:4).

The above statement by Hutchcroft suggests that, despite its considerable potential, the Philippines has not yet performed as expected by the nation and the market. The Philippines is a country that has suffered enormously from weak institutions and strong personalities. Political parties, for instance, have been traditionally used merely as instruments for individuals to pursue their political agenda. The courts, many units of the bureaucracy and even corporations tend to be guided by the leading personalities who happen to direct their actions and decisions.

Foreign direct investment (FDI) in the Philippines faces the issue of political and social instability; for example, Turner emphasised that “MNCs must adjust to an international environment which many of them will find distasteful and dangerous” (1970:157). Furthermore, MNCs realise that developing countries need technology and capital, and that:

they will still be basically motivated by the search for profit ... [however] they will learn that the survivors in the developing world will be those who best fit in with the priorities imposed by governments ... [and that] they are no longer the sole arbiters of what is good for a country (Turner, 1970:157).

The Philippines is what can be termed a *continually* (emphasis added) developing country¹⁸ (CDC) that, throughout the many years since independence, has struggled to maintain economic growth. Apart from some short periods of what appeared to be

¹⁸ For the purpose of this thesis, the Philippines will be referred as a continually developing country (CDC) as it does not fit into the definition of either an emerging economy or a developing country and/or is between the two. A CDC is proposed here to be a country which has struggled for years to achieve sustained economic growth, and does not appear to have a government that is competent enough to enable the country to achieve fully developed economy status even though it has the resources to do so.

sustained growth during the Marcos and Ramos eras, the country has not fared anywhere near as well as its immediate and other neighbours such as, for example, Thailand, Vietnam or Indonesia.

The country has been labeled weak and even the 'sick man of Asia' (*Asia Times Online*, 2004). One of the aims of this thesis is to turn that perception around, and to do this, it will be shown that the country has great potential, but that there needs to be sustained efforts to administer structural reforms in all sectors, for example in political, corporate, bureaucratic and legal institutions. One of the starting points is to look at and evaluate both foreign and domestic investments. The country has some difficulties attracting foreign direct investments (FDI), and this is a central theme of this thesis. Investment is coming in, though not necessarily in abundance, through the main agencies that are engaged in promoting the entry of foreign direct investments.

There is no doubt, as indicated by evidence from research and from data obtained, that the Philippines has abundant natural resources and that for some reason or other it is not using such potential wealth effectively to get the country out of its economic misery. One obvious obstacle is the bureaucracy (to be discussed later), and the other arises from the priorities of the political elites. On top of this, slow economic growth in the United States and globally beginning in 2002, in addition to increased competition from China, dampened demand for the Philippines' manufactured products and discouraged new investment or reinvestment in the export sector.

According to NEDA (2004), investment and trade, among other factors, are essential to job creation. Modest investment spending is a key reason why unemployment in the Philippines has remained high. Investment in the Philippines as a proportion of gross domestic product (GDP) was 19.5 per cent in 2003¹⁹ and was projected to be at 20.1 per cent in 2004. Foreign investments have been slow in coming to the country. For example, the increase in foreign direct investment inflows, from US\$1.43 billion in 2002 to US\$1.49 billion in 2003, was insignificant and did not reduce unemployment. This situation is a result of several factors, including the pull of investments towards China, weakening investor confidence due to concerns about

¹⁹ Source: NEDA S-I Gap, computed using National Income Accounts data in 1985 constant prices.

fiscal sustainability and structural problems such as peace and order and a weak infrastructure and logistics system. The latter, for example, has hampered the distribution of products (NEDA, 2004).

Based on the World Competitiveness Report, among the countries included in the Global Competitiveness Ranking (GCR), the Philippines' ranking slid from 48 in 2001 to 56 in 2002 to 71 in 2007²⁰. The high cost of doing business has hampered the Philippines' competitiveness. Power costs are higher compared to those in China, Taipei, Korea and Indonesia due to high distribution charges. (Philippine power rates to the consumer, however, are lower than in Singapore, Malaysia, Thailand and India). At the same time, telephone and mobile phone charges were the highest among ASEAN member countries²¹ (NEDA, 2004).

Moreover, limited government funding for infrastructure is adversely affecting the country's competitiveness. The Philippines' infrastructure and capital outlay performance vis-à-vis other Asian countries is the lowest for the period 1998–2002, averaging a mere 3.3 per cent of GDP. The poor quality of infrastructure is perennially cited as the main problem in the Philippines' global competitiveness. Philippine exports also face stiff global competition as countries continually strive to improve their productivity and competitiveness. Exports (in dollar terms) grew by 2.4 per cent in 2003 and 8.5 per cent as of August 2004, while imports grew at 6.1 per cent in 2003 and 6.9 per cent as of July 2004 (NEDA, 2004).

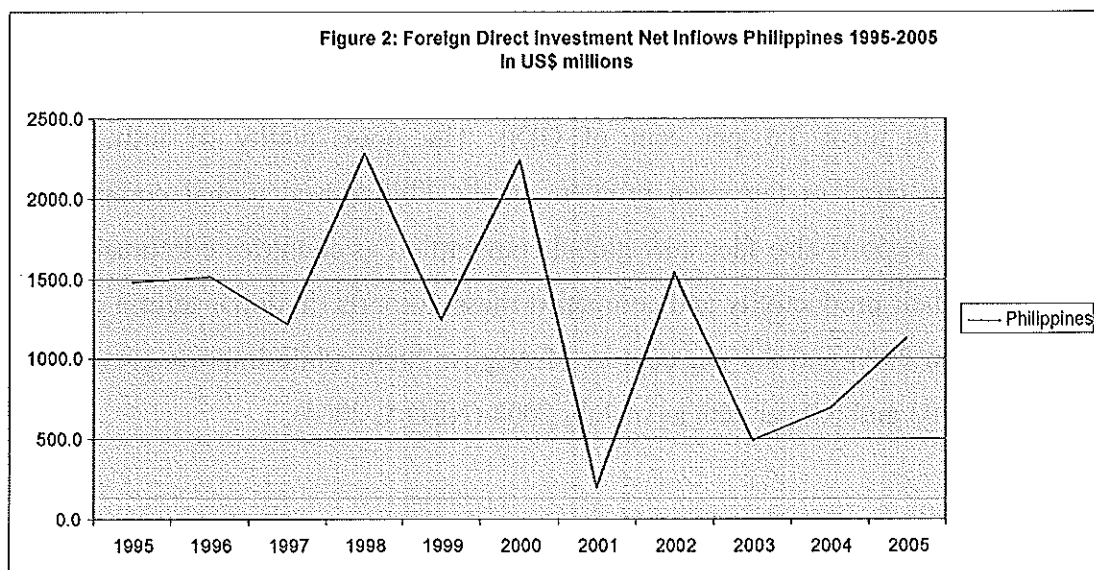
While Philippine merchandise exports (in dollars) grew at an average of 19.2 per cent in the period 1992–1997, export growth declined to 14.8 per cent in 1998–2000 and still further to –1.1 per cent in 2001–2003 (NEDA, 2004). As of October 2004 export growth had climbed back up to 10.0 per cent (ADB, 2004, cited in NEDA, 2004). Philippine merchandise exports were affected by the meltdown in the IT sector in 2000; however, exports experienced modest growth in 2003 as global demand firmed

²⁰ Source: The Global Competitiveness Report 2007–2008 @ 2007 World Economic Forum. Eaber Working Paper Series No. 34. Trade in Services and Investments Flows in Asia: Regionalisation or Globalisation, The Australian National University, Canberra.

²¹ Source: The 13th Survey of Investment-Related Cost and Comparison in Major Cities and Regions in Asia, March 2003.

up. The ADB's forecast of 8.5 per cent growth of Philippine merchandise exports in 2004 was on par with Malaysia and five percentage points higher than Indonesia's, while Thailand and Singapore were projected to post higher growth rates (NEDA, 2004).

One development at the end of 2004 offered hope that the Philippines would become more open to foreign investment: a December 2004 Supreme Court ruling to allow 100 per cent foreign ownership of mining companies involved in large-scale exploration, development and utilisation of mineral resources. Given the country's substantial mineral wealth, especially copper and gold, analysts expect this decision to dramatically increase FDI inflows to the Philippines and thus strengthen the country's bargaining power (see Figure 2).



Note: 2001 figures were derived from IMF, *International Financial Statistics 2002*

Source: Asian Development Bank, *Key Indicators 2007*; IMF, *International Financial Statistics 2002*.

According to DFAT (1998), the main problems that affected potential FDI to the Philippines were “high cost of unskilled labour, lack of infrastructure, lack of support industries” and, most importantly, “commitment to the reform process”. Added to that is the social instability in the southern regions which is attributed to high poverty

levels. In addressing the issue of commitment, it is recognised in the literature that the two decades leading to the Aquino administration did much to cause an element of mistrust in the policies of the governments, particularly those that address reforms.

The Philippine Institute for Development Studies (PIDS) explained that there is consensus among analysts that the reasons for poverty in the country are: (1) the failure of growth and the lack of employment opportunities; (2) the inequality of income; (3) high population growth; (4) declining productivity; and (5) inadequate social services (Orbeta, 1996). It has been accepted by many analysts that, while growth is not sufficient for poverty alleviation, it is nonetheless a necessary condition for any sustained poverty alleviation effort (Orbeta, 1996; De Dios et al., 1993; ADB, n.d.; World Bank, 1995).

However, the overall business environment in the Philippines remains rather positive, particularly when one considers the effects of the Asian financial crisis on its neighbours. The Philippines has policies in place geared to maintaining macroeconomic stability and a more open economic environment. In order to understand the economic environment and the Philippines bargaining power it is necessary to analyse the influence of American occupation in the process of the country's economic development historically.

3.3 The Philippines' economic development up to the Asian currency crisis

This section deals with the setting for economic development prior to independence. It highlights the influence of American occupation up to the early 1950s and discusses some of the positives and negatives of this era in the country's economic and political history. This section focuses on the work and opinions of Paul Hutchcroft and his views of Philippine capitalism and most importantly the weakness of the state. As well the section focuses on a historical overview of economic development up to the Asian Crisis and the implications for the country's bargaining power.

In pre-war Philippines, key industries comprised basic crops – rice, sugar, corn, coconut, abaca and tobacco. These six key industries accounted for all agricultural

products produced in the country, which was 65 per cent of the value of manufacturing within the Philippines and about 90 per cent of all exports (Villegas and Abola, 1973, cited in Rodriguez, 1996:17). Rodriguez argued that:

The free trade relations that the Americans granted to the Philippines contributed greatly to the economic development of the country. However, Philippine foreign trade grew faster than ... domestic trade [because] the latter was mostly in the hands of foreigners (1996:18).

Likewise there was development in other Philippine industries. For example as Agoncillo and Alfonso argue:

Mining became a major industry. [However] the economic prosperity that followed Philippine–American free-trade relations was deceptive. While it improved the standard of living, it was nevertheless artificial, for economic prosperity was dependent on a relation that was basically unsound. Owing to the free-trade relations most of the Philippine exports went to American markets” (1967:337, cited in Rodriguez, 1996:18).

One may add two comments to the argument above when considering the effects of some of the negative investments in the Philippines that were also unsound and certainly did not contribute to the economic development of the country. Moreover, in today’s global economy, a country that does not export its products globally and focuses on only one particular country may be put at a disadvantage, something that may not have been so evident in the 1960s. In a sense:

the American occupation had its negative and positive results. Some of its positive results were in the areas of education, public health, economy and government. But side by side with these were the negative results: economic dependence²² on the Americans, colonial mentality, and a distorted sense of moral values among most Filipinos (Rodriguez, 1996:18).

²² Certainly this dependence is fairly much in place today, as the US is very much the major trading partner of the Philippines.

Certainly looking deeper into Teodoro Agoncillo's view that "while the Spaniards almost killed the Filipinos by maltreatment, the Americans on the other hand almost smothered the Filipinos with kindness", it is a reassertion that the Filipinos are still trying to emerge from this era of occupation in order to assert their own influence on the world scene (Agoncillo, cited in Rodriguez, 1996:18). Rodriguez furthered this view by arguing that:

The general condition of the country's economy, which had been ravaged by the war, led the American Government to make a survey of the extent of the damages. The findings of this survey resulted in the introduction of a bill known as the Bell Trade Relations Act. This bill provided for free trade relations between the Philippines and the United States until 1954 ... For the Filipinos, the bad feature of this law was the provision giving 'parity' rights to the Americans, giving them the right to dispose of, exploit, develop, and utilise all agricultural, timber, and mineral lands of the Philippines.... During the rehabilitation period or the 20-year period after World War II, the economy of the country was so low, and gave rise to rampant graft and corruption, high rate of unemployment and crimes, especially during elections, increased political power, and too much dependence on American financial aids. This situation led to American intervention in the economic, political and social affairs of the country. Financial aids were used to diversify the Philippine economy. At that time, big business corporations were in the hands of foreigners. The general picture of the country's economy was therefore low and the problem of rehabilitation and developing the country's agriculture became more difficult to solve (1996:109).

The argument is fairly clear that there needed to be some focus on national goals. This led, for example, to Abueva arguing that:

the unending process of national development requires that the people who constitute the Filipino nation and are the citizens of the Philippine state, the Republic of the Philippines, speaking and acting through and with their leaders, shape and share national goals and aspirations, define and seek solutions to national problems, formulate public policies and programmes, and

strive to realise them for the common welfare of all Filipinos (Abueva, 1988:20).

Furthermore, it became evident that:

Filipino efforts at national development have been marked by gropings and strides, by hesitation and decisiveness, by wrong and right decisions, by successes and failures, by advances and setbacks. All these indicate that national development is a purposeful and yet not easily controllable evolution. It is ever-changing and often unpredictable (Abueva, 1988:20).

In addition, Abueva comments that “No matter what ... the Philippine government, attempts to do or actually achieves, many national problems will continue to exist ... Examples of these ... are lawlessness and violence, national disunity and strife, and official abuse [of power] and corruption” (1988:21). This quantifies the situation with the bureaucracy, which is at the heart of the Philippines development and at times a constraint and a weakening of its bargaining power.

Paul Hutchcroft stressed that, to fully comprehend the Philippines’ economic model, one must firstly realise and establish that:

‘[P]rogress’ toward the bureaucratic state, arbitrating and administering according to rationally established law and regulation, is nowadays very closely related to the modern capitalist development. The modern capitalist venture rests primarily on *calculation* and presupposes a legal and administrative system, whose performance can be rationally predicted, *just like the expected performance of a machine* (1998:34).

Furthermore, Hutchcroft identified that in “creating and responding to opportunities for [improvement] provided by favourable access to the state machinery, the [Philippines’ wealthy] major families have created highly diversified conglomerates, and few have any strong loyalty to specific sectors of the economy [and politics]” (1998:21); hence the “most enduring division among capital is that of the ‘ins’ versus the ‘outs’” (1998:21).

Hutchcroft is correct in this assessment, as the dimensions are mostly in favour of the “ins” based on the very fact that, unless an individual has wealth and belongs to one of these oligarchies, it would be almost impossible to break through this maze where only the “ins” have the key to the state apparatus for economic advantages. Example of this was evident during field research, where, in order to get access to the state hierarchy, one had to find the way “in”. Doing so was of utmost importance to progress with the agenda of interviews. As Montes explained (cited in Hutchcroft, 1998), “ownership of property alone guarantees the access to wealth” and that those who gain such property need not develop it; rather, “they only need to maintain their influence over people in the government machinery to maintain and expand their ownership of economic advantages” (1998:21).

Hutchcroft further contends that the power of the oligarchy²³ so clearly overwhelms the power of the state that the state in turn is more or less compliant to the powerful elites. From a historical point of view, this is, firstly, as a result of the nonexistence of any sustained effort at state building and secondly, that “during the process of agricultural commercialisation the Spaniards, for example, were upstaged by British and American trading houses, Chinese traders, and an increasing powerful landed elite dominated by Chinese mestizos”²⁴ (Hutchcroft, 1998:24). Thirdly, the American

²³ Joseph Schumpeter elaborated particularly about the importance of entrepreneurs as an effective tool of sustainable competitive advantage when he stated that “[t]he function of entrepreneurs is to reform or revolutionise the pattern of production by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by recognising an industry and so on” (1950:132).

²⁴ “The Chinese soon after the war controlled approximately 40 per cent of importing and an equal share of the retail trade (Golay, 1961:318). Import controls with a nationalist bias were imposed in 1950, nearly squeezing the Chinese out by the end of the decade; and in 1957 the Retail Trade Nationalisation Act began to be widely enforced as well. These pressures, in addition to the incentives provided to manufacturing in the import-substitution policy of the 1950s, turned Chinese businessmen into industrialists ... The Plight of the Chinese ‘pariah entrepreneur’ and his techniques for avoiding adversity actually helped stimulate the growth of Filipino entrepreneurship” (Wurfel, 1988:58).

“Filipino economic nationalism against the Chinese tended to accelerate naturalisation and to some extent cultural assimilation. But businessmen of Chinese origin, even if they became citizens, still faced discrimination, for which they compensated with money under the table ... Thus ‘Chinese’ businessmen gained a reputation, only partly justified, as corrupters of bureaucrats and politicians; and indeed, campaign financing was usually the only way they could enter the political process to protect their economic interests. The Chinese in the economic elite depended more on the ruling group than did their Filipino competitors” (Wurfel, 1988:58).

colonial rule actually strengthened the decentralised character of the Philippines by “concentrating far less on structuring a central bureaucracy than on the introduction of representative institutions” (Hutchcroft, 1998:25). Fourthly, the oligarchy controlled the legislature, showing little importance in directly assuming bureaucratic positions. Fifthly, a bureaucratic elite actually never emerged; this was despite growth in the bureaucracy (Hutchcroft, 1998:26). Sixth, the oligarchy under American rule combined itself into a national force, took undeviating control of the central government in Manila and responded to immeasurable new opportunities for enhancement (Hutchcroft, 1998:26-27). For example, one form of control came in the form of favored right of entry for Philippine agricultural products in American markets; a second form of control came from successful management of the growing colonial state apparatus (Hutchcroft, 1998:27). Seventh, only three years after independence, the Philippine state practically collapsed (see Frank Golay, 1961, as cited in footnote Hutchcroft, 1998:28) and remedial assistance (for war damage) was ransacked by the oligarchs. The salvage was actually coordinated from Washington (Hutchcroft, 1998:28). And eighth, despite changes in establishments, basic patterns persevered throughout the first forty years of the post-war era; while the state was plundered internally, it was repeatedly rescued externally (Hutchcroft, 1998:30).

Weber, according to Hutchcroft, provides a necessary remedy to those who forget the central role of the state in the creation of a *laissez-faire* political economy, and places lopsided faith in the “magic of the marketplace”. Radical free-marketeers often make the one-dimensional argument that the best thing for capitalism is for the state to “get off the backs of the private sector”. The Philippines, on the contrary, presents a living example of what kinds of obstacles to capitalist development can result when the power of an oligarchic private sector is never restrained and there is no determined effort to support the development of the public sector (Hutchcroft, 1998:32). Therefore Weber’s analysis/theory of capitalist development is necessary for an understanding of the predicament of the Philippine economy (Hutchcroft, 1998:32).

Hutchcroft also demonstrated throughout his argument that:

If one uses Weber's [1981] theory as a guide for evaluating the [character] of capitalism in the Philippines today, it is clear that capitalist structures are an integral part of the process of production ... Despite the [noticeable existence] of capitalist structures, however, one finds on closer [assessment] that the Philippine political economy lacks certain attributes that Weber considered essential to the development of modern, rational capitalism (1998:34-35).

However, the problems associated with this, according to Hutchcroft, are, firstly, that there is a:

weak degree of calculability in the legal and administrative sphere ... [and] secondly [this] inhibits the fuller development of calculability in the sphere of production – particularly by impeding the clear separation of the household and the enterprise, one of Weber's six conditions of modern, rational capitalism that relate to the production process (1998:35).

Moreover, Weber (1978) stressed that:

What is striking about many patrimonial states [such as the Philippines], Weber reminds us, is not the prevalence of corruption per se, but the great variability of corruption ... The patrimonial state lacks the political and procedural predictability, indispensable for capitalist development, which is provided by the rational rules of modern bureaucratic administration (cited in Hutchcroft, 1998:41).

However, Hutchcroft points out that "The Philippine state does not even fit into Weber's (1978) basic definition of a state: it lacks an effective monopoly over violence and taxation, and it is too weak to maintain control over much of its territory" (1998:42).

Studies of the post-war economic policies were unanimous in pointing to import-substituting policies as the main cause in the country's failure to develop rapidly (Orbeta, 1996). Given the long history of protection of industry, the employment generation record of the Philippine economy is expectedly not remarkable; in the late

1990s it was one of the highest in Southeast Asia. This led the government to continue on the path of the liberalisation process it embarked on in the late 1980s, which included the liberalisation of foreign investments, liberalisation of the foreign exchange markets, privatisation of government owned and controlled corporations and the opening up of previously oligopolistic industries such as telecommunications and shipping, among others. These policies were designed to gear up the economy for an outward-looking strategy based on comparative advantage (Orbeta, 1996).

From another angle, De Guzman et al., argues that:

accomplishing what government wants to do is the central role of the Philippine Bureaucracy ... When the term bureaucracy is used, it is taken to mean the ministries, bureaus, agencies, and instrumentalities of the government. It is the formal administrative mechanism through which the different policies, programmes, and projects of the government are carried out (1988:180).

In effect, it is agreed that: “Essentially the bureaucracy²⁵ provides continuity in the government system when the top leadership of the government changes” (De Guzman et al., 1988:180). In addition, Cheetham and Hawkins commented that:

The very nature of Philippine economic development may be creating inequality. Privately owned business firms have been increasing in size, and in 1967 the larger the firm the smaller the proportion of value-added that the workers received. And the greater the profit, the smaller was the worker's share in it. Nor does state intervention in the economy decrease inequality. The role of the Philippine state was not large, among the smallest, in fact, in the developing world (1976, cited in Wurfel, 1988:56).

The Philippines has traditionally had a private enterprise economy both in policy and in practice. Direct state participation in economic activity has generally been limited because the government intervened primarily through fiscal and monetary policy and

²⁵ The word bureaucracy is derived from the French word *bureau*, meaning office, and the Greek word *kratos*, meaning strength, power, or mastery (Baker, 1972:34, cited in De Guzman et al., 1988:181).

in the exercise of its regulatory authority, although expansion of public sector enterprises occurred during the Marcos presidency. The Aquino government set a major policy program of consolidating and privatising government-owned and government-controlled firms. Economic planning was limited largely to establishing targets for economic growth and other macroeconomic goals, engaging in project planning and implementation and advising the government in the use of capital funds for development projects.

Philippine governments as early as the 1950s have sought, as did the Aquino administration, to encourage investment into priority areas of the economy by providing economic incentives to both domestic and foreign firms. Administered by the Board of Investments (BOI), the 1967 Investment Incentives Act was introduced to nurture and direct investment in a more systematic fashion. This was followed up by the 1970 Export Incentives Act, whose primary purpose was to assist the country to move its manufacturing sector beyond mere import substitution manufacturing. Although the country made great strides towards developing its economy, there was much criticism in the late 1960s and 1970s of the incentive structure that overlooked investment in agriculture and export industries in favour of very capital-intensive investment. The export incentives were not enough to counteract the overvalued peso and the export biases contained within the tariff protection structure at the time.

Created in 1973, the National Economic and Development Authority (NEDA) assumed responsibility for macroeconomic planning, the role previously held by the National Economic Council for project planning and implementation, previously the domain of the Presidential Economic Staff. With the economic planning mandate firmly in hand, the National Economic and Development Authority then set about developing a plan for the future of the Philippines. The authority's plan developed during the Marcos era between 1974 and 1988 and the Aquino administration of 1987 to 1992 outlined a number of important goals including expanding employment, attaining a level of fiscal responsibility and monetary stability, providing a range of social services, distributing the income of the country more equitably and maximising economic growth. The important goal of economic growth was promoted through the provision of the necessary infrastructure and incentives for private capital to invest. One of the derivative goals of the economic development, the creation of equity, was

to be attained as a result of dynamic economic expansion within a policy environment with a heavy emphasis on labour-intensive production.

The monetary policy of the Philippines, like its investment policy and fiscal policy, was geared towards fostering conditions favourable to economic growth. Monetary policy was the domain of the Central Bank of the Philippines, which was established in 1948 and whose purpose was to preserve the value and convertibility of the national currency, maintain monetary stability and nurture monetary, credit and exchange conditions that would further the nation's economic development. The actual policy-making body of the Central Bank is the Monetary Board, comprising of the bank's governor as chairman, the secretary of finance, the director-general of NEDA, the chairman of the BOI and three private sector members. The function of the Central Bank was the supervision of the commercial banking system and managing the foreign exchange system.

It also extended credit to the commercial banks through its rediscounting system, and in the 1970s assisted the entire system to get foreign credit without accounting for foreign exchange risk. Until the early 1980s, the Central Bank quite often took an interventionist role in the country's finances. For example, it set interest rates on loans and deposits that, once adjusted for inflation, were in fact actually negative. These factors hindered the development of financial intermediation in the economy and stalled the growth of long-term saving. It also created a dependence on the Central Bank by the banking system for low-interest funds. This, coupled with its discretionary powers, played a role in the financial chaos of the 1980s.

The Marcos regime saw his cronies exploit access to the Central Bank and its subsidised interest rates to obtain loans and bailouts, with the proportion of loans and advances the Central Bank handed to government financial institutions increasing from 25 per cent to 45 per cent in the period 1970 to 1982 (Mongabay, 2004). One significant borrower, the Development Bank of the Philippines, increased their borrowing one hundred fold during this period.

In the period between 1975 and 1982, domestic saving made up 25 per cent of GDP. With domestic gross capital formation around 30 per cent of GDP, the difference was

provided by foreign capital. But from 1983 until 1989, domestic saving dropped by 8 per cent of GDP (ADB, 1998). In the beginning, this was caused by erosion of personal savings by the economic crisis, but towards the end of the 1980s, the government's negative spending habit was the chief reason for the drop. Investment also declined substantially in this period, so much so that three of the years in this period saw savings actually exceed gross investment.

Seeing a need to improve the poor monetary environment, at the beginning of the 1980s, the government followed on from its 1972 reforms to increase the entire banking system's ability to provide long-term finance. It was hoped that, by promoting mergers and consolidations, the capital base of banks would widen. A new class of banks, "unibanks" or "expanded commercial banks", were allowed to spread out and engage in a wider array of financial services, effectively combining the operations of a commercial bank with the activities of investment houses. In order to qualify for this new class, a bank needed a base in excess of P500 million. Along with the new class, many of the distinctions between other categories of banks were lowered, with the distinction between thrift and rural banks actually eliminated altogether. These changes were made in the hope of increasing competition and efficiency of the sector and long-term saving.

The monetary and fiscal policy set by the Marcos regime in the early 1980s saw an unusual feature develop within the Philippine banking system: large intermediation margins or differences between the lending and borrowing rates. An example of this in 1988 was that loan rates averaged 16.8 per cent but the rates on deposits barely crept above 4 per cent. At the time the Central Bank's policy on reserve requirements was fairly conservative, with banks required to hold in excess of 20 per cent of their deposits. In 1990 this reserve requirement was increased to 21 per cent and then to 25 per cent. The government, meanwhile, was taking 5 per cent gross tax on bank receipts and 20 per cent tax on deposit interest. This skimming, combined with its own large borrowings from the system, was used to cover increasing budget deficits and to absorb the money supply's excess growth (Mongabay, 2004).

Another unusual feature of the Philippine banking system was significant differences in rates for different sized deposits. The interest rates in 1988, for example, were

averaging some 13 per cent for large depositors but a mere 4 per cent for small savers. Unfortunately for small-time savers, their options were quite limited. There is a high probability that the commercial banking industry exploited this lack of choice, and the fact that 60 per cent of total bank deposits were savings, to offer significant interest rate advantages to more affluent and well-informed depositors. Capital flight was reduced by increasing the interest rates for time deposits. It is no surprise, then, that the large difference in intermediation rates and interest rate discrimination led to accusations of an oligopolistic banking sector by Philippine economists and the World Bank (Mongabay, 2004).

The constant see-sawing between placating the needs of domestic politics and meeting IMF requirements caused the growth of the money supply to be highly volatile. The growth would rapidly expand during economic and political turmoil but shrink during periods of compliance with the IMF plan. Elections were also a significant factor in the money supply's volatility, with the money supply expanding rapidly before the 1969, 1984 and 1986 elections.

With the rapid expansion of the money supply during the 1986 elections, the newly elected Aquino administration was given more reason to abandon the existing agreement it then had with the IMF. The money supply also rapidly expanded following the finance scandal of 1981, the economic crisis of 1983 and the coup attempt of 1989. This meant that the money the Central Bank released during these periods was subsequently repurchased by both the Treasury and Central Bank at very high interest rates that peaked at 43 per cent in October 1984 and approached 35 per cent in late 1990. With interest rate highs, the government was forced to borrow further to cover debts. In 1984 and 1985, the need to get access to international capital pushed the government to meet IMF dictates, which led to a contraction of the money supply and a consequent decline in the national inflation rate. The positive benefits that control steep inflation hikes were often overshadowed, however, by steep declines in national output and sharply rising unemployment (Mongabay, 2004).

The money problems of the Aquino administration were not limited to money supply, however, with the government in the unenviable position of having to write off some P130 billion in bad debts that had been loaned to Marcos cronies by the Philippine

National Bank and the Development Bank of the Philippines during his term in office. The massive amount of bad debt accumulated by these two institutions in conjunction with the large amount of inefficient and unprofitable public enterprises created during the Marcos era would have a lasting effect on the economic well-being of the country for many years.

In order to alleviate these problems, the Aquino administration formulated a plan to deal with the burdensome 296 public sector enterprises and 399 other non-performing assets. It initially transferred the assets from the Philippine National Bank and the Development Bank of the Philippines to the government where, under the Asset Privatisation Trust it created in 1986, it was able to start disposing of all these government-owned and government-controlled properties. Within five years, 230 of the assets had been sold, netting some P14.3 billion for the government coffers. A further 74 public sector enterprises that owed their creation to government investors were offered for sale and another 57 enterprises were eventually sold or at least partly sold to add another P6 billion to the treasury. It set aside 30 per cent of the original public sector enterprises and earmarked 20 per cent that were expected to be dissolved (Mongabay, 2004). Even so, this paring back of government enterprises was met with some criticism as it was thought that the offloading was less than transparent and would in fact give greater economic power to the few wealthy families that made up the country's elite.

After the overthrow of the Marcos government, the National Economic and Development Authority's Medium-Term Development Plan became more aligned with the campaign themes of newly elected President Corazon Aquino. These included the elimination of structures of privilege and monopoly within the economy, decentralising power and decision making and reducing unemployment and mass poverty, especially in the rural regions of the nation.

These campaign themes prompted a change of view concerning economic development, with the private sector of the Philippines now seen largely as the "initiator" and "prime mover" of the country's economic development. Consequently, state participation in the economy was minimised and decentralised, with the government working more from the background by encouraging and supporting

private initiative. Goals including poverty alleviation, productive employment generation, promotion of equity and social justice and sustainable economic growth were to be achieved through a series of agricultural reforms, such as the strengthening of the collective bargaining process, creating more labour-intensive, rural infrastructure projects, providing social services and increasing education and skill training levels. Like previous plans, these goals were to be attained as a flow-on effect of achieving sustainable economic growth but with more of an agricultural focus.

In addition to agricultural reforms, the plan's success would also require market-orientated fiscal and monetary policies, liberalising trade policy, improving the bureaucracy's efficiency and effectiveness and better enforcement of government laws and regulations. But perhaps the most important factor was the responsible management of the Philippines' external debt to allow an acceptable rate of growth and the establishment of a foreign policy orientated towards sensible development.

Unfortunately, even with these reforms, economic performance levels did not meet the planned targets. For instance, during the period from 1987 to 1990, the real GDP growth rate averaged 25 per cent less than the target rate, the real export growth rate was 33 per cent less than the target rate and the real import growth rate was more than double the target rate (ADB, 1998). The targets formed the basis for debate on whether these planned growth rates were achievable, given that the country had to maintain external debt-repayment obligations, with the government eventually having to cut services and resources available for development projects to keep the peace with international creditors. There was an upside to the plan as it set priorities, and the priority that was emphasised in Aquino's campaign announcements and the policies of the planning document was on policies that would positively affect the poor and the rural sector. This priority could not be fully realised, unfortunately, because of numerous factors such as cabinet dissent, conflict with Congress and presidential indecision, which led to important policies such as land and tax reform either not being implemented or being watered down.

Consequently, this led to revisions of the system in 1983 and again in 1987, which gave greater performance rewards to export and labour-intensive production. This

specific assistance to exporters, though, was somewhat curtailed in the 1987 version in order to placate the United States and other industrial nations who objected to the export-subsidy provisions contained in the 1983 revision. As a result of the 1987 Investment Code, the BOI was handed far-reaching discretionary powers in situations where foreign investment in a firm exceeded 40 per cent. These powers came under review in 1991, with the Congress reassessing the situation to limit the BOI's control so long as the foreign investment was not in a list of specific industries.

Unlike its investment policies, the fiscal policy of the Philippine government had historically remained fairly consistent with a lean towards fiscal conservatism. National government expenditures and taxation up until the 1970s was generally less than 10 per cent of GDP, but under the Marcos regime this figure jumped to 15–17 per cent of GDP. Initially this was because of increased capital expenditure but later was used to meet growing debt-service payments. The years 1987 and 1988 saw the government's expenditure eventually rise above 20 per cent of GDP. Unfortunately, during this period the nation's tax revenue remained at a relatively stable 12 per cent of GDP, leading to a situation where the chronic budget shortfalls had to be covered by international borrowing under the Marcos regime and domestic borrowing under Aquino's administration. The vicious circle of borrowing to pay off deficits leading to more deficits eventually got to the point where by 1990 the government deficit of 5.2 per cent of GDP was a significant factor in the standby agreement the government had with the IMF (Mongabay, 2004).

The effect the deficit had on government spending was considerable, with 43.9 per cent of its budget going towards debt servicing. The rest went towards largely economic services and social services including education, with only 9.1 per cent of the budget going towards defence. Compared to other South-East Asian nations, the Philippines' spending on defence was the lowest as a proportion of GDP (Mongabay, 2004).

In order to counteract the growing gap between government expenditures and tax revenues, the Aquino administration set about reforming the tax system in 1986 with some 30 new measures, including the elimination of most export taxes, the simplification of income taxes, revision of the investments incentives scheme and the

imposition of new luxury taxes. But the keystone to the administration's tax reform effort was the introduction of a 10 per cent value-added tax to replace the variety of sales taxes then in use. Even with these reform efforts, there was not a significant rise in tax revenues as a percentage of GDP.

The major problem with tax revenues was not in the system but in the collection of the taxes themselves, with estimates for individual tax compliance falling between 13 per cent and 27 per cent during the late 1980s. Estimates of corporate income tax evasion in 1984 and 1985 ranged from P1.7 billion to P13 billion. The higher figure was reached when taking into account that only 38 per cent of registered firms actually bothered to file. In 1989, a few years after the tax reforms, the country's collections were around P10.1 billion, 70 per cent higher than the previous year but some P1.4 billion short of target. Tax evasion was exacerbated by mismanagement and corruption, with a government study conducted in 1987 determining that some 25 per cent of the nation's budget was siphoned off by graft and corruption (Mongabay, 2004).

Coupled with the low tax collections was a regressive tax structure which, according to the World Bank, effectively meant that lower-income households paid some 50 per cent more tax as a proportion of income than high-income families during this period. Middle-income families, though, shouldered the largest portion of the tax burden, a situation caused by greater use of indirect taxes by the government. Even so, the overall contribution of individual income taxes to government coffers was relatively minor at 8.9 per cent of tax collections in 1989, with corporate income taxes not much better at 18.5 per cent. 70 per cent of the tax revenue in 1989 was made up of goods and services tax duties on international transactions, not much different to the tax collections of the 1960s (Mongabay, 2004).

The problem of insufficient tax revenue would make its presence felt in the late 1980s and early 1990s when the combined deficit of the national and local governments and the public sector enterprise budgets would start to increase. The first two years of the Aquino administration saw this deficit decrease, but by the end of 1990 it rose to 5.2 per cent of GDP, forcing the government to propose a more comprehensive tax reform package to bring the deficit under control. To make matters worse, the IMF, World

Bank and Japanese government chose this time to halt loan disbursements because of the Philippines' failure to comply with the standby agreement it had negotiated with the IMF. A year later, the Persian Gulf crisis would increase petroleum prices and increase interest rates because remittances for the large number of Philippine contract workers in Kuwait and Iraq ceased. The increase in petroleum prices would strain the budget, but the pain would really come from the increase in the domestic interest rates as the Aquino government, unlike the Marcos government, utilised domestic borrowing more to finance budget deficits.

In 1990, the Aquino administration was unable to convince Congress to accept all its tax proposals and ended up negotiating an agreement which focused on improving tax collections including imposing a temporary import levy and fast-tracking the privatisation of government-owned and government-controlled corporations. The new agreement the Aquino administration negotiated with the IMF in 1991, which committed them to raise taxes and energy prices, did nothing to improve the less than ideal relationship it had with Congress, but given its need to secure fresh loans, it had no choice.

This section has focussed on economic development leading to independence, highlighting in the process the impact of American colonisation. Some of the positives and negatives of the period from the 1950s in the country's economic and political history was discussed. In addition Paul Hutchcroft's indications of the weakness of the Philippine state and his assessment of Philippine capitalism was highlighted. This historical and academic perspective of the country's economic development up to the Asian crisis and the impacts on the country's bargaining power is relevant for the overall argument of this thesis.

3.4 The Philippines' economic development during the post-Asian currency crisis period

This section discusses the Philippines' economic development since the Asian currency crisis. The section shows that FDI into the country has remained steady and GDP growth has improved sharply from a low negative growth in 1998 to a high of

6.2 per cent in early 2005. Moreover, amidst changes in government, the country still shows it is very weak and has several problems with both economics and politics, which contribute further to the weaknesses in its bargaining power.

The Asian crisis was caused, among other factors, by fundamental weaknesses in the economies of the affected countries manifested by macroeconomic imbalances, excessive borrowings, overvalued currencies and poor investments (Moreno, Pasadilla and Remolona, 1998; Glick, 1998, cited in Alburo, 1999:439). At the other extreme is an argument that the crisis was triggered by speculators and their panic behaviour of fleeing emerging markets for fear of losses (Moreno, Pasadilla and Remolona, 1998; Montes, 1998, cited in Alburo, 1999:439). Between these two extremes are various shades of explanation. There is the notion of lack of governance in both public and private transactions, especially in terms of close relationships between financial institutions and regulators; there is the notion that corruption weakens the system of investment decision making in emerging markets; there is the notion that “Asian values” had dictated the manner of financial exchanges; and there is the notion that the crisis is essentially a bubble crisis (Nomura, 1999, cited in Alburo, 1999:439).

The Philippines manifested several symptoms of the crisis such as (a) the surge of short-term capital mostly in the form of portfolio investments relative to the flows of foreign direct investments, (b) a bubble in the economy shown by the exuberance in the stock markets and price inflation of real estate and non-tradables, (c) the rapid expansion of domestic credit extended by the commercial banking system, (d) a widening current account deficit, and (e) an overvaluation of the local currency. It will be recalled that these are also, but not exclusively, the same symptoms as the Mexican crisis of 1994 (Alburo, 1999:441).

The Philippines had all the symptoms of a financial crisis even if it was not actually a direct casualty of the crisis that exploded in the region. What has kept it from acquiring the severity that others have experienced is its late exposure to the symptoms, and not necessarily that the country had strong “fundamentals” to begin with (Alburo, 1999:441-442).

The crisis was immediately transmitted to the country through the sharp depreciation of the peso, from a stable rate of P26.4 to a US\$ in June 1997 to a rate of P42.7 by January 1998. The economic and financial impacts of the crisis were not only immediate but were also clear in the sense that the transmission process is readily traceable (Alburo, 1999:446).

Although it had been shown that foreign direct investments (FDI) seemed to be immune from the effects of the crisis (based on the behavioural assertion that these are determined by long-run profit considerations), the facts indicate that, by 1998, FDI had fallen from its pre-crisis levels. Ironically, comparisons with the severely affected Republic of Korea and Thailand show that FDI increased in those countries in the period after the crisis. It is not clear whether recent FDI behaviour in the Philippines (and for that matter Korea and Thailand) can be attributed to the crisis or not, given the short span of time when changes took place. What is clear is that FDI behaviour had been influenced by the crisis, and that the affected countries' long-run growth sustainability would be threatened even more since the more stable component of capital flows would then be subject to the vagaries of short-run changes (Alburo, 1999:448).

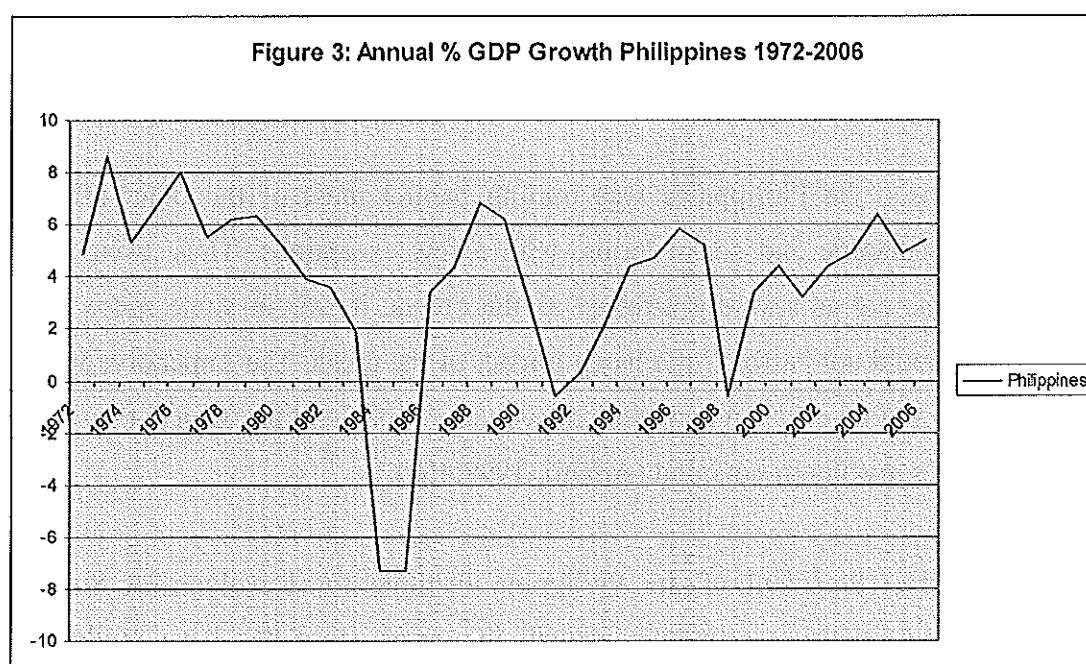
Before the crisis, the Philippines was trailing behind most of the other affected countries in economic and social terms, with a few exceptions. Thus, even if the Philippines was not as severely affected as the others, it was in some sense made worse off. It could not "afford" the harsh impact of the crisis. The imperative was to come out of it a more efficient and resilient economy capable of growing at rates close to the country's maximum potential (Alburo, 1999:456).

Mario Lamberte (President of the Philippine Institute for Development Studies) argues that the country's economic growth in recent years has been modest by regional standards. There are areas, such as investment, exports, FDI, where it clearly lags behind its neighbours (Lamberte, 2004:1). Poverty reduction had been placed high in the development agenda of previous administrations. However, it is not enough to place poverty reduction high in its development agenda. It must now take bolder measures to achieve substantial reduction in poverty within the next six years. In 2000, the proportion of the population below the poverty income threshold stood at

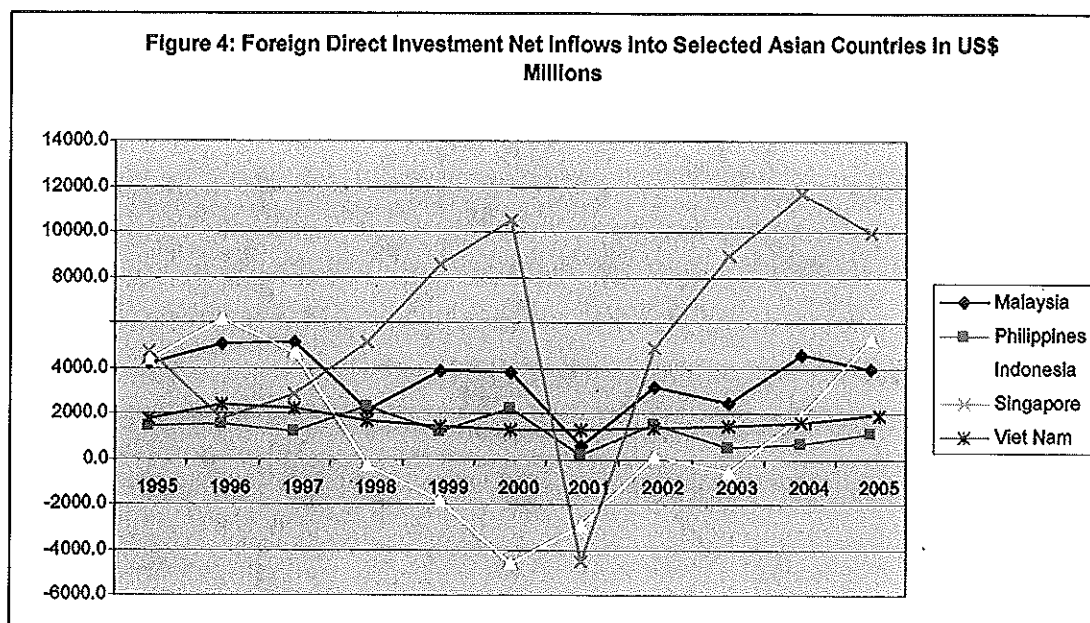
34 per cent. In terms of magnitude, there were 26.54 million Filipinos considered poor. There is a large disparity in urban and rural poverty: 18.6 per cent of the urban population (or 7.1 million people) vs. 48.8 per cent of the rural population (or 19.4 million people (Lamberte, 2004:2-3).

Despite the unfavourable global impact in 2003 of SARS and the war in Iraq, the economy grew by 4.7 per cent. All three major sectors of the economy contributed to this growth. The services sector grew by 5.8 per cent, agriculture, 3.8 per cent and industry, 3.8 per cent. The manufacturing sector grew by 4.2 per cent.

The Philippines' GDP growth rate in 2003 was comparable to countries in the region. Countries whose GDP performed worse than the Philippines were Singapore, Korea and Indonesia, which grew by 1.1 per cent, 3.1 per cent and 4.5 per cent, respectively. See Figures 3 and 4 below for an insight into Philippines GDP growth from 1972–2006 and FDI net inflows into selected Asian countries 1995–2005.



Source: Asian Development Bank, *Key Indicators*, various yearly issues.



Source: Asian Development Bank, *Key Indicators 2007*

Lamberte argued that “The performance of the economy in the first half of 2004 proved to be better than [in 2003] ... More specifically, GDP grew by 6.3 per cent. Again, the services sector led the way, with a growth rate of 6.9 per cent. Agriculture and industry grew by 6.0 per cent and 5.6 per cent, respectively. The manufacturing sector seems to have maintained its growth of 4.2 per cent” (Lamberte, 2004:4).

The political uncertainty that was only resolved in the second quarter of 2001, the continuing peace and order problems, particularly in Mindanao, the deteriorating fiscal position and concerns about the world economy all affected investors’ confidence.

Foreign investments, even though insufficient, have, however, played some part in developing the domestic economy of the Philippines for years, and the government, knowing the country’s scarce capital and lack of technology and expertise in most economic sectors, has exerted efforts, such as amending the legal framework for foreign investment and aggressive investment promotion programs, to attract more foreign capital. Net foreign direct investment (FDI) surged, averaging US\$962 million annually during the period 1990–1997 and US\$1.3 billion annually during the period 1998–2002. However, net FDI dipped to only US\$161 million in 2003. It is to be

noted that other countries in the region, notably China, Thailand, Vietnam and India, have been able to attract more FDI than the Philippines.

To attract more FDI, the Philippines need to improve its overall competitiveness. In a recent survey of 30 countries in Group 1, however, the Philippines' rank in overall competitiveness slipped to 22nd in 2003, which is two notches from its rank in 2002 (Macaranas, 2003). To reverse this trend, the Philippines has to work harder on all four key components of the overall competitiveness index, namely: economic performance, government efficiency, business efficiency and infrastructure (Lamberte, 2004:6).

The widening national government deficit can be attributed largely to poor revenue collection. More specifically, the tax effort dropped from 17 per cent of GDP in 1997 to about 12.7 per cent in 2003, which is even lower than Indonesia's tax effort of more than 13 per cent. Interestingly, while the tax effort of other ASEAN countries started to recover after 2000, the Philippines' tax effort had continued to decline. The continuous decline in the Philippines' tax effort can be attributed to both tax structure and administration. The tax reforms envisioned in 1997 were not completed, thus creating several leakages (Lamberte, 2004:10).

Aside from exerting effort to increase tax collection, the government also needs to address the runaway losses of government-owned non-financial corporations. Resolving the National Power Corporation's losses, which accounted for 85 per cent of the total losses of government-owned corporations in 2003, is of utmost importance (Lamberte, 2004:12).

It was stated by the Philippines' Board of Investments (BOI) in the *Asia Pacific Bulletin* in 2003 that "a 70 per cent drop in foreign direct investment (FDI) into the country [that] year [was] both significant and alarming". According to the Bangko Sentral ng Pilipinas, the central bank, the country attracted only US\$600 million in FDI in 2002 compared to US\$2 billion in 2001. Immediate explanations for the setback are not hard to find: continuing national security concerns, especially in the Muslim-dominated southern provinces; depressed economies in top trade and investment partners, the US and Japan; continuing lacklustre demand for microchips,

the country's top export industry; as well as the emergence of China as a rival manufacturing hub and investment destination. Although the impact of these factors should not be overlooked, the roots of the problem lie in the chronically weak state of Manila's public finances.

The International Monetary Fund (IMF) has proposed Manila deal with its shortfall through its standard formula of "fiscal responsibility" – balancing the budget by cutting public expenditures. The IMF formula misses the point in the case of the Philippines, because its budget deficits are not really the result of excessive public spending, but rather of the state's inability to collect revenue in the form of taxes – in short, corruption. As a recent World Bank study demonstrates, expenditures have remained stable at around 18–19 per cent of GDP since 1995, while tax revenue has dropped from 19 per cent to around 12 per cent in 2002.

The key to the poor revenue collection is the inability of the Bureau of Internal Revenue (BIR), which accounts for about 80 per cent of total government revenues, to keep a firm hold on tax collection. In 2002, the BIR only collected the equivalent of some 12 per cent of total GDP in taxes, well below the 20 per cent gathered by its neighbour Malaysia, and the regional average of 30 per cent. Morgan Stanley has recently noted that tax evasion, rather than payments of amounts due to the government, is the norm.

Without considerable improvement in revenue collection, the government will find it hard to sustain needed social expenditures in health and education while at the same time providing incentives to attract foreign investment. Recent initiatives to improve state capacity and tax collection include the computerisation of the BIR and the automation of the Bureau of Customs. Similarly, key leaders in Congress have proposed a bill to create an Internal Revenue Management Authority with the final objective of increasing managerial flexibility and strengthening accounting methods in practice within the BIR.

There is strong empirical evidence that countries with high level of effort in R&D normally have high productivity and, consequently, high economic growth performance (Cororaton, 1999:1). While the rates of return to R&D investment are

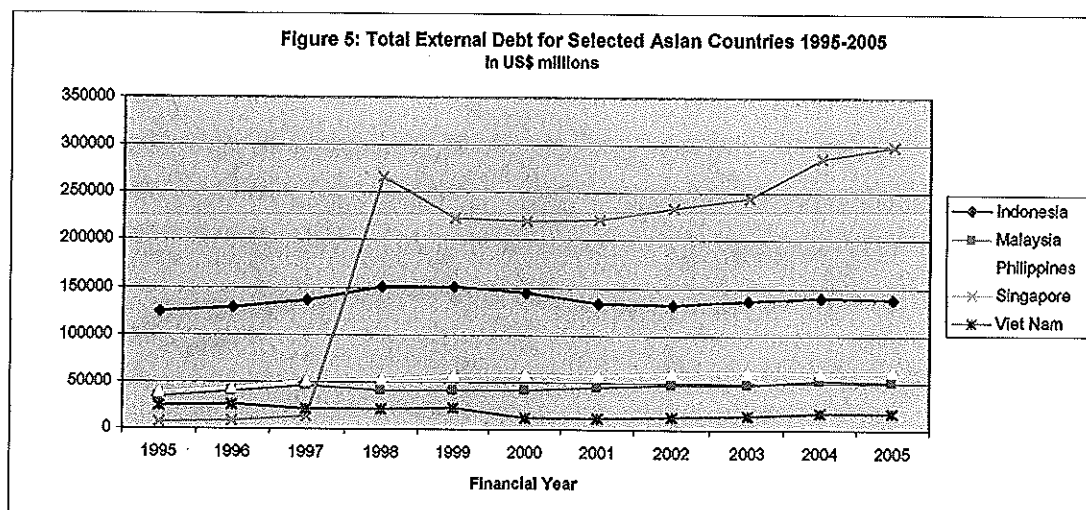
high, there are indications the Philippines has been underinvesting in R&D. Cororaton (1998) showed that, in terms of two broad indicators of R&D activities, i.e., expenditure on R&D and the number of scientists and engineers, the Philippines ranks very low. The economic costs of underinvesting in R&D may be substantial. Cororaton (1998) surveyed some indicators of productivity in the Philippines and found that the productivity performance has not been very encouraging (Cororaton, 1999:2).

Cororaton emphasises that “A drop in productivity can be explained by the inability of the country to allocate its resources efficiently because of policies that intervened in the process of resource allocation. The decline in productivity is mainly caused by the deterioration of technical progress over time ... is attributed to the general failure in the approach of acquiring and adapting new or foreign technology” (1999:3). The relatively poor productivity performance in the Philippines is one of the key reasons why it has not been able to sustain its growth process. In fact, the Philippine economy performed poorly over the last three decades compared to its Asian neighbours. It grew an average of 2.5 per cent per annum over the period 1980–1996, far below the growth performance of Singapore (8.0 per cent), South Korea (8.2 per cent), Thailand (8.0 per cent), Malaysia (8.2 per cent), and Indonesia (7.6 per cent) (Cororaton, 1999:4).

However, the Philippines still recorded respectable growth in the 1990s and up to 2005 and managed to show a fairly good performance despite the Asian crisis and the subsequent political problems that followed the Estrada administration blemishes. This good macro-economic performance suggests that the reforms implemented since the late 1980s, and intensified by the Ramos administration in the early 1990s, are now bearing fruit. However, much remains to be done, as several structural problems threaten to affect the long term growth. Barring any major event that will disrupt this growth trend, the Philippines is expected to post a better performance during the next few years of the first decade of the 21st century. This is further emphasised by Rivera who argued that, “as the Philippines negotiates the threshold of the twenty-first century, it struggles to join the ranks of late industrialising economies in the region while strengthening the foundations of a stable democratic political order. The terms of this transition, however, remain difficult” (Rivera, 1996:46).

The investment and trade policies of the country have been liberalised since the 1990s. Such change offers firms from outside and within Asia the opportunity to expand their market base in the Philippines. The government has liberalised the entry of foreign investment with the enactment of the Foreign Investment Act of 1991. With its large pool of educated, trainable, English speaking workforce, the Philippines offers good business opportunities to foreign firms.

The Philippines is a country that emerged in the 1990s from a very long period of slow growth and economic imbalances going back to the period of American occupation, and then somehow managed to escape the Asian crisis relatively unscathed. The good economic performance of the Philippines, especially in the mid-1990s, can definitely be attributed to the increasing openness, stable investment rates and increase in foreign direct investments. In contrast, the poor performance of the Philippines from 1970–1995 relative to other Asian countries is due to the lack of the same factors that led to the good performance in the mid-1990s. For example, in terms of external debts, the Philippines is much better off than several of its counterparts (see Figure 5).



Source: Asian Development Bank, *Key Indicators 2007*

Most of all, the comprehensive reform package that former President Fidel Ramos and his administration succeeded in implementing for most of the 1990s liberalised the economy, stabilised economic performance and corrected structural rigidities. Privatisation was encouraged and accelerated while opening up and levelling the playing field for the entry of new players in selected sectors (e.g., banking, telecommunications and oil). The level of protection of local industries was reduced with the lowering of tariffs and liberalisation of foreign participation in various sectors.

However, while the Philippines has succeeded in dramatically improving its economic performance, there remain several structural problems, typical of many emerging Asian economies, that tend to restrict rapid economic growth and development. These structural problems include low domestic savings, weak tax collection, limited progress in civil and local government reforms, weaknesses in the banking sector (as will be stressed further) and the continued high incidence of poverty. While these structural problems prevail, it is worth noting that the Philippines, in spite of these problems and the relatively slower growth, provided a fairly stable business climate compared to its Asian neighbours during the Asian crisis in 1997.

Many potential and existing investors, in particular American investors, remain interested in the Philippines, but many of them consider that constitutional coups, similar to the one that put current President Gloria Macapagal-Arroyo in office and that have continued to persist since her election, lead to a nagging question of whether any Philippine administration can hold safely on to power. That question calls for “solid assurances’ from the new dispensation, said economist Florian Alburo ... and continuity in government is important to them” (Luib, 2001).

This demands a concerted look at development in the processes of democracy and the Philippine constitution or changes that have been effected. Hutchcroft adds to this argument further by explaining that “[The] combination of a poorly developed state apparatus, a powerful oligarchy, and ready made support from an external military power [the US’s] has left the Philippines with a booty capitalism that endures to the present day” (Hutchcroft, 1998:23), and as stipulated by Fidel Ramos (cited in Hutchcroft, 1998:23), the Philippine economic system “rewards people who do not

produce at the expense of those who do". The Philippines is said to be incapable of providing the administrative and legal apparatus necessary for the development of open-market capitalism (Hutchcroft, 1998:23).

In summary and as expressed by Paul Haslam (2004):

Over the last thirty years the rules and regulations which govern foreign direct investment in most developing countries (and in the developed world too) have become increasingly liberal and fixed – regardless of the combination of assets (or lack thereof) held, and strategies pursued by the foreign investor.

However, this trend is not measurable on a country-to-country basis, as 'the rules' are more than often broken in order to meet the demands of local interests. For example, in the Philippines much depends on the actions of the local oligarchy and how they respond to the foreign direct investor. This is clearly an area where the Philippine government has got it wrong, hence demonstrating its weaknesses as the administrator of the state's foreign policy in respect to FDI and MNCs. Haslam (2004) further explains that:

the liberal bargaining model pioneered by Vernon (1971) and Moran (1974) saw the inevitable conflict between the national interest of the host country and the global interests of the multinational enterprise as resulting in state-firm bargaining over the terms of investment at the entry, operational, and exit stage of the investment (how they would share the expected economic rent).

Agarwal and Ramaswami (1992:21) highlighted that:

the trend towards globalisation has meant that not only are multinational firms taking a global view of their strategies but also countries are beginning to recognise that their economic development strategies must take on a global dimension. [They argue] that firms that have a higher preference for investment entry modes are sensitive to investment/contractual risk-related attributes. The governments in host countries, therefore, will not only have to

develop policies that make it attractive for foreign firms to invest in their markets, but more importantly, will have to reduce risk perceptions through regulations that permit repatriation of profits, majority ownership and control, patent protection for technology/products and enforcement of contracts. From the government's perspective, it should be noted that, regardless of the stage of economic development of the country, policy variables that reduce the risk will have a positive impact on foreign direct investment and technology transfer.

In the case of the Philippines, this thesis demonstrates clearly that the “conditions [have been] created for a more favourable investment climate through relaxation of investment controls and provision of investment incentives including better protection of property rights and enforcement of contracts” (Agarwal and Ramaswami, 1992:21). However, there are still many issues to be dealt with because the government lacks the strength in taking action against several impediments to foreign investment.

For example the “Inability to collect taxes caused Gunnar Myrdal to categorise the Philippines as a ‘soft state’” (Myrdal, cited in Wurfel, 1988:56). Furthermore, Wurfel argues that:

That inability was a result of the pervasive corruption in the bureaucracy, which was in turn a reflection of the patronage system. Potential taxpayers in the upper brackets found it easy to buy their way out of a heavy assessment, either by bribing the tax collector or by making a ‘campaign contribution’ to his patron, usually in Congress (1988:56).

3.5 Conclusions

This chapter has dealt with three major points that explain areas of concern that particularly weaken the bargaining power of the Philippines. Firstly, the complexity of the environment in which economic development in the Philippines occurs makes it

rather difficult for policy makers to attract foreign investors even though the business environment in the country is argued to be positive. However, it was emphasised that political and social instability raises issues that may turn investors away. Secondly, economic development in the Philippines leading to the Asian currency crisis was expanded on highlighting the influence of the US in the process. It was explained that this period in many ways contributed to the weakness of the economy and the bargaining power of the country. Thirdly, the Philippines' recovery and economic development post-Asian currency crisis was analysed. This part of the chapter highlighted that, even though FDI remained steady, GDP growth recovered sharply and government policies slightly improved, there still remain weaknesses politically, economically and socially that impact on the Philippines' bargaining power. In summary, the main issue for this chapter was to present the past and current environment for economic development in the Philippines and to point to the weaknesses of the state in developing a clear focus on strengthening its bargaining power.

Chapter 4 An Analysis of the Bargaining Power of the Philippines

4.1 Introduction

Theoretically, the Philippines has through its constituents had much bargaining power, and most believe it will have bargaining power for much of its future political and economic history. However, where does its bargaining power lie and how does it use that power? It is the intention and aim of this chapter and Chapter 5 to show that the country has bargaining power in many areas but it is lacking in other areas. As a result, the country does not use its bargaining power effectively to achieve its potential to sustain its political, economic, social and environmental development.

The country possesses high levels of literacy and a highly educated workforce, fluent in the English language. This is an advantage that the Philippines has over most of its neighbours in Asia and is an important resource in attracting FDI. On top of its English proficiency, the government has a well-established set of institutional bodies like NEDA, PEZA, the SEC, BOI etc., aimed specifically at foreign direct investors and MNCs. These institutions came about as a result of constitutional amendments and positive reform measures adopted by the Aquino government and implemented by Ramos, who also enacted additional reforms in the process of liberalising the economy. The Philippines has abundant mining resources, as an example of which it has been ranked in the world's top ten in the production of chromite, copper, nickel and gold (Lyday, 1998, 2004).

The Mining Act (RA 7942) was designed “to establish a legal framework for the mining sector and to streamline the law to ensure that the Philippines could compete effectively for foreign investments in the country's mining industry” (Lyday, 1998). It has been recognised that the act is “one of the most modern in Southeast Asia and incorporates environmental provisions on a par with other established mineral-producing countries while also safeguarding the indigenous culture of local communities” (Luna, 1998, cited in Lyday, 1998). However, as will be shown in Chapter 5, some MNCs appear to disregard the Mining Act's aims.

The Philippines also offers investors an established, highly-skilled, abundant, and highly-rated workforce at fairly low and competitive labour prices. Moreover the country is a democracy, which is supposedly more conducive to opening the door for investments and poses few restrictions on ownership and repatriation of profits. However, on the negative side, there are several problems that impede the country's bargaining power and from being a safe environment for investors. These include corruption, political instability and turmoil, insurgencies, a very influential oligarchy, a highly influential Catholic Church, and on top of these a bureaucracy that stands in the way of potential large foreign investors.

To determine the extent of the country's bargaining power, this chapter analyses the findings of interviews that were conducted in 2004 as part of field studies. Firstly, the strengths of the Philippines' bargaining power are analysed, followed by an analysis of the weaknesses of the country's bargaining power. Secondly, the issue of corruption is addressed to further point out its negative consequences on the country's ability to strengthen its bargaining power. Thirdly, the chapter discusses the environment within which the Philippines exercises its bargaining for FDI and some of the processes of negotiations for FDI, highlighting in the process some of the problems that the Philippines encounters in attracting FDI.

The Philippines' political economy is very complex and defining it is likewise not a simple exercise. The country cannot dwell on the failures of previous governments that never attempted to address the economy's problems and earn the country some respectability within the Asian region. However, in most recent times, the government has introduced several institutional bodies such as NEDA, PEZA, PIDS and BOI to deal with the many problems obstructing its push for economic stability, strengthening the size of its middle class and raising business education to the level required to promote the importance of FDI to the country.

However, no matter how many institutions are put into place to deal with such issues, the necessity for a committee to reform the entire bureaucratic process cannot be stressed enough. The difficulty of administrative and bureaucratic reform in any given country is common knowledge and is under constant public scrutiny, particularly

more so in democratic countries, as the demand for open and transparent governance is high. It could be argued that the bureaucratic situation in the Philippines is fairly grim. A potential investor faced with bureaucratic and administrative problems or interference would in many cases simply turn to other countries with less cumbersome procedures.

In order to establish if the Philippines actually places much importance on gaining strong bargaining power, it is extremely important to obtain and analyse the different views of several people from various sectors of the Philippine economic and political scene. Particularly emphasis is on the importance of the views of academics and business sector representatives such as those from universities and Chambers of Commerce. One cannot possibly draw a conclusion unless the perspectives of all those representatives are analysed to highlight the positives and negatives. By doing so, scholars, politicians, business groups etc. will have a much more identifiable model to scrutinise when assessing the bargaining power of the country as well as that of other developing countries with similar characteristics.

4.2 Strengths of the Philippines' bargaining power

De Ocampo (2004) is critical of the current Arroyo government when it comes to its efforts in attracting FDI. He believes the country is now more inward looking and is embroiled in internal domestic problems instead of focussing on making the Philippines more competitive globally and regionally. He states that, for the past six years, local newspapers talk about local politics and do not focus enough on economics. One of the positive things the current government is doing is making investment in the English language a top priority. Crediting the present administration for reversing the mistaken policy of the previous government, De Ocampo (2004) in rating the Philippines' English proficiency²⁶ as one of the country's comparative advantages argues that:

²⁶ Beeson, Mark. 2007. "East Asia's Developmental States", in *Regionalism and Globalisation in East Asia: Politics Security and Economic Development*, Palgrave MacMillan, Basingstoke, Pp. 141-182, Chapter 5.

administrations in the past guided by a very myopic view of nationalism were trying their best to diminish English. As a result we find our new graduates becoming less and less capable in the English language. The Philippines' English comparative advantage helps the country attract FDI and specialise in the IT and service industry. For example, the 2 leading countries when it comes to backroom operations, call centres, software development in Asia are India and the Philippines.

NEDA (2004) indicates in their Medium Term Development Plan 2004–2010 that “the quality of Philippine basic education has been deteriorating continuously. Severe budgetary constraints have led to underinvestment in basic education”. The problem is that while government spending on basic education in 2000–2004 grew at an annual average of 4.5 per cent, some 89 per cent of the budget of the Department of Education went to salaries and personal benefits and only some 7 per cent went towards developmental purposes on training and purchase of instructional materials. However, based on the 2000 Census of Population and Housing, basic or simple literacy stood at 92.28 per cent, still the highest for the entire Southeast Asian region (NEDA, 2004).

The current administration is trying to pinpoint such areas like mining and education in which the Philippines has comparative advantages and more bargaining power, and is giving incentives and encouragement to investors, students and teachers. In education, for example, NEDA highlights that attendance at elementary schools stands at 90.08 per cent, and the aim of the government is to attain 100 per cent attendance by 2010 (NEDA 2004). However, while a well-educated workforce is important for investors, there are other non-economic reasons that are keeping large numbers of foreign investors from coming into the Philippines. These include peace, security, perceived political instability, corruption and democracy.

There is a very strong realisation in the mining industry that the Philippines needs to capitalise on the potential of the industry. A deeper insight into the mining sector suggests that the Philippines has fairly strong bargaining power which it needs to use effectively, regardless of the consequences of the Supreme Court's rulings in respect to environmental concerns that were generated by the Marcopper mines' tailings

spills. Angeles²⁷ (2003) argues that the mineral industry has the “capacity to generate US\$964 billion from the unexplored metallic and non-metallic reserves of the Philippines” (BOI, 2002, cited in Angeles, 2003). Theoretically, according to Angeles (2003), this “would transfer to about US\$10 billion a year over 100 years”. Angeles (2003) further adds that, with “exploration and utilisation of these resources, it is not unlikely that the mining industry may surpass the electronic sector in terms of income generation ... And aside from [this] the mineral sector has vast horizontal linkages with various industries that create a vast multiplier effect in terms of employment and economic activities”. This would certainly convert to strengthening the Philippine’s bargaining power.

However, in 2005 the US Department of State predicted that the Philippine’s ability to attract foreign direct investment would face crucial setbacks due to government malpractices such as corruption, failure to carry out adequate reforms and the decline of American English proficiency. This statement gave potential future investors the impression that the Philippines was not a suitable environment for investment. However, a study conducted in the Philippines revealed that the US Department of State issued a generalised statement on the Philippines’ investment climate that did not accurately reflect the Philippines’ bargaining power and comparative advantage in attracting direct foreign investment in manufacturing, infrastructure and mining sectors. Interviewee 1, who works for the American Chamber of Commerce and has extensive knowledge of the Philippines investment climate, states that, “all of the other things the Philippines tend to be negative are outweighed by their workforce”. According to Interviewee 1 (2004), the reason American companies keep coming to the Philippines to conduct their business is that they see that the Philippines has the comparative advantage of an American English speaking²⁸ workforce that is highly rated and educated offering competitive labour prices whether in “management, technical people, engineers, factory managers, clerical people, factory floor people who have been consistently highly rated that you get at fairly reasonable prices not the lowest, but good combination [of] quality and quantity” (Interviewee 1, 2004).

²⁷ Raul Angeles at the time (2003) was Director of the Mining, Marine and Other Natural Resource-based Products Department, Board of Investments, Department of Trade and Industry, Philippines.

²⁸ Luib, Romulo T. (2001) *Business World*.

Anton Naguiat (2004) of the ANZ Chamber of Commerce argues that clearly the bargaining power of the Philippines lies within the country. Naguiat (2004) states that:

the Philippines creates the law, MNCs are visitors that have knocked on the doors of the Philippines. But to say can we come in, can we do this, and can we do that is not possible because if anything is related to the government, they will always dictate, and MNCs need to find the right approach. If the MNCs goals can fit into the positive objectives of the government, then the government might realise maybe for example the MNC can offer an alternative form of energy that will enable every single house to have a light bulb. The Philippine government might argue that it does not like the way it is presented. So what do you do? Do you force the issue? That's how it is. It's on that very basic principle that in a country like the Philippines it becomes more apparent that for people who do their homework they know that there will be some areas where of course they will have the better bargaining card. But in terms of, relative to the Philippines, what is factored in may be as an expense that is given, whether you like it or not.

On the other hand, a foreign diplomat (Interviewee 3, 2004) argues that it can be difficult to find the bargaining power of the Philippines because it really depends on the situation. In the case of Fraport AG for example, the foreign diplomat (Interviewee 3, 2004) argued:

that the Philippines government was probably in the box seat at the point in time because they could afford to sit there and wait until the dispute resolved itself, while this German company has shareholders haemorrhaging money just waiting for it to be resolved. In the case of the mining industry once again it is difficult to agree that the government is in the box seat but the Catholic Church in the local provinces is in the box seat controlling what happens and they control that better than the government.

From a Philippine academic's perspective, the Philippines has enough bargaining power. Bargaining power, argues Alburo (2004):

really is a function of what you have. When you operate in a rather poor environment you may not possess any bargaining power no matter how many tax incentives you offer. Even if the law is changed there is just no way any MNC could be persuaded to come into the country no matter how many incentives you have. If you give 100 per cent tax breaks, and change the law to the extent that, there is stability and the bureaucracy in that particular sector is effective and not corrupt then the country's bargaining power would be quite strong.

But in many cases, Alburo emphasises, it may have bargaining power. For example, in telecommunications and outsourcing services, the Philippines government has bargaining power in the sense "they have decided this is what they want to do; they have decided they are going to create zones for that. They are willing to provide support to MNCs in that area as provided for in existing BOI regulations" (Alburo, 2004).

Furthermore, Alburo argues that one of the most important resources that the Philippines has is English-speaking people (Alburo 2004; Cruz, 2002). However, Alburo, as opposed to Angeles (2003), points out that "in some areas like mining for example, they may not have that kind of bargaining power because the country has archaic mining laws and does not have sufficient environmental support for that industry" (Alburo, 2004).

The Philippines has a democratic system of government modelled on the United States. The executive, legislative and judicial branches of government are independent of each other in a system of separation of powers. Of particular relevance to corruption prevention mechanisms, the Philippines Constitution provides for the creation of independent commissions that monitor the performance of public officials, both elected and civil servants. The members of these bodies are constitutionally assured of security of tenure and insulation from political influence.²⁹

²⁹ Mauro argues that "Corruption is most prevalent where there are other forms of institutional inefficiency, such as political instability, bureaucratic red tape, and weak legislative and judicial systems" (1998:12).

Martinez reports that the political structure was transformed in 1991 by the introduction of the Local Government Code (1991). This empowers local government units who were once wholly dependent on the central or national government to become self-reliant communities. More power, authority, resources and responsibility have been devolved to the local level. A provision of the Code facilitates people's participation in local government affairs by requiring that there be 25 per cent of local community involvement in the areas of local planning (local development council), law enforcement (people's law enforcement board), tendering (pre-qualification bids and awards board), education (local education board) and health (local health board) (Martinez, 1999:3).

In addition, Martinez explains that the Constitution created the office of the Ombudsman through the Ombudsman Act. There is also an Anti-Graft Practices Act which defines corruption and a Code of Conduct, which regulates the actions of employees in the public service.

The passing of the Local Government Code has galvanised the involvement of non-government organisations and the private sector in the task of governance. The media, despite its commercial need to sensationalise stories, has joined the bandwagon of participatory good governance (Martinez, 1999:6). Addressing corruption in the Philippines requires a multi-pronged strategy to raise general community awareness of the problem and create public pressure to make public officials more accountable for their actions.

The literature has not clearly identified the bargaining power of the Philippines. In effect little has been written on the matter of bargaining other than on employment bargaining processes. The task at hand was made even more difficult when trying to identify what, if any, bargaining power the country possesses. To be able to bargain effectively, the Philippines according to Lamberte (2004:6), needs "to improve its overall competitiveness" and "work harder on all four key components of overall competitiveness index, namely: economic performance; government efficiency; business efficiency; and infrastructure".

Added to the necessity of improving its overall competitiveness the government needs to deal with the dilemma in the southern Philippines and the problems this area of the country poses for potential investors. Mindanao in particular represents one of the bargaining strengths and is crucial for the Philippines' economic growth; however its value is yet to be realised, as many opportunities have gone begging with previous governments, apart for a short time during the Ramos administration. However the island can also be an impediment in weakening the bargaining power of the country. Whilst this thesis is centred more on FDI and the bargaining power of the Philippines, one has to be aware of the importance of Mindanao, and further studies on this area of the Philippines are crucial. This will not only enable the government to gain further insights into where it should focus its attention, but also promote more scope for investors into the region. However, the question of insurgencies is undoubtedly one that the current government lacks the ability to deal with. Because of the focus of this paper it is not possible to develop this argument further. It is recommended that such organisations as the Mindanao Business Council (MBC) are a good starting point of reference.

The Philippines' laws and regulations in regard to FDI are now more relaxed for foreign investors into the Philippines (Antonio 2004; Philippine Political Monitor, 1996). Antonio (2004) identifies two programs that are being given incentives by the government. These are pioneer and non-pioneer programs. The government has an annual Investment Priorities Plan to give priority to provide incentives to companies which are thought to be beneficial to the Philippines' economy.

Nestlé, for example, is a fully established company and does not require additional incentives from the government; however, it does receive export revenue increment and tax credits when the company exports more (Antonio, 2004). The Philippines does provide incentives in the way of, for example, PEZA, amendments to ownership laws, tax breaks. Under FDI arrangements there is nothing to stop the host government seeking to renegotiate and, if renegotiation fails, then expropriation is the next step. Although the Philippines has shown tendencies to change their laws too often and resorted to expropriation, it would be unwise for the country to impose full

taxes, as this would result in investors viewing the Philippines as an unstable place where business contracts are not honoured.

The Philippines' attempt to revitalise its economy via FDI is worthy of mention and lends to its bargaining power. Provisions made by the concerted efforts of Special Economic Zones (SEZs), the Department of Labor and Employment (DOLE), Social Security Agency, Philippines Economic Zone Authority (PEZA) and Bases Conversion Development Authority (BCDA) continue to attract FDI. The investment climate assessment of 2005 states that:

Special Economic Zones (SEZs) continue to play a significant role in attracting new investors to the country. SEZs normally include their own labor centers for assisting investors with recruitment, coordinating with the Department of Labor and Employment (DOLE) and Social Security Agency, and mediating labor disputes. As of November 2004, there were 111 SEZs operating in the country under the Philippine Economic Zone Authority (PEZA), of which 4 are government-owned Ecozones located in Mactan, Bataan, Baguio, and Cavite, and 5 Zones under Bases Conversion Development Authority (BCDA). Another 97 have been approved by PEZA but are not yet operational. As of November 2004, an estimated 1,012,067 employees were working in PEZA SEZs, of which 404,827 were directly employed, and about 607,240 were indirectly employed as seasonal and contractual workers. Low wages: Multinational managers report that their total compensation packages tend to be lower than other neighbouring countries, a good value for their mid-level management and skilled staff in the Philippines. In the call center industry, labor cost is between US\$1 to US\$1.22 per hour (US Department of State, 2005:27).

Doing business in the Philippines has certainly been made much easier with considerable attention being given to ease approval procedures, and this contributes to the country's bargaining power. Several laws have been passed by the legislative body to strengthen the government's policy for attracting MNCs. AIG Online (2004) stresses that the Foreign Investments Acts now allows 100 per cent ownership in any

permissible business other than those that are strictly limited by existing Philippine laws. The Omnibus Investments Code, which is implemented by the BOI, provides a very comprehensive set of incentives for businesses that engage in industries that are perceived as valuable for national development (SGV and Co, 2003). Moreover, enterprises are entitled to incentives as long they export 70 per cent of their production (SGV and Co, 2003).

4.3 Weaknesses in the Philippines' bargaining power

Alburo (2004) argues that legal provisions are in place. However, these need to be amended, and at the same the visions of the government and including the private sector need to be balanced in order to foster economic growth. Moreover, Alburo contends that Filipinos are short-sighted and most of them are not interested in long-term investment. They believe it is the government's duty to turn this cycle around and encourage growth by minimising corrupt practices. Furthermore, Alburo (2004) highlights that the "Philippine government is not cohesive – it's porous. And therefore it is a government that fritters power away to certain groups and which does not have a consolidated view of social needs".

Adding to this argument, Congressman Padilla (2004) explains that "while we [the Philippines] have some bargaining power to use, however we are not using it effectively. For e.g., if you are a soldier going to the battlefield, you have some ammunition, but the problem is that you are not using your ammunition. Your enemy keeps on shooting you, and you have no way of shooting back. In a sense we need to teach our negotiators how to (shoot) negotiate".

Some of the major problems or weaknesses in the Philippines highlighted within this thesis are a result of extensive interviews, case studies research, and literature reviews that identified the country's ability to deal with major corporations. The failure of the government in combating some of the issues mentioned is simply in its very weak state apparatus, a weakness undoubtedly made even weaker by the mere fact that the government is unable to confront the two major hurdles. Or put simply, it is not ready or prepared to deal with either because that would cost it the ability to govern. The

wealthy elites, the major families who control everyday life for the majority of society, represent a factor in the inability of the Philippines to advance their democracy and economic well-being. It is another contention of this thesis that the Catholic Church also is often an impediment in the government's ability to perform its functions.

The Catholic Church and the many elite families of the Philippines share a great proportion of land, and this in many ways weakens the ability of the government to strengthen its bargaining power.³⁰ For example the Church has demonstrated clear objections to the opening up of the mining sector and in many ways has strongly influenced government decisions to reform not only mining but to provide much needed land reforms. Nevertheless, one must acknowledge the role of the Catholic Church in Filipino society and its ability to bring about peaceful resolutions to many instances of potential clashes, as was the case in People Power "EDSA 1 Revolution" in 1986, which brought about the fall of the Marcos regime. Government reforms can only be achieved without the negative influence of both the church and the elite families if the Philippines is to advance towards sustained economic well-being.

The role of the Catholic Church would benefit Filipino society more by focussing on the elite families and impressing upon them the need for a just system of government, which is a government run by the electors, for the electors, a government that must not and should not be influenced by those who feel they have a given right to run the country. The Philippines is not a monarchy, at least not since the Spanish left. The government must be accountable to all Filipinos, not to the church and certainly not to a select group of wealthy family clans. For example Vernon argues that:

³⁰ Coates states that "at the same time, Governor-General of the Philippines Terrero was making enquiries within his secretariat about one of the thorny problems of Philippine administration, the taxation returns on land owned by the religious corporations. It was a subject so potentially dangerous than none less than a governor-general would dare touch it, and even many of these, though aware from the tax returns that the friars were cheating the government on an extensive scale, preferred to let the matter pass without comment rather than risk an encounter with the religious corporations and the possibility of a dismissal engineered by them in Madrid" (1968:138).

Coates clearly demonstrates that land being used for cultivation has increased extensively in the Philippines and this is clearly seen with the land tax returns increasing. However, it was very clear the amount of revenue showed little or no actual change in the wealthiest parts of the country. It is generally assumed that revenue would normally be good, particularly where the best land has been owned and managed by corporations owned by religious organisations or movements (1968: 139).

the presence of foreign investment in any local economy generally helps to bolster the strength of certain local elite groups and is usually seen as a threat to the strength of others. To some extent, the identity and the relative strength of the various elites have changed predictably with the country's growth. (1971:190).

The root of the Philippines' bargaining problem has two branches – the elite families and the Catholic Church – and it is deeply entrenched. Like all systems of power it is difficult to remove once the belief that an absolute power exists because of a supposedly divine right. There is only one way for the government to be effective in strengthening its bargaining power in a country where democracy is dominant, and certainly a country that leads the democratic movement in the entire region, and that is for the government to become the ruler in its own right as elected by the people, the majority.

In 2005, the US Department of State issued an Investment Climate Statement warning that the Philippines was in trouble because it was losing its comparative advantage when compared to its Asian neighbours. The Philippines' main advantage in attracting foreign direct investment was due to its English-speaking highly educated workforce; however, the US Department of State argued that the level of English language proficiency was declining in the Philippines and improving in other Southeast Asian countries.

Furthermore, the Philippine government's failure to invest in vital infrastructure such as roads, communications, education and healthcare has undermined the performance of both domestic and foreign investors. The Philippine government needs to loosen its fiscal constraints and spend on infrastructure that is vital to both its domestic and foreign investors.

With reference to legal issues, the Philippine's judicial system, the Supreme Court and the Court of Appeals in particular have been identified as a hindrance to economic development. The problem with court rulings in the Philippines is that the courts are constitutionally independent and there is nothing that parties can do even if

it can be proven that their decisions have “strayed beyond matters of legal interpretations into policy making functions” (US Department of State, 2005). It has also been alleged that some judges accept bribes and their decisions favour one party over the other. A significant problem with the judicial system is that some of the judges do not have “any background in or thorough understanding of economics, business or competitive economic system and their decisions have strayed from the interpretation of law to policy making” (US Department of State, 2005:7).

Protecting intellectual property rights is a significant issue in today’s business environment, and providing inadequate protection can work against the objective of attracting foreign direct investment. Although the Philippines has promised to uphold the protection of intellectual rights according to aggregated industry statistics, in 2004 alone there was US\$160 million of loss resulting from copyright piracy (US Department of State, 2005:15). Firstly, the agencies that are supposed to enforce intellectual property rights (IPR) are constrained by lack of resources and budgetary shortfalls. Secondly, government agencies will only enforce infringement laws when copyright owners bring an infringement case to the government’s attention and work with the government on surveillance and enforcement actions.

The Investment Climate Statement also highlighted that, in the area of diplomatic relations, the Philippines is concerned about Chinese fishing vessels that regularly enter disputed and undisputed Philippine territory. The Philippines also experiences disputes with its neighbouring regions over who owns the Spratly Islands. Other than these cases, there are no major external threats against the Philippines, and military relations between the Philippines and the United States and ASEAN members is strengthening (US Department of State, 2005:22).

Corruption is inherent in the Philippines, even though the Philippine’s Revised Penal Code, Anti-Graft and Corrupt Practices Act, and Code of Ethical Conduct for public officials have been enacted to combat corruption and anti-competitive business practices (US Department of State, 2005:22).

Furthermore, although incidences of politically motivated violence against American business people and facilities are rare, kidnappings for ransom, bombing incidents and threats do occur because of the presence of criminal gangs, terrorists, communist insurgents and Islamic separatists in various parts of the Philippines (US Department of State, 2005:20-21). These all impact negatively on the ability of the Philippines to use its bargaining power.

The greatest threat to a foreigner's personal safety and business is kidnapping. Terrorist group Abu Sayyaf Group (ASG) is a US-listed terrorist organisation that continues to operate in the Philippines despite the military's efforts in cracking down on the group. In 2004, the Philippine government concluded that ASG was responsible for the bombing of a ferry that resulted in the deaths of 118 passengers. In addition, the armed wing of the Communist Party of the Philippines (CPP), the New People's Army (NPA), poses a threat to the long-term stability of the country. The Philippine government has made some progress with the Muslim separatists in southern Philippines: "1996 accord with the Moro National Liberation Front (MNLF) strengthened the Autonomous Region in Muslim Mindanao (ARMM), and peace with the MNLF continues to hold" (US Department of State, 2005).

The US Department of State (2005) also identified many other factors such as:

high levels of corruption; failure to reform the judicial system; ineffective protection of intellectual property rights; the slow pace of energy sector reform, price liberalisation, and privatisation; delays in passing key economic and fiscal reform legislation; and political uncertainties ... combined to constrain the government's ability to attract foreign direct investment.

De Ocampo argues that "what is keeping investors from coming in, in large numbers of course are largely non-economic factors. The peace and order situation, the appearance of political instability, the workings of a democratic process that do not

enforce a sense of continuity and long-term perspective, which business of course needs” (De Ocampo, 2004)³¹.

4.3.1 Corruption and political problems

Explaining exactly what public corruption³² is can be fairly difficult; however, De Dios and Ferrer (2000:3) argue that:

To borrow from a known phrase, public corruption is not a thing but a relation, more precisely, it is the breakdown or rupture (cor + *rumpere* = “completely breach”) of a presumed relation between social agents. The fundamental relationship affected in corruption partakes of the nature of the well-known principal-agent (henceforth, the PA) problem in economics (see, e.g., Arrow [1986]) The PA problem refers to a situation where one party (the “agent”) is contracted to promote an outcome in behalf of someone else, namely the “principal”.

The agent’s action or attribute, however, according to De Dios and Ferrer, potentially affects not only the principal’s interest but also his own. When the agent’s action or “characteristic cannot be directly observed by the principal, or where the outcome is affected not only by such an action or characteristic, the problem arise for the principal of ensuring that the agent takes appropriate action (or possesses the characteristic) that will promote the principal’s interest (De Dios and Ferrer, 2000:3).

In 2002, the American Chamber of Commerce conducted a survey among 17 business sectors in the Philippines that revealed that foreign executives agree that government attempts to combat corruption and politically motivated violence have been fairly fruitless (US Department of State, 2005:23).

³¹ See also Philip Harms, 2001. Political Risk and Equity Investment in Developing Countries.

³² Transparency International defines corruption as “operationally defined as the misuse of entrusted power for private gain” TI further differentiates between ‘according to rule’ corruption and ‘against the rule’ corruption. Facilitation payments, where a bribe is paid to receive preferential treatment for something that the bribe receiver is required to do by law, constitute the former. The latter, on the other hand, is a bribe paid to obtain services the bribe receiver is prohibited from providing” (Transparency International, No date. <http://www.transparency.org/>)

Generally foreign investors are critical of poor infrastructure and corrupt bureaucracy. Whilst Interviewee 1 (2004) believes the Philippine's comparative advantage lies with the highly-educated workforce, he identifies some of the negative circumstances that have resulted in foreign companies exercising caution when considering investing in the Philippines. For example, Interviewee 1 points out: "the negatives why people question being here is infrastructure is breaking down, such as ports, airports, roads, waterworks, power stations and on top of all these the convoluted bureaucracy of having to operate in the country as well as this corruption" (Interviewee 1, 2004).

However, in the case of corruption, the principal must be understood as being the government, taken in its most impersonal sense as embodying public interest in its laws, policies and strategies. Government performs functions and distributes resources to attain its goals (De Dios and Ferrer, 2000:9). The performance of such functions, however, is devolved upon real people, bureaucrats and politicians (or even private individuals, such as concessionaires), who may be presumed to act in their own interests.³³ A contract implicitly exists between governments and its agents, for the latter to discharge their functions in the former's behalf. Since the actions and qualities of such agents can be "observed only imperfectly, however, government cannot always be sure that its agents always perform fully in its interest" (De Dios and Ferrer, 2000:9).

Furthermore, De Dios and Ferrer (2000:17) argue that, "the overarching importance of political corruption is evident in terms of what is required to stop corruption in the bureaucracy itself". In addition it is fairly important when assessing the bargaining power of the Philippines to note that, "it is difficult to imagine that any serious move to limit the regular forms of corruption in the bureaucracy can succeed without first demonstrating a realistic commitment to drastically reducing political corruption" (2000:17). And in many ways one of the main problems is that:

³³ Mauro contends that "Since the ultimate source of rent-seeking behaviour is the availability of rents, corruption is likely to occur where restrictions and government intervention lead to the presence of such excessive profits" (1998:11).

In the Philippines, the absence of a stable party system is well known and justly lamented. Rather the system appears to proceed on the idealistic assumption that an occasional direct accountability to voters is sufficient to guarantee responsible and responsive behaviour (De Dios and Ferrer, 2000: 9).

Corruption in the Philippines occurs, first of all, on virtually all levels of government, both on a petty and a grand scale (De Dios and Ferrer, 2000:9). Petty or retail corruption tends to exist in closed and routine bureaucratic contexts, such as the internal revenue and customs collection agencies, and among the police, where bribery and extortion (various terms being *lagay*, *padulas*, *komisyon*, *kotong*, *tong*) are predominant forms (De Dios and Ferrer, 2000:9). While not always involving large amounts, this form of corruption is often the kind that ordinary citizens must confront (De Dios and Ferrer, 2000:9). These types of corruption have generally existed continuously and have been subordinated to changing political leaderships, which have either tolerated them or benefited from them in varying degrees. The Estrada administration was unique in that it directly involved itself as a major beneficiary of closed-form corruption (De Dios and Ferrer, 2000). Higher levels of government are associated with greater levels of discretion, and thus with larger amounts, culminating in the grand corruption that only high elected officials engage in. Typical of these are large one-of-a-kind procurement contracts and awards, as well as the sale of policy (De Dios and Ferrer, 2000:27-28). These are impediments to potential investors and impinge on the bargaining power of the government, particularly when considering that MNCs and host governments are the primary agents that govern not only the international political economy, but also play a major role in regional, national, as well as local political economy.

At the local level, a government decision to allow a MNC to locate in a region formerly served by domestic interests would have some impact on the overall composition of the local economy, local employment and perhaps even lead to local government by-laws being amended to suit the MNC more than the local business enterprises. Vernon highlights that:

Forces operating to shift the perspective of host governments have come from other directions as well. In most countries and in most periods, the party in

power occasionally finds it useful to make a show of independence from the foreign investor. The obvious way for a political group in power to respond to the opposition charge of being a lackey of the foreigner, for instance, is to open up existing arrangements for renegotiation (1971:58).

Another argument proposed by Vernon is that:

the insistence of some governments that foreign-owned subsidiaries should be subject to special rules of the game is sometimes motivated by questions of public policy. At other times, however, the object is simply to show preference for a national group over foreigners, without much regard for national economic consequences³⁴ (1971:234).

The collective interplay of the two major actors, the MNC and the host government, and the bargaining between them has been severely understudied by practitioners, particularly in the area of governance and corruption. This is more evident in the Philippines as no major study has been done to put that bargaining process in perspective. The literature review examined within this thesis on the bargaining power of both did not find the material to fit into a Philippine context. However, in many instances, successful projects, Nestlé Philippines for example, reduce market risks and make the host economy more attractive to prospective investors. Development of a particular sector and the attractiveness of the investment location create the incentives for change and reform. That is not to say that a country should only focus on a particular sector, as this would create a situation where the country will end up without the skills required to deal or operate in other sectors that form part of a balanced economy.

However, in order to strengthen the bargaining power of the Philippines, the country has to deal with the issue of corruption (De Ocampo, 2004; De Dios & Ferrer, 2000). De Ocampo (2004) adds that this is a very big issue. For those who look at it as simply a law and order issue, De Ocampo (2004) suggests that:

³⁴ This form of preference for national groups or companies was mentioned during an interview with Interviewee 1 and is discussed further in this chapter in relation to the Department of Science and Technology (DOST).

they'd say well get a few examples of big fish, put them to jail. I am sure there is that aspect which could be utilised but it is not enough and then for those that think that all corruption is just on the government side and so they'd say well we should punish the government culprits.

Whilst this is partly correct, there are, however, those that take the long-term view, "and say education, everybody should be inculcated somehow" (De Ocampo, 2004).

De Ocampo (2004) argues that the Philippines must also address the issue from a practical approach. The practical approach comes to mind because, as Ramos' Secretary of Finance, De Ocampo controlled entities of government that were most corrupt. The excesses of the Bureau of Internal Revenue, the Bureau of Customs and all kinds of collecting agencies were within the purview of the Secretary of Finance. De Ocampo (2004) was happy to add that, during his stint in office, "corruption was at its lowest even in the entities". What De Ocampo did was to get a combination of "big fish examples, of course catch them red handed and off with their heads" (2004).

The point of that, it appears, was to narrow the areas of discretion that become the grounds for graft and corruption. When it came to physical workplaces, De Ocampo (2004) stressed that he resorted to some things that he observed in places like the United States. De Ocampo (2004) stressed that he tried to institute, but was not able to complete as the government was put out of office, "a MacDonalds principle into all the public, all the BIR offices ... the design basically entailed putting a physical wall between the public and the people that are working on their transactions". In the Philippines, De Ocampo (2004) pointed out:

it is an open house and therefore conducive to a person going from desk to desk to desk, to desk holding their papers, and then in each desk there is an open draw. But in other countries there is a design that basically entails putting a physical wall between the public and the people that are working on their transactions so that there is no room for discretion. Interestingly enough just by the introduction of that architectural design corruption was diminished.

Whilst government provides legal incentives to foreign investors, the issue of corruption needs to be addressed in addition to the demand for infrastructure such as communication and power when considering accumulating FDI. It is firmly believed and accepted that corruption in the Philippines is widespread throughout every level of society, giving foreigners the impression that it is not worth investing money in a country where one is confronted with the practice of corruption on daily basis.

The nature of Philippine society is essentially based on patronage. A society based on patronage is by its inherent nature corrupt, because each level of the patronage chain is looking for a pay-off at the next level (De Ocampo, 2004; Sison, 1999), and the highest level wants to stay in power no matter what. Difficulties will exist as long as that patronage system is in place, according to De Ocampo, because the Philippines has the trappings of democratic processes that were imposed on an essentially feudal patronage system. According to De Ocampo, “you perpetuate a dependency relationship between the rich and the poor, the have and have nots, the powers that be and everybody else. The question becomes how do you start breaking down this patronage system and grow the middle-class” (De Ocampo, 2004).

De Ocampo (2004) believes that corruption, whilst it is inherently present in a patronage system like the Philippines, can be minimised by the government. Law and order and education can be utilised to fight corruption, but there are also other approaches that can work more effectively, two of which were mentioned earlier. The first is the practical approach and the second is structural reform. One way of reducing corruption, according to De Ocampo (2004), is to introduce practical measures that narrow areas for discretion, the other was to minimise the number of people needed to sign papers and to know the paper flow. De Ocampo’s time as Finance Secretary for the Ramos administration was the period of the lowest incidences of corruption because of measures he took that in many ways improved the bargaining power of the Philippines. The measures he took included introducing, in his own words, a:

processes and premises approach. On processes I had a total review of the way paper flows. And I put an end to ad hoc manufacturing of forms telling them that form design is actually a science. And so we changed and reduced the

number of forms and therefore the number of signatures etc. We introduced the express lane at the customs and port areas. I got the Philippines Chamber of Commerce to be the major entity involved in the collection processes that the Department of course put in the private sector. What was the point of that? It was to narrow the areas of discretion that become the grounds for graft and corruption. So I cannot police everybody, but I shut down a lot of the holes and as a result there was not much they could do about it (De Ocampo, 2004).

De Ocampo (2004) argues that the Philippines needs to consider ways by which people can think of innovation to narrow the areas of discretion, and that catching officials who accept bribery who then can be punished is not always an effective way of ending corruption. The Philippines' lack of a strong middle class³⁵ is another factor that encourages corruption:

beyond distributing land titles and focus on productivity rather than ownership, the middle class would be transformed and become credit worthy, and would be able to raise their income. Raising income raises the middle class, raising the middle class raises the educational capability which improves electoral decision-making, and which therefore will put more pressure on society as a whole to behave much more professionally, morally (De Ocampo, 2004).

In analysing barriers to attracting foreign direct investment from a policy perspective, De Ocampo (2004) argues that democracy in the Philippines is both a blessing and a curse when it comes to attracting foreign direct investment (De Ocampo, 2004; Miranda, 1997). He states that the Philippines is the oldest, most democratic country in Southeast Asia; its press is one hundred per cent free; its government structure laws are very westernised, and its political structure follows closely that of the US. However, democracy is also a weakness, because it has a tendency to be open to the possibilities of a discontinuance in policy (De Ocampo, 2004). He gives the example

³⁵ The Philippines' 'middle class' is a shifting middle class that looks abroad for better opportunities into states like the USA, Canada and Australia. Many Filipinos emigrate to these and other countries, thus causing a continuous drain on the growth of a local middle class that could bridge the gap between the elites/rich families and the very poor lower class.

whereby the checks and balances structure in the Philippines can result in decisions that can work against the Philippine's economy in terms of attracting foreign direct investment. This is evident in De Ocampo's comment where he states:

Too many cooks trying to come up to spoil the broth. The checks and balance type of government to encroach on each other's territory. So that you may have a situation where the project is approved through the executive branch. Somebody cries foul, whether it's really foul or not brings it up to the courts. And you end up with the Supreme Court decisions that might be, correct legally but may not be correct economically and gives the overall signal that there is no consistency in policy (De Ocampo, 2004).

If the Philippines wishes to be competitive with other countries like China or Singapore, where the central governments' goal of attracting foreign direct investment is not compromised by the actions of different levels of government as happens too often in democratic Philippines, it needs to reassure companies who want to invest in the country that their applications are not going to be rejected or that they will not be taken to court for any uncertain reason, because these actions could result in less interest from MNCs. But democracy and openness are strengths in terms of being able to attract MNCs to a country where they do not have to spend as much on training or translations, and where people are not likely to accidentally do the wrong thing because they did not understand what they were supposed to do (De Ocampo, 2004; Ringuet & Estrada, 2003). However, Congressman Padilla (2004) believes that improvements are needed in the Philippines business climate because the government is not doing enough to provide the essential services that foreign investors depend on for their business operations.

4.4 The climate for FDI negotiations in the Philippines

There are so many other actors in the process of negotiations and bargaining that need to be considered as being important in both the short and long term, such as politicians, civil society, individuals, consumers, private investors, the WTO etc.

Inevitably governments and MNCs have to deal with each other. MNCs are important contributors to national wealth and offer the advantages of being global in terms of access to worldwide markets and leverage of cutting-edge technologies. Both sides have and activate bargaining power in their dealings with each other. Governments are sovereign regulators of the economies in which MNCs operate. But the MNC can dilute the ability of governments to exercise control of it, especially outside the territorial boundaries where government jurisdiction holds sway.

Countries face many obstacles when exercising their ability to compete abroad for more FDI. Some of these impediments include protectionism in foreign markets, inadequately trained employees, failures in international cooperation and lack of knowledge about international conditions. While those factors certainly influence trade and capital flows, issues dealing with competitiveness disregard the main engine of those flows. Negotiating foreign investment transactions is a painstaking process that can often fail even in the presence of the most favourable policies and institutions. Therefore the difference between failure and success often depends on the knowledge and the ability of the negotiators. If a nation is to become more competitive globally, a large section of its business community has to be skilful at international negotiations.

The Philippines has to move beyond its national boundaries and merge more into the global sphere of foreign investment. It needs to search worldwide for both large and small businesses, for customers, opportunities, suppliers, partners, for labour, for technological know-how and for sources of finance. While the Philippines is a reasonably sophisticated global player, it needs to recognise that globalisation has implemented new demands on business executives and their strategies; one of the most important is the ability to negotiate deals all over the world to get the best possible outcomes for their companies. They have to place emphasis on the differences in cultures, because making a deal in Mexico, for example, is quite different from doing the same in Syria. The Philippines needs to recognise that the move from a domestic environment to a global one is not an easy road to tread. Moreover, they need to recognise that every negotiation is special, and that each negotiation is affected by a number of different factors and in several ways.

From a politician's viewpoint, it appears that one of the greatest problems is that negotiators working for investment into the Philippines appear to be inadequate, and that the government should be looking at ways of improving the quality of the negotiators or people in the field promoting the Philippines (Congressman Padilla, 2004). However, De Ocampo (2004) believes that the smartest people in the Philippines have been doing the negotiations. De Ocampo (2004) iterates, however, that "successful negotiators are not as unbalanced as some people might think", arguing instead that the overall impressions, not only currently but throughout the years, are that many of the negotiators have kept the bargaining positions rather well. To some extent De Ocampo tosses the blame of any failure to maintain strong bargaining power back on the political leadership.

De Ocampo (2004) blames the Philippines' political leadership for not being able to negotiate more investments with foreign investors because as he says "politicians do not have the ability to demonstrate the negotiating skills to attract foreign investors". For example, De Ocampo (2004) points out that for a long time the Philippines had:

The Foreign Investment Act, and out of the misguided sense of nationalism this was a law passed by legislators keeping Foreign Investors from certain businesses. This came from the notion that the way to go is import substitution, and import substitution required protections of infant industries but this went on and on and on until a lot of infants were oldest infants in the universe.

In order to address negotiating issues, De Ocampo believes that the current government should follow the steps of former President Ramos by providing an environment where negotiators for the Philippines can do their job more effectively. Whereas present-day negotiators are hindered by the government's actions, the Ramos government provided an environment that allowed the natural advantages of the Philippines to be appreciated and combined with "a ridding of these obstacles which were artificially imposed by mistaken actions of nationalism or political priorities" (De Ocampo, 2004).

Aside from problems associated with negotiators is the perception that instability remains, added to which is the political situation in the Philippines; these factors have a negative impact on MNCs and could thereby lead to a trend of investors quitting the Philippines. De Ocampo (2004) argued that there were two things to contend with. Firstly, there is the Philippines' own internal environment, which, although not insurmountable, at present leaves much to be desired, because much of it has to do with a return to a focus in the competitive positioning of the Philippines as a major economic centrepiece rather than domestic political manoeuvring. This means a return to the policy to encourage growth zones, such as Subic and Clark Bases focussing on English, and on comparative advantage areas like the IT industry with a sense of policy consistency where the country does not end up with the Supreme Court getting in the way of economic decision-making (De Ocampo, 2004).

Secondly, to some extent needing an enlightened sense of strategy and consciousness on the country's part, policy makers need to look at making the country more attractive for investors. One of the main issues is the sheer magnet that China has become, not only in the Philippines but all over the world. A lot of companies may be leaving the Philippines not because they find it unattractive, but because China has become so compelling that it is clearly luring just about every manufacturing business worldwide, even from the USA, so that the textile industry in the US is folding up one big plant after another. Therefore the Philippines needs to be very aware of what this phenomenon is and start building a serious and well thought out plan as to what is its niche in the overall scheme of things is so that the country can properly identify where it has an edge and how long it could retain that edge (De Ocampo, 2004).

Secretary Gregory Domingo (2004) from the DTI argues that the business environment is really what counts more when talking about attracting FDI and in the case of the Philippines he stresses that:

we have many other advantages in terms of attracting investors because we are very westernised and we understand western cultures extremely well. We are unique in the sense that we understand both Western and Eastern culture. We understand western culture better than the Japanese do and better than a lot of

other places in Asia do, because we were under western influence for a long time. We also possess a very well educated labour force and we excel in many professions. In the last 15 yrs, the infrastructure of the Philippines has improved tremendously in terms of telecommunications, power, road and bridges, modern buildings, rail system within metro Manila, and shopping malls. So there has been huge improvement in infrastructure. But our biggest problem right now is really the perception. Unfortunately, that is number one on the list because the perception more than the reality in many countries is that Manila is more like a war zone.

So why is FDI important for the Philippines? And are the current entry requirements fair to all MNCs? Congressman Padilla (2004; Medina Arango, 2008) states that capital derived from FDI is important, but more attention should be given to asking foreigners to come to the Philippines to conduct their business. Padilla is convinced that there is enough capital in the Philippines but is not used effectively for business purposes because Filipinos consistently undermine the Philippines' capacity as a suitable business environment. Padilla argues that it is up to the Filipino people to show confidence and trust in their government and the climate to boost the Philippines economy, adding that "if the Filipinos themselves do not trust their government and do not trust the climate here, how can we expect foreigners to come" (Congressman Padilla, 2004).

Antonio from Nestlé Philippines emphasises that foreign direct investment is essential for the Philippines and that if the country did not receive enough foreign direct investment the pace of its economic development would be fairly slow (Antonio, 2004; Hanson, 2001), whilst University of the Philippines professor and economist Florian Alburo believes there are not enough savings in the country. He argues that FDI will bring economic and financial benefits, transfer of technology and managerial skills, all of which are very crucial to a developing country like the Philippines (Alburo, 2004). Whereas Padilla (2004) believes:

there are complaints of course that red tape in our government is very deplorable, that you need many signatures before one would be able to get a

license or authority to do business and it is one of the things that we, as well as the candidates for the Presidency are looking into.

Padilla (2004) also claims that laws not properly implemented prevent businesses from coming into the country. This is supported by Interviewee 1 from the AMCHAM who suggests that investors who try to compete with local companies are not welcomed in the Philippines.

What then have been the benefits for the Philippines from FDI? To answer this question, the Philippines benefits from FDI into the country in several ways. FDI contributes to the national development of the host country by providing finance, transferring technical skills, investing in infrastructure, creating jobs, improving macro and micro economic practices, creating competitive industries, providing skilled jobs and raising the living standards of the local population.

Then one has to ask, based on the above findings, does the Philippines have bargaining power when dealing with MNCs? And what can the Philippine government do to obtain some bargaining power over MNCs? De Ocampo believes that the Philippines is a democratic nation that has a highly educated English-speaking workforce with very competitive labour prices. Traditionally, the Philippines' number one bargaining power is its people, according to De Ocampo (2004) who stresses, "we have said that the strength of the Philippines are No. 1 its people. It's very hard to match the Philippines core, technically proficient, highly educated, and competitively priced labour force". Although some MNCs make the mistake of comparing basic costs to basic costs and can hire people from other countries at a lower cost, according to De Ocampo (2004) these MNCs:

need to include the fact that in these other countries they most probably have to hire for a longer period of time at higher levels of pay. They would have to go into intensive training program which are not inexpensive. And on top of this the other issues, like not following instructions and breaking down the machinery because they read it wrong.

De Ocampo (2004) also highlights that those who promote the Philippines need to get the message across that doing business in the Philippines is the attraction, and not just focus on the Philippines' ability in speaking English.

Furthermore, on the issue of corruption³⁶, Interviewee 1 (2004) advises that he does not see too much corruption, but "I've seen enough of it to know that it exists just about everywhere". He adds that the Philippines economy is a kind of dichotomy, where "you've got local companies that serve the domestic market and they are dominated by Philippines and Philippines Chinese owned companies that are making wide industrial product, food products, health care products, cosmetics". Moreover, Interviewee 1 (2004) emphasises that:

you have got this other part of the economy which has been growing since basically 1990 or 1992 which is an export orientated economy involved in electronic devices, which is 70 per cent of Philippines' exports. And now something new since about 1997-1998, is the IT enabled services industries which is called Call Centres and back office service centres. That's growing very fast ... this week I've seen 3 new entrants already, and I have more coming tomorrow.

Another reason, according to Interviewee 1, that American investors come into the Philippines is because it is a 'junkyard' for investors. This means that, as long as the foreign investor is not trying to compete with local companies, the Filipinos will bend every rule to allow entry and investment in any product the investor wants. However, if the intention of the investor is to compete with locals, then the Filipinos will find rules to refuse them. Interviewee 1 (2004) argues that this can be a positive on one hand and a hindrance on the other:

that means that anything is ok. You know you come in here you want to make fishing flies, you come in here you want to make plumbing fixtures. It's ok

³⁶ President Arroyo was quoted recently to say that corruption was no longer "a problem within the system, it may have become the system itself" (GMA News.TV, 2007. 'WB wants safeguards vs corruption in RP road project' Issue 20/11/2007, available from <http://www.gmanews.tv/story/69423/WB-wants-safeguards-vs-corruption-in-RP-road-project>, accessed on 15/11/2008)

every year the country comes up with what they call an Investment Plan which is drawn up in this building here with the NEDA. And that document has become less and less relevant. You have got an investor to do something here; we say 'come on in'. We will try and bend every rule to let them in as long as they do not compete with a Philippine company that is doing the same thing. They have an outfit here called the DOST, the Department of Science and Technology, that is a thinly disguised outfit to keep foreign investment out. What happens over there is if somebody comes to the BOI and wants to apply for the usual tax incentives, as you know these are things we can provide over here, we can provide up to 8 years tax holiday. If you want to apply for that tax holiday and you are making say packaging material. Your application goes straight away to the DOST to be evaluated to see if there are any Filipino company that are in that particular industry. And if there are then your chances are, your application's going to get rejected and what happens then is the DOST will frequently consult with Philippine companies and say, you know who is making this kind of packaging material here. No, but I think we should be, come to think of it you know. We were thinking about it now that you mention it. Oh ok in that case, stamp, application disapprove.

Considering the quote above, it is clear that this form of interference from the DOST is an impediment to the Philippines and contributes to a weakness in the country's bargaining power. This sort of reaction combined with other compounding issues can lead to foreign investors losing interest in pursuing the Philippines as a viable source for investment. For example, on the subject of why Australian investors were not keen on the Philippines, Interviewee 1 highlights that an investor goes where he is most welcome, and that a country that welcomes investment aims to provide the most suitable infrastructure, legal, political and economic incentives, incentives that the Philippines does not provide. Furthermore Interviewee 1 (2004) says:

you know how welcome foreign investment is here in the broad sense of the word right; you've got crappy roads, corruption, red tape, predatory congressmen, mayors and so forth. I really have no idea how much Australian investment there is here, probably not very much.

Whilst Alburo (2004) believes that the Philippines does have bargaining power, he argues that the Supreme Court's influence in business law can be an impediment that undermines Philippines potential in attracting FDI. The Supreme Court's decision on Fraport and Marcopper, Alburo argues, are setbacks for the Philippines in terms of signals to MNCs about extent of the law (Alburo 2004; Yap, 1999; Gopalakrishnan, 2008). There have been foreign investors who have had their contracts terminated because the law did not give provisions to promote and protect businesses. Stability and consistency in the law are very important in attracting FDI and, unless the Philippines improves on its consistency in implementing business laws, then its potential will continue to be undermined by the actions of its courts. Alburo believes that the Philippines does have enough bargaining power in some areas like telecommunications and services industry but lacks it in others like mining because of its antiquated laws (Alburo, 2004).

Alburo (2004) concurs that the provision of the law are really set and he argues that firstly, "you look at the original terms of the Fraport Agreement. I think it was well within the boundaries of existing BOT law. And in terms of tariff changes, pricing changes, or pricing of services I mean that is provided for in the, in law". Secondly, the problem there, at least from the point of view of government, was:

an intent to deceive in the sense that you know only after the contract had been approved, the projects have been approved they came back again and say we need to renegotiate. And once you renegotiate on many instances, depending on the magnitude of the renegotiation it does not go to higher levels of decision-making, so it goes to a technical committee. This would have the discretion to amend the contract (Alburo, 2004).

Thirdly, what happened in fact in the Fraport Case is they amended the contract, for example, to raise revenue and to raise tariffs for services. They amended the contract in terms of what kinds of control the foreign investor would have in the operations. So the perception was that "it was renegotiated, it was revised at the lower level without having to refer it to exterior levels" (Alburo, 2004). In some sense this might be a flaw in the law itself which needs to be reviewed. From the government's point of

view, Alburo states, “we caught them in this situation and therefore we have to correct it” (Alburo, 2004).

Does the government expect MNCs to contribute to economic development and in what way? Do MNCs have the best interests of the host country in mind when they apply for access to the Philippine market? Antonio believes that Nestlé’s staff has been committed to marketing the Philippines to other countries as an investment option. Nestlé has been allowed to form a partnership with Philippine industries or departments that promote economic development, and their success in the Philippines signals to foreign investors that investing in the Philippines is worthwhile.

On the other hand, the Philippines anti-colonial mentality impacts negatively on the process of attracting FDI into the country, as they believe that foreigners come into the country to exploit it. The aim of a foreign investor is to make profit, not necessarily to exploit locals. In today’s business environment it is very difficult for most companies to exploit host countries because of the fear of backlash in their own countries.

For example, Interviewee 1 (2004) explains that American companies are presently under a great deal of scrutiny from shareholders, the Justice Department and the SEC, but mostly from shareholders, who believe that if you screw up “in country A where you’re exploiting the poor workers of Bangladesh it’s going to end up costing you. The potential backfire back in your own market place is too risky to take a chance. And then there is a new thing called the Patriot Act which further tightens up the anti-foreign corrupt practices act”.

In the raw-materials industries, it could be foreseen that countries would continue to press foreign-owned enterprises for a repartitioning of the rewards and that the outcome would depend on the bargaining position of the two parties (Vernon, 1971:246). And according to Vernon:

One fundamental problem stems from the fact that [MNCs] have something to offer that host countries badly want and that the acceptance of these offerings

generates problems of overlapping jurisdictions, accompanied by a sense of loss of national control. Can remedies be suggested that might leave the multinational enterprise to perform its creative functions, accompanied by more tolerable levels of tension and by the needed sense among governments of more effective control? (1971:259).

Negotiations between foreign governments and MNCs are nothing new, of course; indeed they have been continuing almost uninterrupted since the 1920s. But during the 1960s and early 1970s, the negotiating issues changed from the familiar questions of taxes and other such benefits to the more vital issues of ownership and the prerogatives of management (Vernon, 1971:46-47).

4.5 Conclusion

Throughout this chapter an analysis of the advantages and disadvantages of the Philippines in attracting FDI to the country was made possible by the findings from a series of interviews undertaken from field studies in 2004 and 2006. It was clearly shown that the Philippines possess bargaining power, even though the country does not use this effectively. In trying to determine the bargaining advantages the country has, results of several interviews were analysed. Particular focus was given to former Finance Secretary Roberto De Ocampo's comments and arguments, particularly the strengths of the country's English language proficient workforce as a comparative advantage in sectors like the IT industry or the service industry such as in call centres, a view backed up by University of the Philippines academic Florian Alburo.

The analysis also looked at how the Philippines engage in negotiations with MNCs as it promotes the country as a worthy destination for FDI. In determining the potentials of the country as a viable destination, the issues of corruption and political risks were also discussed as both impinge on the country's ability to attract investors. The chapter also highlighted that the Philippines has shown tendencies to change its laws, which can at times send the wrong signals to investors. It was also stressed that MNCs needed to abide by the laws of the Philippines, particularly in sensitive industries such as infrastructure and mining.

The chapter highlighted the importance of the mining industry to the bargaining power of the Philippines; however it was also clear that this industry had suffered significantly as a result of government actions in blocking the entry of foreign mining companies as a response to the Marcopper Mine disaster. However, as will be indicated in the case studies in the next chapter, the Philippines has a rather mixed record with MNCs, particularly in most recent time with Fraport AG and Marcopper Mining Corporation. The Supreme Court's decisions on both these cases will be discussed in greater detail in the case studies to follow.

Chapter 5 Case Studies

5.1 Introduction

This section considers five case studies on the bargaining power between MNCs and the Philippine government. The case studies focus on a number of issues, including the benefits for the Philippines, the advantages that the country can provide, different aspects of corporate behaviour and the issues related to the bargaining power of the country. In the case of Fraport AG and Marcopper Mine, it is clear that in both cases the Philippine government was involved extensively in challenging the operations of both companies. In the process it is argued that Vernon's 'obsolescing bargain theory' was applicable to both cases. The Samsung case shows the workings of an MNC in the electronics industry situated in a PEZA ecozone.

Whilst a rather new entrant, Samsung shows a high level of involvement, innovation and production in this industry; however, there are issues in respect to employee relations. The Nestlé case is of a company that has been in operation in the Philippines since the 1960s and is highly rated and valued by the Philippine government as a major drawcard for other MNCs as well as for the company's high level of employment. However, Nestlé whilst a good corporate citizen, has had major issues with unions and labour strikes. Lastly, the PEZA case study is used to highlight the advantages for companies to operate within the PEZA ecozones to avail themselves of the many incentives that the government offers to investors. Companies have a choice of locating in either a public or private zone.³⁷ These case studies highlight the strengths and weaknesses of the bargaining power of the Philippines.

5.2 Case Study: Fraport AG

In the 1990s, like many other democracies, the Philippine government realised that the private sector was more efficient, had the capital, technology and the skills in

³⁷ An exception to this of course is mining companies who can only gain access to where the actual resources are positioned.

building, investing and managing infrastructure. For the Philippines to obtain the infrastructure it needed, or to improve on existing infrastructure, the role of the private sector evidently became fairly crucial. As a result, the BOT law was enacted to allow private companies to invest in infrastructure projects using their own initiatives and transfer the projects to the state at an agreed date. During the operations the contractor may charge fees to recoup its investment, and to gain some returns from its investments.

The Philippines, as mentioned earlier, is a continually developing country (CDC) that offers many investment opportunities to foreign investors. It can, however, be argued that the country does not maximise its bargaining power when negotiating contracts with MNCs, and as a result decisions taken by the government constrain the Philippines' ability to attract FDI. Drawing on fieldwork interviews and other research material, this case study discusses the Fraport case, which involved an investment dispute between the multinational company, Fraport AG, and the Philippine government on allegations of breach of contract, fraud and corruption by company representatives and past government officials. The Fraport case demonstrates how a government can take over a company, whether owned by domestic or foreign investors, if it perceives there has been sufficient misconduct or if illegal terms have been drafted by parties to the contract when negotiating a contract. The expropriation of the Fraport built NAIA-3 terminal by the current Philippine government outlines the implications for the Philippines in terms of attracting future FDI that it needs to boost its economic development, and shows clear links with Vernon's obsolescing bargaining theory. Additionally, the case examines the Philippine government's responses and actions, its bargaining power and legal outcomes of the Fraport dispute.

The Ramos and the Estrada governments' plan was to build a new international airport passenger terminal, as the current NAIA IPT 1 had exceeded its maximum capacity of 7,000,000 passengers per annum, and replace it with the NAIA IPT 3 (Ninoy Aquino International Airport Terminal), which would have the capacity to handle 13,000,000 passengers per year (Asian Development Bank, 1998).

Fraport AG is a German-owned MNC specialising in airport services. In 1997 the company entered into a contract under the Philippines Build-Operate and Transfer Scheme (1994) with its Philippine partner, the Philippine International Air Terminals Company (Piatco), which would give Fraport a 30 per cent stake in the venture. Fraport AG and Piatco won the contract to build-operate and transfer (BOT) International Passenger Terminal (NAIA-3), with the agreement that, after a period of 25 years of operation the facility was to transfer to the Philippine government.

Under such a scheme, only the government could change the terms and conditions of the contract after renegotiating with the private contractor. Among the various legal disputes surrounding the Fraport project, was an ongoing dispute before the terminal was completed between the Philippine government and Fraport and the main contractor Piatco over violation of the BOT concession agreement, anti-dummy laws, allegations of bribery and fraud and technical faults in the terminal.

Fraport invested in Philippine infrastructure, expecting the Philippines to uphold the promotion and reciprocal protection of the investment agreement of 1997 (Palacio, 2006:2). However, the Philippine government claimed that Fraport 'made its investment in violation of the laws of the Philippines, in particular foreign ownership and control legislation known as the 'Anti-Dummy Law' (Palacio, 2006:2). According to Villanueva (2005), Fraport decided to flex its diplomatic muscle in pressing for immediate compensation from the Philippine government for their investment in the NAIA-3 project, under the terms of the 1997 Philippine-German bilateral investment treaty.

The Philippine government sought a court order from the Supreme Court to expropriate the terminal. Fraport and Piatco, however, took legal action on two occasions before the international arbitration courts in Singapore/Paris and Washington for compensation against the Philippine government. Fraport maintained that the government takeover of the terminal and the cancelling of the contract were both illegal. The government, on the other hand, claimed that the terminal was a public utility and, according to the Philippine law on public utilities (the anti-dummy law); foreigners are forbidden from exercising any management decisions on a public utility company.

Grudgings (2006) states that the Fraport dispute “has been the most high profile example of the perils faced by foreign investors doing business in the corruption-prone country”. Fraport also claimed that the Philippine government’s actions were blatant violations of the law, and the government’s action was criticised as another symbol of government inefficiency and paralysis. Nevertheless, senior government officials consulted extensively with local and foreign investors before taking the move and emphasised that the government would provide the consortium “just and fair compensation.” The foreign business community concurred and were pleased with the move and certainly hopeful that these developments would send a clear and positive signal to potential investors (Chikiamco, 2003).

An article by Quemado in *Cargo News Asia* on June 17 2002 states that Piatco’s spokesman and official corporate representative to the legislative investigation proceedings Attorney Moises Tolentino accused a former consultant of Fraport AG of lying before the Philippines’ Commission Appointments deliberation. The article added that the former consultant claimed that he was aware of the alleged bribery made by Piatco to the then “Department of Transportation and Communications Secretary to obtain additional concessions for the NAIA3 construction contract”. The article claimed that “Arroyo’s presidential adviser was of the view that the allegations had some substance” (Quemado, 2002).

In 2002, Fraport AG’s executive board was optimistic about negotiations with the Philippine government in transferring the terminal to the Philippine government, but refused to fund Piatco until an acceptable solution was achieved (Fraport, 2002). The perception was that business contracts were being bypassed and reversed by higher courts, which could have intimidated the business community. However, there are other underlying factors which needed to be taken into consideration when establishing why the Supreme Court decided to rescind a contract.

Originally the terminal was to be opened in late 2002; however, the Supreme Court cancelled the contract in May 2002 after the current government declared the contract null and void. The court ruled in favour of the government by ruling that the deal signed in 1997 by the Estrada government was illegal and fraught with irregularities.

MNCs who invest in a foreign country expect a host government to honour its end of the bargain and allow the companies to carry out their business operations without uncertainties or unfavourable court orders.

When a government changes office, the new government in power can try to renegotiate contract terms with a company. The Arroyo government halted its bid to purchase shares owned by Fraport after the administrative committee set up to investigate and evaluate the terms of the contract discovered many faults and loopholes. This included the substantial amendment of the contract to guarantee that the Philippine government assured that it would fulfil Piatco's obligations to its creditors and contractors, knowing full well that the BOT laws disallow the granting of sovereign guarantee. Fraport as a foreign investor could only claim up to 40 per cent of shares, although it had purchased other shares owned in Piatco to raise its shares to 61.44 per cent, which was a clear violation of the anti-dummy law. The Supreme Court ruled that the BOT contract was null and void because the 1997 concession agreement was illegal and therefore contrary to public policy.

As a result, the current Philippine President Gloria Arroyo ordered the contract to be transferred to the government, as some of the terms had been illegally renegotiated with the past government. Following the decision of President Arroyo to void the Piatco contract, which was subsequently upheld by the Supreme Court, Fraport sued the Philippine government before the International Centre for Settlement of Investment Disputes (ICSID) in Washington DC (Villanueva, 2005). A separate case was also filed by Piatco and Fraport before the International Chamber of Commerce (ICC) in Singapore (Villanueva, 2005).

Despite the World Bank dismissing Fraport's move to seek compensation, the company's Chief Executive, Wilhelm Bender, still seeks over \$400 million in compensation from the Philippine government for expropriating a terminal project at the Manila airport (Sheahan, 2007). It is Fraport's contention that the Philippine government's decision to expropriate and its refusal to pay adequate compensation to shareholders was unjust and in breach of the bilateral investment agreement signed in 1997. The Philippine government promised to pay compensation after a lengthy period of negotiations, but not the amount requested by the companies. However, the

damage has been done to the Philippines' image in not honouring business contracts with foreign companies, as Japanese investors in the Philippines stated in an article in *The Manila Times*. Egawa noted that, "because of the court ruling on the project, the Philippines might gain the image of not honouring business contracts with foreign companies" (Egawa, 2004).

Whilst Fraport AG claimed the takeover was illegal, the government counterclaimed that the takeover was legal under Philippine law. A statement issued by Fraport representatives declared that "Fraport considers the actions of the Philippine government as a further flagrant breach of the law" (Vanzi, 2004). The government's response was praised by President Arroyo's spokesman, Ignacio Bunye, who stated that, "[t]he constitutional move of the government can only signal better public service and convenience and greater business confidence" (cited in Vanzi, 2004).

The Philippine government paid \$53.57 million as a down payment to Piatco, which Fraport rejected as insufficient. The Philippine government, wanted to pay some compensation to Fraport and Piatco, and maintained that the amount claimed by Fraport, in the words of Senator M. Roxas, Chairman of the Senate Committees on Trade and Commerce and on Economic Affairs, "[was] excessive, inflated and grossly disadvantageous to the government and the taxpaying public" (cited in Vanzi, 2004).

Whilst the relationship between MNCs and host governments can be mutually beneficial, there have been incidences where business relations have broken down and ended up in litigation because an investor has either broken a law or the government attempted to renegotiate a contract so that it could have more bargaining power. Some have argued that the delay in arbitration and settlement of the dispute could have potentially damaged the Philippines' international reputation with MNCs and reflected negatively on the Philippines' ability to attract foreign direct investment.

The greatest implication for the Philippines in regard to Fraport is that future investors will take note of the outcome of the case and may not be as keen to invest in the Philippines. For a country that could do well with a great flow of FDI, it is essential that the Philippines finds a way of receiving the FDI that it needs.

Alburo (2004) argues that, “in the Fraport case, the feeling of the government was that it was short changed in the contract and, in one sense the government believes that the contracts were revised so many times in favour of the private contractor even if it was a BOT scheme”. Furthermore, Alburo (2004) contends that there was evidence, at least according to the government, that, in fact, there had been corruption in the process of this contract variation, or contract renegotiation. Thus, one has to balance the perception by the private sector that there is a lot of uncertainty in the country as opposed to the view of the government. Alburo further emphasised that “we want to clean up the place, but we also want to give a signal you can’t mess up with us to benefit the private sector so, those are the two views” (Alburo, 2004).

When a foreign company invests into a country, it enters into a business partnership with a host government with the belief that responsibilities and rewards will be equally shared by both the government and the investor. This can be compared with government, which when there are irregularities with the way the investment is conducted, will prosecute the company.

Fraport brought the Philippines before the World Bank’s International Centre for Settlement of Investment Disputes (ICSID). The government claimed that there were also technical concerns with the terminal following the collapse of about 100m of the ceiling. To solve the dispute, the Philippines offered to get three independent and reputable foreign engineering appraisers to evaluate how much the terminal was worth and that the government would meet the midpoint of the three estimates, but Piatco declined the offer. A Senate Minority leader, Aquilino Pimentel Jr., has commented that the government takeover is justified only when the project investors are paid their due compensation. He questions whether the government’s response is the correct path to be taken, stating the “government’s takeover of NAIA-3, if it is meant to run the terminal, is a good preliminary move. But will investors be paid what is due to them? Is expropriation the proper remedy?” (cited in Vanzi, 2004).

So far Fraport and Piatco have made compensation claims on the Philippine government and have taken the government to two international arbitration bodies. On both accounts Fraport was unsuccessful in winning the compensation claims. What is important in this case is that, according to Rimando (2007):

ICSID's decision is already final. Fraport can file a separate claim or have this current decision annulled if it could prove that there was fraud in the execution of the decision. But Philippine government lawyers say this is unlikely since it is difficult to reverse an ICSID decision, which was made by three arbitrators, two of whom (a Spanish and American) were each nominated by Fraport and the Philippine government. The third arbitrator, a Canadian, was chosen by both parties.

Alburo emphasised this point clearly: "I think the provisions of the law are really set and if you look at the original terms of the Fraport Agreement. I think it was well within the boundaries of existing BOT law" (Alburo, 2004). Furthermore, Alburo (2004) contended that:

in terms of tariff changes, pricing changes, or pricing of services that are provided for in the, well within the boundaries of the law. The problem there at least from the point of view of government was that there was an intent to deceive, in the sense that only after the contract have been approved, the projects have been approved they came back again and say we need to renegotiate. Furthermore, another problem there is that once you renegotiate on many instances, depending on the magnitude of the renegotiation it does not go to higher levels of decision-making, so it goes to a technical committee, which would have the discretion to amend the contract.

What happened in fact in the Fraport Case, argues Alburo (2004), is that:

they amended the contract for example, to raise revenue, to raise tariffs for services. They amended the contracts in terms of what kinds of control the foreign investor would have in their operations. So the perception was that, it was renegotiated; it was revised at the lower level without having to refer it to exterior levels.

According to Alburo, in some sense it might be a flaw in the law itself and that, “one would have to review that in the government’s point of view it is that we caught them, in this situation and therefore we have to correct it” (Alburo, 2004).

The Fraport case proves Vernon’s (1971) hypothesis that investors have the greatest bargaining power before the investment comes to fruition; however afterwards it is the host government that retains more bargaining power and can easily subject an investor to practices perceived as unfair or business unfriendly by the MNCs. Fraport believed that its involvement in the Philippines was protected under the German Philippines Investment Guarantee Treaty and that concession agreements were in no way breaking Philippine law. If a company breaks host government laws, it is not protected by any other law. When Piatco offered to buy Fraport’s shares to take full control of the terminal, it violated BOT law, which clearly stated that there cannot be a monopoly on services. The implications are that the Philippine’s decision in not fully compensating Fraport could result in other investors not wanting to invest in the Philippines for fear the government could expropriate their assets anytime it wished to do so. The Fraport case could potentially impair Philippine’s international reputation as an investment environment.

On February 26, 2003, President Arroyo issued Administrative Order (75), which allowed a cabinet committee to oversee the NAIA-3 in June 25, 2003. When news broke that the German firm Fraport complained to the World Bank that it was being allegedly shaken down by the personal lawyer of President Arroyo, it was not at all surprising to jaded observers of the Philippine political scene. Some even went further, arguing that “this extortion culture extends from the low to the high levels of government. The term ‘kotong cops’ accurately reflects the public perception of our beloved members of the police force. Instead of ‘to serve and protect’, which is the slogan of the police force, it’s more like ‘to extort and collect’” (Chikiamco, 2003). The extortion culture is accepted by the public as being the norm in Philippine politics, and is really a reflection of two things: one is the prevalence of ‘rent-seeking’ in its society; and the other is the weakness of the state. Rent-seeking is the non-market extraction of surplus. True capitalists make their profit from the market. They create value, whether in manufacturing, trading and distribution, and then extract profit from the value they created in the marketplace. Rent-seeking capitalists, on the

other hand, do not create value at all, but extract a profit nonetheless from the existing wealth in society (Chikiamco, 2003).

The weakness of the state, however, exacerbates the problem. The state has been so captivated by the rent-seekers that there is no one in government that a business can turn to for help. Extortion exists in all societies, but when government itself becomes the problem, as was the problem for Fraport, then the political culture becomes severely dysfunctional. Take note that Fraport did not even bother to seek redress in Philippine courts (who would, when the lawyer could predict the High Court's future resolutions?), but instead ran to the World Bank (Chikiamco, 2003). This phenomenon of a weak state being used and trampled on by powerful rent-seekers to accumulate profits for private ends is what the political scientist Paul Hutchcroft calls 'booty capitalism' (Chikiamco, 2003).

Vernon (1995) best sums up the problems that many MNCs and host governments face, arguing that:

when agreements that clarify the rights and obligations of multinational enterprises are involved, I think the answer is clear, in an anarchic world in which multinationals' basic dilemmas remain unresolved, the resources of the multinationals can easily become the prize over which sovereign states struggle. That is a risk which the multinational enterprises and governments have a major stake in avoiding. If peace can only be achieved through self-denying ordinances and co-operative actions by governments, it is a price easily worth paying.

According to an article in the *Philippine Daily Inquirer*, the bottom line in the controversial NAIA Terminal 3 dispute is 'renegotiation'. The article went on to quote the Justice Secretary, Hernando Perez, who emphasised that "GMA (President Arroyo) has final say on fate of Piatco deal" (Perez, 2002). Perez, who was responding to questions regarding the government's actions, was the chair of a seven-member committee tasked to review the contract awarded to Piatco. Perez stressed that the final word on the contract was for "renegotiation" and not "for cancellation, not for takeover" (Perez, 2002). He noted that his committee had been tasked not just

to review the Piatco contract but also to renegotiate it, and, as he pointed out, that “yes [we should negotiate] because I want the business sector to understand that the government is here not to oppress the business sector but to assist (it)” (Perez, 2002).

When analysing the outcomes in the Fraport dispute in terms of identifying whether the host government or the MNC has more negotiating power, one thing that is clear is that there are no laws to stop a host government from wanting to renegotiate a deal if it sees the contract with an MNC as disadvantageous to the government. However, this is subject to a requirement to pay compensation. Although “a consortium led by Fraport had won the bidding for the right to construct and operate a new passenger terminal at NAIA”, when the Arroyo administration realised that the contract negotiated under the Estrada government disadvantaged the government, Fraport was taken to the Philippines’ Supreme Court in which the court established that the contract was illegal and disadvantageous to the Philippines. As a result, the contract was nullified (Californiaaviation, 2005).

In today’s business environment, the relationship between an MNC and a host government is governed by either direct bilateral bargaining or multilateral institutions. Ideally both government and MNC are aware that the rules affecting FDI can be both bilateral and multilateral. Bargaining power stipulates that an investor has maximum bargaining power before it invests. This is because the government desperately needs access to capital and technology. However, when the deal is struck and the investment project is under way, the MNC’s bargaining power declines, and this makes companies vulnerable to unfavourable decisions resulting from a government’s attempt in trying to serve certain interest groups, renegotiate terms of the contract or expropriate.

This case study raises a number of issues with regard to the relative bargaining power of the two parties. It shows that bargaining power is a complex and dynamic process. At the end of the day, however, the government has the ability to make laws that MNCs will never have. This means that, under their domestic laws, they have the ability to renegotiate and alter contracts and agreements, and to do so lawfully. This power, however, can be a two-edged sword, as the governments who use it without sufficient merit or foundation may be considered too much of an uncertainty for other

companies, and may therefore have difficulties attracting FDI and attention from MNCs. The experience with Fraport also highlights that MNCs are not laws unto themselves, and there remains an obligation and duty to continually follow the laws of the host government.

5.3 Case Study: Samsung Electronics Philippines (SEPhil)

This case study looks at a more recent entry to a PEZA Zone: a company operating in Calamba, Laguna as Samsung Electronics Philippines Manufacturing Corporation (SEPhil). It looks at the relevant bargaining power of SEPhil and the Philippine government, focussing on the company's manufacturing capacity and quality as well as the importance of its exports to the Philippine economy. Furthermore, issues of workers' rights and access to unions are explained to show the shortfall in the company's activities towards employees. Prior to expanding on the company, it is interesting to read management's philosophy, which emphasises that, "we will devote our human resources and technology to create superior products and services, thereby contributing to a better global society. One with customers. Challenging the world. Creating the future" (Samsung Corporate Profile, 2006). Interestingly, whilst the use of human resources forms part of this Mission Statement, it certainly does not operate fully within the framework of the Philippines' Labour Laws and employees' rights to union membership.

The company operates in a total factory area of 17,520 square metres on a total land area of 70,400 square metres. The nature of its business is the design, manufacture and wholesale of electronic products. The company was incorporated on January 12, 2001 and started commercial operations on November 5, 2001 with an initial capitalisation of US\$20 million for a product line of DVD, CD Rom and Read-Write discs. As of 2004 the corporation employs 749 people at its Calamba plant. The human resources manager, Jonjie Ilagan, and another staff member (Interviewee 2) were interviewed and gave an account of their views of the MNC.

Although a new entrant, Samsung is doing very well in manufacturing and selling electronics and semiconductors in the Philippines' market as well as overseas. The

incoming president of Samsung Electronics Philippines Corporation stated that, “we are number two in the market, but [we are] in a very concrete number two position. Perhaps we will attain market leadership in a few years” (Hyuk Jae Shim, 2005). Calimag (2002) reported that Samsung electronics allocated US\$200 million accumulated from its mobile phone business in 2001 in an additional investment to expand its semiconductor plant in the industrial park south of Metro Manila. The additional funds would be used to produce Optical Disc Drives (ODDS) and LCD panels. Samsung’s plant in Carmelray II industrial zone was opened in October 2001 with a capacity to produce 10 million units of ODDs per year that will be exported to Korea, Japan and the US to be sold to other IT giants.

Samsung’s four strategic business areas include Digital Media Network, Device Solution Network, Telecommunications Network and Digital Appliance Division. When Samsung Electronics Philippines was set up, Sang Youl Eom was its CEO. Calimag describes the company thus: “a powerhouse in the semiconductor industry, Samsung Electronics is the world’s dominant producer of DRAM (Dynamic Random Access Memory) chips, VCRs, and digital television sets” (Calimag, 2002). SEPhil is basically considered as an overseas subsidiary/division whose headquarters, or parent company Samsung, is located in the Republic of Korea. Samsung Electronics caters mostly to the consumer of electronics and household appliances and is closely linked to Samsung’s Optical Media Solution Division (OMS), which involves such new technology as developing media storage.

Samsung Electronics in Calamba, Laguna is a registered operator with PEZA. The senior management is composed mostly of Koreans and the company is 100 per cent owned by Samsung Korea. The company now has two manufacturing plants in the Philippines, SEMPHIL and SEPhil, located in Laguna, and provides employment to 4000 workers (Sino Cruz, 2004). Under PEZA arrangements, there has to be an understudy, because corporations have to declare a certain set of offices for the company. The government stipulates that there must be two Philippine nationals to understudy key senior management positions in the company, because ultimately even the government supports the idea of localising some key position. Ilagan states that: “there has to be like a good transfer of knowledge from senior management to the local Filipino staff” (Ilagan, 2004). To build good relations with employees, the

Human Resource group have been proactive in its employee development by providing an employee relations program. Samsung employs 66,000 people in 45 countries. In 2001, the company had a net income of \$4.8 billion from its global revenues of \$33.4 billion and allocates 5 per cent of its earnings in research and development (Calimag, 2002). However, the company's employee relations are not consistent, particularly in the Philippines as is discussed below.

All MNCs operating in the Philippines and situated in a PEZA zone obtain the rights to manufacture any type of product line that they desire. In the case of Samsung Electronics, particularly in Laguna, the company's operations, as part of its OMS division, consists of the manufacturing of CD ROMs, CD RWs, computer peripherals etc., where 90-95 per cent is for exports and 5-10 per cent aimed at local consumption. The company finds that, in comparison to companies that do not operate within a PEZA zone, they are very satisfied with the infrastructure that has been made available for their operations. The high standard of PEZA locations is advantageous to corporations, and the fact that PEZA focuses on locating companies that are very successful make it worthwhile to operate within the export zone (Samsung Corporate Profile, 2006).

The Philippines encourages companies in the IT industry to set up their production in PEZA zones. Samsung Electronics receives incentives under the PEZA incentive schemes and does not receive any incentives from the BOI. Under PEZA the corporation receives an income tax holiday as a non-pioneer firm, which is standard for companies setting up a manufacturing plant (Samsung Corporate Profile, 2006).

To be considered a pioneer status firm, a company must be the first to manufacture a given product line in the Philippines. Samsung has non-pioneer status, and whilst it has several products, for example, CD ROMs, CD RWs, that qualify it for pioneer status, it has chosen not to submit an application for such status. The company is financed primarily by its parent company; however it relies on local banks for many of its financial needs. All MNCs that set up under PEZA region have the right to innovate and manufacture any product they wish, but they must export up to 90 per cent of their production with only 5-20 per cent for local consumption (Samsung Corporate Profile, 2006).

According to Ilagan, companies register with PEZA because of the incentives that it offers in the form of high standard infrastructure services and a tax holiday. Ilagan (2004) explained that:

in comparison with other companies not under PEZA we have high standards, because being under PEZA; there are a lot of advantages for the companies like Samsung in such a way that PEZA are able to line up all of these infrastructure services to companies. It's actually one of the turn-ons for companies to be registered under PEZA aside from the tax holidays.

Issues of the comparative bargaining power of the government and MNCs are raised with regard to the cost and skill of the country's labour force. With a sound workforce and a readily available and skilful labour force, there were obvious gaps shown in respect to the treatment of employees at the Calamba plant. The Philippines needs to address its labour costs and labour unrest because MNCs are starting to look more to China because it provides cheaper, more competitive labour prices. The Philippines could, however, counter-claim by stating that its workforce is more educated and skilful. For example, Samsung designs its own training needs analysis, an annual training calendar that looks at the whole organisation in terms of individual training needs that is designed to measure the level of staff competency. Training programs in line with Samsung's vision concentrate on the Filipino staff and are directed by the Koreans who are mostly in the top management positions.

There are several company initiatives and statutory allowances that benefit employees. For example, by Philippine labour standards days of paid leave in the Philippines are set out at five days a year, but Samsung allows twelve days a year, and this benefit is actually convertible to cash should employees not be able to use it (Ilagan, 2004). Ilagan also emphasised that "aside from that, the company also give out other leaves mandated by the government, such as 7 days paternity leave. There are also other benefits such as insurances, social security system, and meal subsidy allowance of 30 pesos per day" (Ilagan, 2004). As Ilagan points out, there is also transportation for children, and employees are shuttled to and from pick up points; in addition, "they of course get a uniform. Each employee is given a health card for

hospitalisation, and out-patient check up they need”. As well as performance incentive bonuses, “as employees of Samsung we get to avail of our Samsung products. We get to buy our, patronise our own products at much lower rates directly from our sales and marketing departments, at around 20 per cent - 30 per cent less than market price” (Ilagan, 2004).

Whilst this is all appealing to some employees, the overall issue here is that Samsung, like many other companies in Economic Zones, fails to abide by Philippine labour laws. Samsung sets and follows strict rules and demands a lot from its staff. A Samsung employee (Interviewee 2, 2004) explains the process an employee of Samsung has to undergo:

Upon entering Samsung you would be on probation for a six month period. If ever you pass evaluation upon reaching 6 months you will be on regular status and then if ever you fail in the first evaluation you’ll be given a certain time to improve your performance. The performance analysis consists of your knowledge of your work, your output, the quantity and quality of output, your leadership for managers, leadership style, how you communicate with your subordinates. If a person does not perform, or if the person fails all the standards of the company, their services will be terminated by their immediate supervisor who rates them. Probationary employment period in SEPhil is the first six months of employment in which opportunity is given for the employee to demonstrate his or her fitness for the position. A performance evaluation will be conducted at the fourth month to decide whether the employee will be regularised on the sixth month. Unlike Nestlé, what is interesting about Samsung is that it does not have Union bodies which represent the workers.

Kelly explains that “the 1987 Philippine Constitution guarantees some fundamental labour rights. These include the right to form and join unions; to bargain collectively with managers. And under specific conditions engage in strike actions” (Jurado and Sanchez, 1998, cited in Kelly, 2001:8). However, various pieces of legislation,

including the 1974 Labour Code³⁸ and subsequent Acts and Amendments, administered by the Department of Labour and Employment (DOLE), enshrine the rights of workers in fairly liberal terms. There are still a lot of threats made by employers that do not permit workers their basic right to union membership. Within the SEPhil case this is certainly so. The word 'Union' seemed to be a no-go zone when some of the employees were asked if they were union members. One employee replied rather angrily "there are no unions allowed" (Interviewee 2, 2004).

The early years of the Aquino government saw some flourishing of labour organisations after the relaxation of regulations set down during the Marcos era. However, entering the 1990s, the Philippines had a relatively liberal legislative framework for labour regulation, although one that imposed some restrictions on the freedom of movement of labour organisations. (Kelly, 2001:9). And here, perhaps, the question of the Samsung case is answered by Kelly:

perhaps more important than the explicit labour regulation during the 1990s, however, was a concerted push toward a globalised development strategy based on attracting FDI in export manufacturing sectors. The two key agencies in this drive ... [being] the BOI and PEZA ... [both] do not have an explicit mandate to regulate labour, but as a key factor of production for foreign investors, labour issues inevitably enter their range of activities. This happens in several ways. First, in promoting the Philippines as an investment destination, the 'attractions' of the Filipino work force are central to the discourse promulgated by these agencies ... Moreover, despite the legislative space for union organisation ... there exists a de facto union-free policy in most economic zones, a situation that PEZA cannot formally endorse and facilitate, but it does prove useful in selling Philippine locations to foreign investors (2001:10).

It has been shown within this case study that companies that are successfully established in the Philippines such as Samsung have more bargaining power than the

³⁸ The Philippine Constitution and Labour Code of the Philippines provide the basic framework for workers' rights.

government because the Philippine government is backed into a corner because it needs access to ready capital, technology and expertise but finds it difficult to attract foreign investors; furthermore, Samsung's export market contributes fairly well to the Philippines' economy. However, Samsung's attitudes towards Philippine labour laws indicate that it has a high level of bargaining power compared with the government, and it does not see itself bound by the national laws. However, the government is still the legislator and this should lend more support to its own bargaining power.

5.4 Case Study: Nestlé Philippines

This case study provides a brief background of Nestlé in the Philippines, highlighting the benefits for the Philippines, advantages of location, corporate behaviour and bargaining power of the company. Information in the case study is based on an interview conducted in 2004 and other information gathered from Nestlé brochures and electronic sources. The case study highlights the importance of Nestlé's operations in the Philippines and that the government will ensure such a company is well catered for to ensure it remains in the Philippines.

Nestlé is important to the Philippines for the mere fact of its size and strength and the lengthy period it has been operating in the Philippines; it is now very much a part of corporate Philippines. Nestlé Philippines Incorporation is a wholly owned subsidiary of Nestlé Switzerland and is locally incorporated in the Philippines. The owner or the shareholder is Nestlé SA and "we are a wholly owned subsidiary of Nestlé Switzerland" (Antonio, 2004). Nestlé specialises in foods and beverages, manufacturing in several countries, and it is the largest food company in the world. Nestlé Philippines Inc. is also the Philippines' largest market for the country's coffee and therefore is an authority on the nature of the coffee market (Nuguid-Anden, 2003).

Nestlé's operations in the Philippines began when a joint venture (JV) was formed in 1960 between San Miguel and Nestlé to set up the first local factory of Nestlé in the Philippines. The JV was undertaken in an environment of mutual respect, trust and cooperation between the two JV partners and was very profitable for both. Through

the JV partnership, one factory blossomed into five factories. In 1998, 45 per cent of the shares owned by San Miguel were transferred to Nestlé Switzerland and Nestlé Philippines and as a result 100 percent of the shares in Nestlé Philippines are now owned by Nestlé SA Corporation.

In the early 1960s, importation was very much restricted and was subject to quotas by the Philippine government. However, even before the turn of the century, Nestlé products were already being imported. And then in the 1960s, the government decided there can only be so much that can be imported. Therefore this paved the way for the creation of the joint venture; in other words there was going to be a local factory in operation in the Philippines (Antonio 2004). When the JV was formed in 1960, there was a limitation on what foreign companies could own in a local corporation. At the time conditions on local ownership were managed by the BOI who regulated the ownership laws. In other words it had to be a 60/40 split for the manufacturing operation. As the country geared towards liberalisation, the government slowly lifted these restrictions on limitations of ownership on manufacturing. These limits were completely removed in the early 1990s when companies could then own up to 100 per cent of businesses; however, companies are still subject to certain exceptions, as there are still businesses that are either nationalised, meaning they require 100 per cent Filipino ownership, or they limit foreign ownership to 30 or 40 per cent. But Nestlé's manufacturing business is not covered by these restrictions (Antonio, 2004).

The Philippines economy has benefited from Nestlé's investment and operations in the country in many ways. The success of Nestlé's branch in the Philippines has demonstrated to other foreign investors and multinational companies that, despite political instabilities, the Philippines offers an environment where business thrives. Potential foreign investors often use Nestlé as a case study to determine if they will likewise succeed in the Philippines.

There are a number of benefits to the Philippine government that arise from its association with Nestlé. Nestlé provides foods and beverages to the population of the Philippines; it provides jobs, allows transfer of skills to the Philippines and exports products manufactured in the Philippines thereby contributing annual taxation revenue. In addition to these benefits, it also gives a positive perception of the

Philippines that is productive as opposed to the negative perception of the Philippines that foreigners often have. Nestlé contributes to the Philippines economy by undertaking development projects in consensus with local and national government. Nuguid-Anden (2003) points out that:

Nestlé's approach of working with government agencies and Local Government Units (LGUs), especially in its coffee development projects, enabled it to ride on the capabilities of local governments to convene and spur community action. This strategy allowed the company to replicate its strategies quickly, without disregarding unique local conditions, and do comparative assessment of results.

Nestlé is involved in community development projects to assist in the development of the local population. In comparison to other companies, Nestlé takes its social corporate responsibility seriously and has demonstrated its commitment to preserve and manage the environment in all its manufacturing practices in the Philippines. According to the Asian Institute of Management, (2005), through its Environmental Protection Programs, Nestlé has been able to achieve 53 per cent reduction of water use, 12 per cent in energy consumption, 31 per cent in unrecoverable solid waste and 25 per cent reduction in packaging waste, saving Php700 million in packaging costs alone. The article published by the Asian Institute of Management on July 14, 2005 states that the PBEC Environmental Award awarded to Nestlé Philippines demonstrates Nestlé's outstanding corporate responsibility practices in the business area. The Asian Institute of Management (2005) notes that:

Nestlé's total Environmental Protection Program's Conservation benefits, its efficient use of technology, and clear managerial innovation. [The award] is a tribute to Nestlé's socially responsible manufacturing practices and incorporation of environmental principles in each business area, The PBEC Environmental Award is the second International award that Nestlé Philippines has received for its outstanding corporate responsibility practices.

Nestlé has performed well in maintaining a well-rounded corporate social responsibility standard. Nestlé's involvement in the community is quite evident. For

example, Nestlé's commitment in playing a key part in the Philippines' development is evident in its involvement in many development projects. In 1999, Nestlé formed a partnership with the Department of Trade and Industry (DTI) in Quezon Province and the Department of Agrarian Reform (DAR) to give coffee farming a boost in Quezon. Nestlé committed to support a program known as the Agrarian Reform Communities (ARCs) by providing technical assistance (Nuguid-Anden, 2003).

Nestlé has been praised for adopting cleaner production approaches in the food and beverages industry. Cleaner production is a sustainable development strategic management initiative in the food industry that allows the industry to develop and meet changing demands while minimising the risk to the environment and the cost of environmental protection to the company. Nestlé also has an impressive commitment to environmental issues as shown by the quality of its corporate environmental report.

The DTI serves as the primary co-ordinating, promoting and facilitating arm for trade, industry and investment activities of the Philippine government. It acts as the catalyst for intensified private sector activity to accelerate and sustain economic growth. The agency has regional and provincial offices all over the country. The enactment of the Comprehensive Agrarian Reform Program (CARP) law in 1988 created a major shift in farming practices in the Philippines. The feudalistic relationship between landowners and tillers in the country was dismantled and the tillers themselves became landowners. The Department of Agrarian Reform (DAR) is the principal agency responsible for implementing the CARP. Specifically it is tasked to improve land tenure through better access to the land and its fruits. It acts also to enhance the welfare and promote the development of agrarian reform beneficiaries through the co-ordinated delivery of essential support services.

Nestlé is the largest food and beverage company in the world. Nestlé Philippines holds the same distinction in that country. The company takes pride in its commitment to environmentally sound business practices as embodied in its policy on environment. It also supports sustainable farming practices that satisfy long-term economic, ecological and social requirements. The company does not engage in commercial farming activities. It sources its agricultural raw materials – primarily

sugar, vegetable oils and coffee – either through trade channels or directly from local producers.

Nestlé is committed to improve the conditions of small coffee farmers and co-operatives and provides agricultural service assistance to those who seek to improve the quality of their produce. In this way, farmers are able to sell their products at market prices and Nestlé is able to procure coffee products of excellent quality.

The Agricultural Services Department of Nestlé Philippines is responsible for extending technical assistance to coffee farmers. In recent years, the company has seen a drop in the domestic supply of coffee such that it has been forced to import in increasing quantities from ASEAN countries to augment their supply. This has prompted Nestlé to network with all concerned parties who are involved in coffee development projects. As such DTI, DAR and Nestlé consider themselves as a “team united with one vision”. They conduct focus group discussions and orientations in co-operation with the LGUs in this regard (Antonio, 2004).

Lectures on topics such as government policies and market viability of coffee and other farm produce are regularly conducted by Nestlé and DTI. Nestlé informs farmers of the coffee buying stations that they have set up to facilitate the selling of their produce, thus acting as a marketing anchor for farmers. The company also pledges to buy all the coffee that the farmers harvest, but at the same time impresses upon them that they are not prohibited from selling to other coffee buyers. Farmers are not bonded to sell to Nestlé exclusively. This is made clear in the lectures to farmers. By providing technical assistance to coffee farmers, Nestlé seeks to create a stable supply of coffee from the Philippines and provide a source of livelihood to farmers. At the same time, Nestlé does not seek to have a monopoly on, for example, Quezon’s coffee produce.

Nestlé’s approach of working with government agencies and LGUs and NGOs, especially in its coffee development projects, enabled it to ride on the capabilities of local governments to convene and spur community action. This strategy allowed the company to replicate their strategies quickly, without disregarding unique local conditions, and do comparative assessment of results. Aldaba takes into consideration

the emerging role for Philippine NGOs and focuses on case studies which included agricultural development, suggesting that the rationale for collaboration was based on synergy by the different contributions made by the key sectors or actors in society – government, business and civil society (2002:180). In relating Aldaba's findings to the Nestle case, NGOs play a significant number of roles. Firstly, as "capacity builders" - identifying the needs of stakeholders in making partnerships work, and providing possibilities for training. Secondly, as "conflict managers" - bridging the gaps and finding compromises and solutions for conflicting interests among the various stakeholders. And, thirdly as "resource mobilisers" - mobilising various resources (human, physical, and financial) from various stakeholders to sustain the partnerships (Aldaba, 2002).

It has been shown that Nestlé has a strong reputation for corporate social responsibility in the Philippines, and has enacted a number of programs to benefit the Philippine government. On one hand, this corporate social responsibility ethos is advantageous for the government. On the other hand, however, this approach increases the bargaining power of Nestlé as the company has become more entrenched in Filipino society, and their departure would have a number of detrimental aspects, particularly for the Philippines' economy.

Nestlé had some labour problems with the unions in the late 1980s as a result of salary disputes. Even though Nestlé says it is among the highest payers to employees in terms of salaries and other fringe benefits, they are still confronted with union strikes. Under Philippine law, negotiations for salary increases take place through collective bargaining every three years. However, in this instance workers and unions did not follow due process and went on strike, refusing to open the factory gates. The law states that even if on strike, the factory has to be opened.

In this case, a Return to Work Order was issued by the Department of Labour and Industry. So on the basis of the return to work order, the labourers should have returned to the factory while the government assisted both parties in finding a solution to the issues. In spite of the Return to Work Order, the employees did not return. According to Antonio (2004):

they defied the work order. We have tried all means of convincing them to return, we published the return to work order by the ministry. We served each and every one of them a notice and we worked in the evening talking to them to return but in spite of this they were told by their leaders not to return. We had no choice but to take in new people and we suffered for some time before we could run the factory now they are insisting that they should go back.

Whilst acknowledging that the labour issues were somehow difficult to resolve and a negative for the Philippines, Antonio (2004) stressed that, on the positive side of the relationship with the Philippines, Nestlé is a company that has evolved successfully in the Philippines' economy and has positively contributed to the development of the Philippines. For foreigners who are interested in the Philippines as an investment location, Nestlé provides a well-balanced example. There are four Nestlé factories in the Philippines: an ice-cream factory located in Manila, a milk factory in Laguna manufacturing infant power, Milo, a third factory in the south, 30 kilometres from Cabuyo; the fourth factory, on the Island of Mindanao in Cagayan de Oro, is the centre for Nescafe Instant Coffee, as well as producing milk and other products. Nestlé Philippines is also the local distributor of breakfast cereals for Nestlé Philippines and also exports breakfast cereals to other countries (Antonio, 2004).

Although Mindanao is often criticised as not being politically stable, Attorney Antonio believes that Nestlé as a foreign-owned multinational corporation encounters no problems and its business is thriving: "coffee is one of our principal products. And Mindanao is the principal producer or grower of locally produced coffee so it makes sense that the factory is located there" (Antonio, 2004). According to Nestlé, perceived insecurities should not stop businesses from investing in the Philippines. In response to whether insecurity was a concern to Nestlé, this is what they had to say:

This question was already asked wherever there were sufficient security problems that would hamper us from setting up there. The answer to us was pretty obvious, we are there, and we've been there for the past 20 years (Antonio, 2004).

Nestlé has been in the Philippines for nearly half a century and does not require any incentives from either BOI or PEZA. This means that Nestlé is not in a special economic zone like PEZA and it does not deal with BOI because the economy under the current government is more liberal and companies do not need a regulatory body to get a permit or approval for their activities. Antonio (2004) emphasised that:

We are not - we are stand alone. The BOI used to be a regulatory body for FDI but the current regime is more liberalised and we do not have to really get any permit or approval from them for our activities. So we have not received any single incentives from government in our operation.

Nestlé also borrows most of its funding from local banks because they are more efficient and compete for Nestlé's business. Antonio stressed that:

It's a question finally of efficiency if it's more efficient to borrow here. That's always been the case of course we are getting more credit, extensions from the bank that we actually need. In other words we are a prime client for local banks (Antonio, 2004).

Philippine law requires a public company to have a minimum of five and a maximum of fifteen members on its board of directors. Nestlé has a board of seven directors. The board sets the policies, which the management team of the company then implements. The management team is headed by the President CEO. The previous president was Mr Salvadore Pigem, a Spanish national. The board is headed by a chairman and the current chairman is Mr Santos.

Antonio (2004) explained that Nestlé has a separate training department headed by a Manager in charge of training. Training is available throughout the year and the training department runs various programs to improve the professional capacity of its employees at all levels from the highest manager all the way down to the factory shop. In addition to these local training programs, employees participate in training held in Switzerland. Every year Nestlé sends 20 to 30 key people to these programs in Switzerland. The third type of training is on-the-job training. Currently there are around 30 Filipinos who are posted in Switzerland and other countries. Overseas job

postings have been in place for at least 20 years, and Nestlé considers this program “is one way of training employees for higher responsibilities in the Philippines” (Antonio, 2004).

The major bargaining power Nestlé has is its capital, and it is a considerable power. However, the long period of time that Nestlé has been in the Philippines indicates that the government has some sort of bargaining power. When determining whether the Philippine government has more bargaining power than the MNC, Nestlé staff member Antonio believes that Nestlé always considers itself to be a visitor who, unless they respect the laws of the host country, all relations would be severed. It can be argued that this is a critical point to note when it comes to investing in a country like the Philippines. Because Nestlé believes that, as a visitor, it has to observe the laws of the country, it has succeeded. This can be compared with companies like the Marcopper mining company and Fraport which broke Philippine law, resulting in either a complete breakdown of relations or expropriation of assets.

This demonstrates that the Philippine government has the ultimate bargaining power when it comes to setting the rules and regulations that it sees as a necessity in forming and conducting business relations in the Philippines. A look at the Marcopper and Fraport incidences can clearly establish that it is the host country’s government that has the final say on whether a corporation who has broken the host country’s laws can continue to function or have its contract cancelled and its assets confiscated. Antonio maintains that, from Nestlé’s perspective, they never believed they had to bargain with the government for incentives or benefits for its operations because “there was nothing we could bargain with the government that was not available under existing rules and regulations” (Antonio, 2004).

The biggest setback experienced by Nestlé in the Philippines has been union instigated labour strife. In 2006, the IUF-affiliated Council of Filipino Nestlé Unions (CFNU) wrote to the Department of Labour and Employment (DOLE) to request that the government inspect all Nestlé’s worksites in the Philippines to assess compliance with labour standards and expose violations. The CFNU reacted against the decision by the Nestlé management of the Cagayan de Oro plant to submit to the DOLE

checklist for self-assessment in compliance with labour standards survey without conducting a joint assessment with the unions.

When conducting a self-assessment checklist on compliance with labour standards survey, a company should interview and document all contractors and subcontractors and provide evidence of social security registration and payment of wages to determine if labour codes are being followed. The unions also argued that contractors were providing labour services they were not contracted to. For example, COFIPAC was not contracted by Nestlé as a coffee packing company to pack Nescafe products, but was serving as a labour contracting firm. On another occasion a complaint was made regarding Nestlé's destruction of permanent work by outsourcing and casualisation and by classifying filling and bagging jobs as non-core jobs (IUF, 2006).

When a company like Nestlé experiences difficulties in the labour front with union-related issues, if they have a good record with the host government they can negotiate with the government to address such issues. According to Antonio, Nestlé had recurring problems with Filipino unions, but as an established MNC was in a position to advise the government of all the benefits the company had brought to the country. Furthermore, if certain labour issues impact negatively on the company's reputation, then the company has no choice but to leave and set up elsewhere. Antonio (2004) explains how Nestlé bargained with the government when there were Union strikes aimed at Nestlé factories:

There was a time when we had to tell government that if these problems cannot be solved then we as a good employer, that have been paying tax, salaries, we are concerned that something should be done because we still encounter labour unrest. In other words this is probably the time we tell government you better do something about otherwise the goods things that we have enjoyed here as well as the government may come to an end.

It is evident that the biggest bargaining power a company has is capital. When a government is not doing enough to protect a company's business interests, then that company may hint that it will move elsewhere if conditions are not adjusted.

Although governments are not in the business of becoming involved in labour disputes, they do make an effort when the national interest is at stake.

Other than labour related issues, Nestlé came under fire in 1999 when the international community boycotted Nestlé products because of the irresponsible marketing of breast milk substitutes on behalf of Nestlé. Nestlé controls 40 per cent of the baby milk market in the world and it was accused of promoting its products unethically in developing countries. Nestlé received negative publicity when it broke an international code for marketing breast milk substitutes by misleading consumers and advertising their products to be better than natural breast milk. Eighteen countries subsequently boycotted the company. Nestlé was criticised across the world for hiring graduate nurses to visit mothers at home and convince them to abandon breast-feeding in favour of Nestlé substitutes.

It can be argued that, when compared to past governments that current Philippine governments since Marcos have gained more bargaining power because they are more liberal. The current laws and regulations are more relaxed and business-oriented. For example, previously if a company wanted to invest in a project, it had to get permission from the BOI and different departments to get an approval. This was time consuming and unnecessary. The business environment in the Philippines now has more potential for attracting FDI because there are legal incentives. Although the direction of the Philippine government has been to encourage investment into the country by providing both legal and economic incentives, there is not enough interest because of what is perceived to be instability in the country. One incentive granted by the BOI is the assurance that there would be no government takeover, but the assurance does not extend to companies who break the law.

Nestlé indirectly receives duty discount incentives as a partner in an Association of South East Asian Nations (ASEAN) project aimed at implementing programs to encourage greater trade and cooperation. Nestlé is a partner in a breakfast cereal company exporting to Thailand, Indonesia, Malaysia and some other ASEAN countries. The program was formed in 1991 and members were given the privilege of a duty discount whenever they export these products. Nestlé exports under a company named Cereals Partners Worldwide (CPW) Philippines (CPW Phil), which is the local

company of the parent company in Switzerland, CPW. It is a JV between Nestlé and General Meals, a United States company that produces breakfast cereals. Additionally, there are incentives in the form of credits for export revenue increments. For example, if Nestlé improves its exports from one year to the next, the government will allow a certain percentage as an incentive. This means that, if Nestlé exports more it will get a tax credit as an incentive. There are no other incentives available to Nestlé because, as discussed above, it does not need incentives from the government.

In terms of infrastructure, the government has dedicated Special Economic Zones that provide the best technology for manufacturing etc. As Nestlé is an established company, it is self-sufficient and can generate all the power it needs to run its operations. However, a Nestlé representative identified that the Philippines needs to invest in transport infrastructure because it has 7,000 islands and most of the customers are on islands. Poor infrastructure is costly for business; improving it, conversely, will boost the investment climate in the Philippines.

Nestlé has bargaining power in the Philippines because it has access to advanced technology according to Antonio (2004):

We consider ourselves fortunate to be part of the Nestlé Group in respect with technological advantages as a member of the group we are entitled to access the technological advantages made in the research centres of Nestlé not only in Switzerland, but in the R&D centres as well. There is one in Singapore for instance.

The case study of Nestlé in the Philippines shows how bargaining power can be improved the longer an MNC has a relationship with the government. The long-lasting partnership between Nestlé and the Philippines government has provided the MNC with considerable bargaining power over a number of areas, most importantly the regulation of labour relations. It also highlights how MNC involvement and FDI can create positive results for both the government and the company involved. It is interesting to note that this mutually beneficial relationship arose without the need for incentives under PEZA or BOI, and Nestlé, unlike Samsung, did not feel the need to bargain for or hunt down extra incentives from the government. Furthermore, Nestlé

obviously feel that their relationship with the Philippine government is so entrenched that if issues arise, they can be negotiated diplomatically, without the need to involve domestic or international dispute resolution.

5.5 Case Study: Marcopper Mine

In a rapidly globalising and competitive world, a developing nation like the Philippines is faced with the difficult task of striking a balance between economic development and environmental management. The Philippine government, however, must find a way to meet the needs of the present generation while at the same time not compromising the needs of future generations. To explore this dilemma further, the behaviour of Canadian-owned Marcopper Mining Corporation (Philippines) and the implications for the Philippines with its dealings with this company gives a good indication of the relationship between a company and a host country. According to United States Geological Survey Yearbook (USGC, 1999), the Philippines had a long and well-established history of major production from its mines and was ranked tenth in the world, but mining activity was hampered by factors such as low FDI, political instability, high production cost, labour problems, environmental damage and natural disasters.

This case study provides background information of Marcopper mine in Marinduque in the Philippines, analyses the implications for the Philippines in regard to mining-based development by looking at economic benefits, social and environmental costs and legal outcomes, and examines the government's responses and actions in dealing with the Marcopper tailings spills. The case study also discusses the bargaining or 'renegotiation' process the Philippines' government undertook to attract FDI in the mining industry. It is also made clear in this case study that, when assessing the potential of the country's natural resources, it is clear that the Philippines has substantial bargaining power in dealing with this class of MNCs. However, it also highlights that, whilst the Philippines appeared to be in a weak bargaining position following its actions as a result of the Marcopper mine disaster, this was not the case. The government demonstrated clearly to foreign investors that it set out to ensure that

further environmental damage to the Philippines would not be caused by the failure of foreign and domestic mining corporations to abide by Philippine environmental laws.

Placer Dome, a Canadian Multinational mining company, allegedly caused devastating environmental damage in its mining activities in the Philippines following two waste disposal leakages in 1993 and 1996. The company claimed not to owe any form of responsibility to those affected by the mining disasters, as it was no longer investing in the mining project. However, the provincial government of Marinduque sued Placer Dome for more than \$100 million to fund cleanup and rehabilitation of the affected environment and compensation to affected villages. Several sources in support of the Philippines' lawsuit against Placer Dome contended that the company neglected its corporate social responsibility owed to the Philippines by failing to assess its waste disposal mechanism and the impact it could have on the environment and local communities who live on the island. Whilst Placer Dome violated international standards on environment management laws and human rights and potentially jeopardised the Philippines' ability in securing FDI, on a positive note, the case has been used as a test case when considering mining-related development in the Philippines.

During the Marcos regime, Marcopper went into the Philippines to invest in non-ferrous metals. Initially the Philippine government saw foreign investment in the mining industry as a positive gain for the Philippines' economic development. The investment provided the opportunity to create more jobs, better infrastructure, extra revenue, gain skills and technology as well as contributing to the Philippines' exports. Placer Dome Giant (PDG) invested in the Philippines at a time when sustainable development was becoming a key part of corporate social responsibility when pursuing development activities such as mining. In a joint venture with the Philippine government, the MNC set up a mining company known as Marcopper Mine on Marinduque Island to mine non-ferrous metals. Until they were privatised in 1994, the company owned 40 per cent of the shares, whilst Marcopper's shareholders and subsequent governments owned the balance of shares. The perception was that the company should shoulder the responsibility to clean up the tailing spills because it was in control of management.

The Marcopper Mining Corporation started its mining operations in the Philippines in 1969 on Marinduque Island. From 1969 to 1990 huge quantities of copper and smaller deposits of gold and silver were mined from the Mount Tapian ore deposits. In the early 1990s when Mount Tapian's reserves were depleted, Marcopper moved on to the San Antonio copper ore body, which lies three kilometres north of the Mount Tapian complex. To produce copper concentrate and tailings residue, the milling process methods used were crushing, grinding, and flotation mill, filtering and thickening (UNDHA, 1996).

The Marcopper Mining Corporation operated on the island of Marinduque for over 30 years. Marinduque is inhabited by poor Filipinos whose livelihood depends on subsistence farming and fishing, and the entry of Marcopper Mine had substantial adverse effects on their living conditions. The company's failure to adhere to corporate social responsibility on behalf of shareholders, mine operators and the Philippine government led to inadequate waste and toxic disposal practices that put the Marinduque community at risk by polluting and contaminating life-supporting water systems, flooding of farms and killing fish, as well as causing serious health problems for the community. On the positive side, Marcopper gave jobs to 1,000 employees, mainly from the island of Marinduque, provided electricity and infrastructure to the island, generated 20 per cent of the Philippines' copper supplies, spent 30 million pesos on services and goods annually, paid 5 million pesos in taxes and 2 million in social projects.

The process of waste disposal involved releasing mine tailings into the shallow waters of Calancan Bay. From 1975 to 1988 an estimated 84 tonnes of tailings were dumped into the bay. However, in response to complaints by local residents, Marcopper decided to temporarily store its mine wastes in a 300-metre deep Mount Tapian pit with a capacity of 69 million cubic metres. The problem was exacerbated by the fact that the company did not invest in adequate waste storage facilities. This resulted in negligent practices where toxic waste was dumped into bays and rivers vital to the survival of the indigenous communities. By government estimation, the tailing spills killed Php1.8 million worth of mature freshwater and marine life and 27 kilometres of the Boac River. For a community that depends on fishing, this was a crippling effect. When Marcopper was granted permission to operate the Marinduque mines it was

allowed to dump waste into the shallow bay. The MNC argued that under the Marcos regime most of the environmental laws were suspended or non-operative as far as the company was concerned. However, what the MNC does not mention is that the Corazon Aquino government issued an order for Marcopper to stop dumping tailings into the bay (Tauli-Corpuz, 1996).

The second problem was that the company neglected to carry out any environmental risk assessment and management studies. The Department of Environment and Natural Resources of the Philippines requested the UNEP and the UN Department of Humanitarian Affairs (DHA) to carry out an independent post-mining ecotoxicological disaster assessment, evaluating the impacts on human health and well-being, outlining the causes, and giving recommendations to avoid future disasters. Their report stated that 'in spite of the unconventional use of the Tapan Pit as a containment system, no environmental risk assessment and management were carried out' (UNHDA, 1996). In 1996, a criminal complaint was filed against Marcopper officials for the disastrous 'leakage into the waterways, for their reckless imprudence causing damage to property, violation of water code, pollution law of 1976 and Philippines law of 1995' (Tauli-Corpuz, 1996).

With inadequate storage facilities in place, it was only a matter of time before disaster struck, and on 24 March 1996, mine tailings leaked through plugged drainage and into the Makulapnit and Boac rivers. Studies conducted revealed that the tailings reached along the entire length of the two rivers as well as the coast, severely affecting the coastal marine environment. There were immediate and long-term negative effects from the tailings disaster. Channels and valley floors of the two rivers were buried under the tailings, about 700 families from five *barangays* (small towns) were affected and most river crossings and road connections and 10 hectares of cropland were damaged.

The mining industry in the Philippines has the potential to contribute to the country's economic development and attract a substantial amount of FDI. However, the tailings spill at the Marcopper mine in 1996 resulted not only in the death of the Boac River and surrounding environment and the loss of livelihood and negative health impacts

for the island's inhabitants, but also opposition to mining, constitutional reforms, law suits against Marcopper as well as obstacles to attracting FDI in the mining industry.

The relationship between a foreign investor and a host government is a contractual one that can be potentially beneficial for both if they are open to renegotiations to correct certain terms and conditions of the contract that are perceived to be time-consuming and disadvantageous to either party. The effective use of bargaining power is crucial for the relationship to work. Although every case is different when it comes to determining whether the foreign investor or the host government has the greater bargaining power, it is understood that they both have strengths and weakness at different stages of the investment process.

For example, a foreign investor has the greater bargaining power before the investment deal is struck (Vernon, 1971; O'Faircheallaigh, 1982). This is the period where the host government need access to capital and technology and the investor has the option to either go ahead with the investment plans or abandon its plans to invest in that country in favour of a better investment opportunity in another country. Once a foreign direct investment has been negotiated successfully, the company and government form a partnership and the investment project begins. If the project becomes very successful, host governments tend to have second thoughts about the contract and usually opt for renegotiating the contract with the investor. If unsuccessful, the government can impose other factors such as a takeover of the company's assets (Vernon, 1971). Very often, foreign companies do not realise the significance of upholding the host government's laws and the implications breaking those laws will have on their contractual relationship. This is a critical aspect that needs to be explained in detail to foreign investors. Whilst foreign investors are under the impression that they will keep operating under the original contract that allowed them to invest in a host country, a host government can at any time pressure a foreign investor to renegotiate the terms of the contract. When the foreign investor breaks local laws it is more crucial for them to renegotiate with the government or they can be subject to restrictions or expropriation (Vernon, 1971).

The mining industry in the Philippines offers great investment opportunities to foreign investors, but the controversial Marcopper tailings spill created a hostile environment

for both foreign investors and local Filipinos. Marcopper Mining Corporation (Philippines) is a perfect example in which a foreign investor joined in a partnership with the Philippines' government in the mining industry but broke the law, thus setting a dangerous precedent that undermined the potential of the Philippines' mining industry.

The assessment by the United Nations mission team concluded that both river systems were sufficiently degraded to consider it an environmental disaster and that the aquatic life, productivity and beneficial use of the rivers for domestic and agricultural purposes were totally lost as a result of the physical process of sedimentation. Coastal communities adjacent to the mouth of the Boac River were also degraded as a result of smothering by mine tailings. There was increased health and safety risk due to immersion and flooding as a result of the very large volume and physical properties of the mine tailings which would be mobilised during the wet season (UNDHA, 1996). Another article confirms that the toxic spills immediately caused flash floods which isolated five villages, with a population of 4400 people, along the far side of the Boac River, "villages were buried under six feet of muddy floodwater and 400 families had to flee to higher grounds. Their sources of water were contaminated while fish, freshwater shrimp and pigs were killed, 20 villages out of 60 were advised to evacuate their communities" (Tauli-Corpuz, 1996).

Those most affected by irresponsible mining projects are traditional tribal groups who live on ancestral lands that are rich in minerals that could be extracted by mining companies. Under the Philippines' Constitution there are provisions to protect traditional communities. In 1987, a Constitutional Act for the protection of indigenous groups, their way of life and their ancestral homes was legislated. However, these groups have been displaced from their ancestral homes to make way for mining companies, and their way of life has been destroyed as a result of environmental pollution.

Past and present governments of the Philippines have been criticised by environmental groups and indigenous communities for failing to pursue sustainable development in the mining industry. As a result of the Marcopper mining incident, mining companies were unwilling to invest in the Philippines because of a strong

backlash from the locals and inadequate legal provisions. This is an unwelcome outcome for the Philippines, since FDI is essential to the country for a number of reasons, including competitiveness, debt relief and to support a growing population (Holden, 2005:237).

The Arroyo administration has been eager to change negative attitudes toward mining and has promised stringent environmental protection laws to be part of mining projects to ensure no irreversible damage is caused by mining operations. Arroyo believes that foreign investment in the mining industry is crucial to the Philippines' development. The Philippines has natural resources which can be used for long-term economic gain; however, tribal groups affected by environmental damage caused by mining operations object to the government's proposals and predict that, based on the past behaviour of foreign companies, more environmental disasters will occur,³⁹ and they argue that constitutional constraints against mining companies should never be lifted.

According to the Mines Geoscience Bureau, the Republic Act No. 7942 (the Philippines Mining Act of 1995) is the governing law that regulates mineral resources exploration, development, utilisation and conservation. It is aimed at revitalising the Philippines' struggling mining industry by providing fiscal reforms and incentives to secure the FDI that is needed for development activities. The Mining Act was prepared in 1995 and revised in 1996 under the Department of Energy and Natural Resources (DENR) Administrative Order no. 96-40, the Revised Implementing Rules Regulations (RIRR). The positive steps highlighted in the act include considering local government empowerment, equitable sharing of benefits and natural wealth, meeting the demands of the present generation while providing the foundation for future generations, and protection and wise management of the environment (Mines and Geoscience Bureau, 2004). These were steps that were not taken seriously prior to the Marcopper mine disaster.

³⁹ Several mayors and local government representatives throughout the Philippines use this argument to prevent or block mining companies from operating within their local jurisdiction (Inquirer 13 November 2006; Tito Natividad Fiel, DCMI 11 November 2006; Jeffrey M. Tupas in Inquirer November 2006; cited in MAC: Mines and Communities. 2006. Philippine Update, Available from <http://www.minesandcommunities.org/article.php?a=598>.

The Philippines' bad experience with foreign mining companies' disregard for sustainable development and proper environmental management led locals to fear and oppose any mining initiatives the Philippines' government proposed to foreign investors. It is clear that anti-mining campaigners in the Philippines fear a repeat of the Marcopper incident, as is evident by the comment made by the Tebtebba Foundation in its national conference on mining: "Placer Dome⁴⁰ until now has not acknowledged its culpability in the disaster it brought to the Boac River and to the people of Marinduque, and its responsibility to undertake rehabilitation work. Instead, it has run away from this obligation. In the meantime, five more tailing dams by Marcopper are in danger of collapse" (Tebtebba Foundation, 2002).

However, Arroyo maintains that, "As the 5th mineralised country in the world with a close proximity to the biggest market for minerals, China – the Philippines is poised for a strong economic take off based on reinvigorated mining industry". That is why for the past years the Congress and the House of Representatives have been campaigning to provide legal incentives that allow foreign companies to invest in the Philippines' mining industry. To do this, the Arroyo administration has campaigned successfully to convince the Supreme Court to reverse certain constitutional laws that outlaw provisions in the Mining Act of 1995 that relate to foreign ownership of mining operations in the Philippines. Foreign investors were constitutionally only allowed a 40 per cent stake in mining companies; however, they are now allowed 100 per cent ownership. By giving foreign investors 100 per cent control, the government hopes to get foreign firms to invest in the 30 per cent of land that it has dedicated to mining.

An article by Carlos Conde published in the *International Herald Tribune* on 3rd December 2004 stated that the decision by the Supreme Court in favour of foreign direct investment to allow foreigners to fully own and operate mining companies in the Philippines was welcomed by the mining industry and the Philippines' President, Gloria Macapagal Arroyo, who believed that the country's economy would benefit from this decision. The new decision gives the President full control over exploration,

⁴⁰ "In 1997 Placer Dome left the country after divesting all its interests in the mining company and without satisfactorily cleaning-up their mess to the environment and the people of Marinduque." (Magalang, 2006)

development and utilisation of natural resources. The article also presented the view of the critics, who argued that the Court's decision "violates Philippines Constitution and makes the country even more vulnerable to environmental degradation". The government, however, maintains that the "decision firmly upholds the national interest ... as mining investments pour in, the rural areas will experience a significant boost in jobs and productivity, plus a strong surge in infrastructure development" (Conde, 2004).

Business groups also welcome this development, as is evident in the comment of Antonio Santos, Chairman of the Mindanao Business Council and the largest business group in the southern Philippines where many mining companies operate:

This ruling will provide an enabling environment to attract foreign investors, bring in considerable wealth by providing jobs, developing local industries, improving infrastructure and supplying of raw materials for industrialisation and modernisation (Conde, 2004).

In response to indigenous and environmentalist criticism, Arroyo stated that the current Philippines' government would make sure it provided "full protection of the environment and a sturdy umbrella of social and economic returns for host communities, especially the indigenous people" (Mines and Geoscience Bureau, 2004).

Anti-mining campaigners, however, were not convinced that this would be the case, and in 2005 they vowed to seek a motion for reconsideration from the Supreme Court in regard to its decision earlier to uphold the Mining Act of 1995 and the implementation of its rules and regulations (Kosich, 2005). After reconsideration, the Supreme Court ruled that all but two provisions of the Financial and Technical Agreements (FTAA) executed in 1995 between the government and Western Mining Corporations would be upheld.

The Supreme Court justified its position by stating that the Mining Act provides a balance between the need to develop the stagnant mining industry and the need to

protect indigenous communities and prevent irreversible ecological damage. Kosich (2005) points out:

The need for appropriate balancing of interests and needs - the need to develop our stagnating mining industry and extract what (former) NEDA Secretary Romulu Neri estimates is some US\$840⁴¹ billion worth of mineral wealth lying hidden in the ground, in order to jump start our floundering economy on the one hand, and on the other, the need to enhance our nationalistic aspirations, protect our indigenous communities and prevent irreversible ecological damage.

The Philippines has the opportunity to secure an estimated investment of 70 billion pesos with annual taxes of 55 billion pesos in mining from 2004 to 2020. In terms of the current situation in the mining industry, Austrade (2007) emphasises that:

Recent legal developments upholding the legitimacy of the Philippine Mining Act and allowing 100 per cent foreign participation in Philippine mining activities have brought back investors into the sector with on-stream investments from both local and mining companies expected to reach US\$3 billion in 2005.

And to express Australia's interest in entering the lucrative Philippine mining industry, Austrade (2007) highlights that, along with other nations such as Canada:

Australian companies are leading the charge with the following Australian companies already active in the Philippines: Lafayette, Indophil, Climax-Arimco, QNI/BHP Billiton Minerals and Red 5. Some of the Australian technology suppliers in the Philippines include: Environmental Systems and Services; Slope Indicator and Boart Longyear.

In summary, this case study has outlined the considerable impact that one incident can have on the reputation of an entire industry and the bargaining power of the Philippines. The Philippines continued to have difficulty attracting MNCs and FDI in

⁴¹ Raul Angeles, Director of the Mining, Marine and Other Natural Resource-based Products Department, Board of Investments, Department of Trade and Industry, Philippines, estimated in 2003 that the figure was US\$964 billion.

their mining and resources sector while the legacy of the Marcopper situation remained in dispute. However, since the Supreme Court's decision in 2004, the industry has regathered momentum. The relationship between Marcopper Mining Corporation⁴² and the Philippines' government highlights, as does the Fraport case study, the importance of following the host country's laws. Failure to do so can result in economic and reputation loss. In the process of extracting resources it is clear that some mining companies are known to create severe environmental degradation; however, with better waste management practices the problems can be managed. This case study demonstrated that Marcopper Mining Corporation did not adequately comply with social corporate responsibility and did not engage in adequate waste disposal practices. The case study has also highlighted the validity of Vernon's study on the mining industry and the 'obsolescing bargaining theory' on government interference and the impact on an MNC once an investment has been sunk.

5.6 Case Study: PEZA – Public and Private Parks (Ecozones)

In assessing the bargaining power of the Philippines, this case study looks at the workings of PEZA and how it promotes investments in both Public and Private Parks (Ecozones). Three interviews were conducted and then analysed to obtain an inside look at the Ecozones; the interviewees were Mr Elmer San Pascual, General Manager of PEZA, Ms Pam Domingo, Promotions officer of PEZA and Mr Chito Zaldariagga, the 2IC of Carmelray Industrial Park II, a private operator. PEZA is one of the bargaining chips of the Philippines, particularly with its management of Ecozones and incentives that are offered to potential investors. Whilst the previous four case studies identify the links between the host government and MNC after an investment has been negotiated and entered into operation in the Philippines, the PEZA case study looks at the importance of PEZA in attracting FDI to the country. PEZA gives the Philippines

⁴² Marcopper Mining Corporation is still a registered company in the Philippines and operates from their headquarters in Makati City; however, the company is not engaged in mining activities at Mt Tapian (Querubin, 2006). In 2005, the "DENR issued a provisional environmental compliance certificate (ECC) to Marcopper Mining Corporation to enable it to immediately conduct remediation and rehabilitation activities in its former mining site in Sta. Cruz, Marinduque" (Government of the Philippines, 2005).

fairly strong bargaining power, offering incentives and sound infrastructure within many of its export-focussed zones, both private and public.

PEZA's Mission Statement reflects a high level of commitment to both domestic and international investors:

PEZA's mission is to accelerate the creation of employment opportunities particularly in the countryside, and to spur the growth and diversification of exports, by attracting foreign investors to either develop or put up their export manufacturing plants, IT companies, or their regional warehouses in world-class, environment-friendly economic zones and IT parks and IT buildings. Adding to this statement PEZA's corporate outlook and service-oriented attitude has gained the trust and confidence of its private sector clientele. It continuously improves its systems and continuously simplifies its procedures to help investors do business in PEZA as easily as possible (PEZA Brochure n.d).

As an important national development strategy, the Philippines' government promotes the establishment of world-class, environment-friendly economic zones and IT parks and IT buildings all over the country to respond to demands for ready-to-occupy locations for foreign investments. At the helm of this strategy is the Philippine Economic Zone Authority (PEZA), a government corporation established through legislative enactment (RA No. 7915 as Amended by RA No. 8748) known as the "Special Economic Zone Act of 1995". The Philippine Economic Zone Authority (PEZA) administers the Act, which was passed in 1995 to encourage economic growth through the development of special economic zones called Ecozones.

Ecozones are areas earmarked by the government for development into balanced agricultural, industrial, commercial and tourist/recreational regions. There are industrial estates (IEs), export processing zones (EPZs), Free Trade Zones, Tourist/Recreational centres and IT parks. PEZA grants incentives to registered Ecozone companies. The incentive available to these companies depends on the nature of their activities.

The Export Development Act of 1994 (RA No. 7844) (EDA) is a law that provides for incentives to exporters to encourage investments in the export sector. Exporters are generally defined as earning at least 50 per cent of their normal operating revenue from the sale of products or services abroad. Aside from incentives offered through PEZA and BOI, EDA grants exporters additional fiscal incentives. These are exempt from Presidential Decree (PD) No. 1853 or advanced payment of customs duties; they receive tax credit for use on import substitution of non-traditional products; and tax credit for an increase in the current year's export revenues.

Firms wishing to get EDA accreditation can apply through the Bureau of Export Trade Promotion (BETP) of the Department of Trade and Industry, and other BETP authorised agencies like PEZA, BOI, the Garment and Textiles Export Board (GTEB), Subic Bay Metropolitan Authority (SBMA), CDC, Philexport and the Philippine Chamber of Commerce and Industry (PCCI). The Special Economic Zone Act of 1995 was set up by the passing into law of Republic Act No. 7916, as amended by Republic Act No. 8748. RA 7916, which is:

an act providing for the legal framework and mechanisms for the creation, operation, administration, and coordination of Special Economic Zones in the Philippines, creating for this purpose, the Philippine Economic Zone Authority (PEZA), and for other Purposes (PEZA, n.d:1).

It is clearly pointed out that PEZA is not an authority acting on its own. This is evident in Chapter II Governing Structures of the Special Economic Zone Act of 1995 in SEC. 11:

The Philippine Economic Zone Authority (PEZA) Board. – There is hereby created a body corporate to be known as the Philippine Economic Zone Authority (PEZA) attached to the Department of Trade and Industry (PEZA, n.d:9).

5.6.1 PEZA – its purposes

According to Elmer San Pascual (2004), the rate of savings in the Philippines is very small, and is of some concern to the government. When compared to some other Asian countries, the Philippines ranks well below in terms of savings. It is clear that without savings, there can be no investment, so there is an obvious need for the government to implement a program to augment savings. The other alternative is to ask foreigners to invest in the country. PEZA is the policy thus created as one of the mechanisms by which the Philippines could attract foreign investment.

The role of PEZA is to offer 'ready-to-occupy' locations to foreign investors. San Pascual stresses that:

PEZA has about 590 Economic Zones, all over the country but these do not include Subic Bay, Clark Base and others ... because Subic, Clark are under separate government authorities. In fact in the Philippines there are about nine investment promotion agencies and PEZA is one of them and BOI another (San Pascual, 2004).

BOI's program of incentives is focussed on export manufacturers. Thus if a company is not an export manufacturer, the incentives will not be permissible. If an investor would like to deal with the domestic markets, it is the role and responsibility of the BOI not PEZA. San Pascual (2004) also points out that the BOI:

incentives can only apply to those Ecozones that have been proclaimed by the President as PEZA Zones. So outside of the zones even if they are exporters we cannot give incentives to them.

When negotiators from PEZA promote the country, investors are asked to locate in PEZA Zones. PEZA wants the investors to be:

very very successful and because we know if they are successful they can even expand their operations here and if they expand their operations that will mean more jobs for Filipinos, and that will also mean more export earnings, so our policy is really to make the company operate and be profitable in their operations in the Philippines (San Pascual, 2004).

Whilst there are those who perceive that Philippine negotiators are not very successful, San Pascual (2004) disagrees:

What is happening here in the country is that when a big corporation starts operating in the Philippines their competitor would immediately ask why is this company going to the Philippines. And most likely in a year or two that competitor will also come to the Philippines and that has happened to us.

5.6.2 Insight into PEZA Public Zone – Cavite

The site for the Cavite Zone (see Appendix 5 for location in Laguna) was developed mainly from land that had formerly been used for farms. It took some fairly lengthy negotiations to prepare the site for development and for it to suit the preparation for the building of infrastructure, for example roads, bridges and actual manufacturing buildings. The first investor began operations in 1988/89 and was followed by many other investors. The site was chosen because of its proximity to Manila and the availability of rental property.

PEZA selected this area, and in particular Rosario, because it no longer exercised the potential for any other type of business. As a result, the then governor of Cavite pushed for the creation of an economic zone in Rosario as he realised the potential for increased employment in the area. The governor was the only person to show the vision and possibilities for the area and chose it to become the Cavite Economic Zone. It was initially called the Cavite Export Processing Zone (Domingo Pam, 2004).

Near and within the Cavite Zone there are many migrant workers, most of whom are not from the surrounding areas. Once inside the Ecozone, there appears to be no control of incoming and outgoing traffic. The main gates open at 8.00am and close around 9.00pm. Access for the companies within and out of the park is via another gate which is considerably wider (Domingo Pam, 2004). Pam Domingo stressed only permitted vehicles were allowed to come in and out, but on entering the park the

security guards seemed unmoved as to who went in and out of the park. The odd check was carried out.

Operating within the Cavite Zone are 240 companies and there is no further room for expansion. If a new company wishes to set up in the Cavite Zone it is almost impossible to do so, therefore PEZA advises the intended parties to look at locating in other Public or Private Zones. Pam Domingo (2004) stated that:

We [PEZA] have 3 other public zones if they are interested and there are other Special Economic Zones, like Carmelray Industrial Park II. But for them to locate within the Cavite Zone, as much as we want to accommodate them, there is no room, no space for them. It's very accessible because we are only 30 kms from Manila.

Within the Cavite Zone almost all of the buildings are privately owned. There are only a few standard buildings that were constructed by PEZA and these are rented out to the companies. Compared to the Private Zone, the vehicles here are parked anywhere along the road within and outside the zone. According to Pam Domingo (2004), one past visitor commented that:

Public Economic zones, Cavite for this matter, compared for example to Carmelray Industrial Park or other special economic zones the Private Economic Zones are the Malls the Shopping Malls, Cavite EcoZone is the variety store, the Public zone is like a convenience store.

The Cavite Zone has 78,000 people working within it who tolerate the less than ideal circumstances. As its most populated zone, PEZA is proud to have the Cavite Zone as the number one employment generator. Power within the zone is supplied by contractors and water is generated from the PEZA supply that services all companies within the zone. PEZA maintains the water quality, which is supplied from nine wells, and the costs are passed on to companies as factory overheads. Costs of all power and water supply within the zone are cheaper than if a company were to operate outside the zone (Domingo Pam, 2004).

5.6.3 Insight into Carmelray Industrial Corporation – Private Zone

Carmelray Industrial Corporation approached PEZA in the first instance to promote jobs, and secondly to develop the industrial park industry in a non-business sense. Being a developer under a PEZA zone gives certain incentives when compared to developing a regular sub-division or industrial park. Business-wise it is, according to Chito Zaldariagga, “very very attractive, and again you help the Philippines to create jobs, to attract FDI in the Philippines” (Zaldariagga, 2004).

Carmelray Industrial Corporation started developing its first park, Carmelray Industrial Park I, in 1997. This park is on 270 hectares and was designed by JTCI of Singapore. Following its successful implementation, Carmelray Industrial Corporation decided to join Jurong Town Corporation International (JTCI) in a joint venture and work on a second park, now called Carmelray Park II (CIP II). CIP II became a possibility as a result of a good turnover of locators, and because of big names in Carmelray Park 1 such as Jollibee, Suzuki, Fujitsu, APC, BASF and Tupperware, which are now referred to as “producers anchor locator. An anchor attracts basically their supply inside the park. So for example most of the semi-conductor electronics or the electronic industry inside Park I are suppliers for Fujitsu” (Zaldariagga, 2004).

CIP II is both freehold and leasehold (See Appendix 6⁴³). Therefore, because of certain events, such as the Asian Financial Crisis, leading to some uncertainty about the near future, a company in the Philippines for a short term will lease a property instead of buying. However, one of the roles of Carmelray management, according to Zaldariagga (2004), was to take that “perception and those uncertainties that they are thinking out of their mind, and show that the Philippines is stable”. The company’s vision is that CIP II shall be the Leading Industrial Park in the Philippines by providing high quality, leading edge facilities and services designed to satisfy the exacting needs of the Electronics/Semiconductor industries.

⁴³ Appendix 6 is the Carmelray-JTCI Corporation Conceptual Site Development Plan Carmelray Industrial Park II as of 22nd January 2004, in Carmelray Industrial Park II Overview Presentation Handbook, January 2004.

The company's vision is clearly outlined in the above paragraph. In the semi-conducting electronic industries, especially with regard to utilities, there are very stringent requirements, and the Carmelray Industrial Corporation, as 60 per cent owner of the JV, felt it could put in place standards for other industries to follow: for example, providing premises that are ten times cleaner than a hospital operating room. The developers therefore targeted these aspects. The ruling for joint ventures is that 60 per cent must be owned by Filipinos and 40 per cent by foreigners. Carmelray Park, therefore, as a development covering 270 hectares and with over 60 companies from (infant) industries, is considered to be an A1 PEZA-rated park.

CIP II is centrally located, being 45 minutes from central Manila, 50 kms from Manila airport, 54 kms from the Makati Central Business district, and 62 kms from Manila and South harbours and 64 kms from the Batangas ports. Logistically speaking, if a company is in manufacturing there should be just 2 kms difference between the two ports. The Laguna Park's corridor has a highly educated English speaking workforce of 135,000 and:

in this corridor there are several residential areas, industrial areas scattered, golf courses and theme parks. And in this corner of the South Super Highway developers like Ayala, are envisioning a part of Laguna, Santa Rosa to be the next business hub, residential, financial area to free Manila or Makati from the congestions within their jurisdictions. That's the plan; actually you can see the plan of what they are going to do (Zaldariagga, 2004).

One unique feature of this park is the rail line⁴⁴, now under construction, that will connect the South Super Highway that is part tollway, cutting travel time by an hour. Another unique feature of the park is that it is the only one where the Philippine National Railway (PNR) cuts through the centre of the park.

Forty hectares of the zone is a proposed residential area in a JV with Santa Lucia. Zaldariagga (2004) emphasises that the "Santa Lucia utility is one of leading developer of residential sub-divisions in the Philippines". CIP II has prepared land

⁴⁴ At the time of the interview with Chito Zaldariagga the rail line was under construction.

suitable for factories from 5000 square metres and upwards with ready-built factories for lease or sale. CIP II is the only industrial park that was given permission by PEZA to develop a residential area within the park. The main roads are 23.8 metres wide, all-weather networks. The CIP II has a cantilever bridge, because the park is bounded by two *barangays*.

CIP II has nine certified deep wells located around the park, with a combined capacity of 9,000 cubic metres per day of potable water within World Health Organisation (WHO) standards. These features are a plus for the locators, the semi-conductor industries being targeted, because:

in other parks they chlorinate their water when it gets to the locator, when it reaches them they chlorinate it and subject it to this process. So what we did is we again went a step ahead, to treat the water in the way they will treat it, so when it reaches them they just use it (Zaldariagga, 2004).

CIP II has sewerage treatment plants, using activated sludge treatment designed to meet the effluent standards of the DENR. Companies are required by CIP II to pre-treat their water to pass the standard requirements. In telecommunications, according to Zaldariagga (2004):

this is a unique feature too. Because in other Industrial Parks they are supplied by the Philippine Long Distance Telephone Company (PLDT). PLDT is the provider for us but we have a Joint Venture (JV) agreement with them. So to simplify what is the latest in telecommunications industry we have it here, fibre optics, E1 lines, T1lines E2, T3. We have that. So again you could get all those communications here.

With power supply, again there is one unique feature: CIP II is the only industrial park to date that has its own dedicated power plant. Not only does it have the advantage of having the same rate as Meralco, but the quality of the power is very clean, because:

we do not have fluctuations, it is basically dedicated to the park, it's a 52 megawatts at full capacity, now it is running on 21. We have 2, 7 megawatts engines and 3.5, 3.5. 24 by 7 backup we distribute our power in a ring mode (Zaldariagga, 2004).

CIP II has a One Stop Shop, which is the PEZA office located at the Bureau of Customs office. Freight forwarding, logistics and Fed X are all on site, and the company is building a hub, a 5000 square metre facility inside the park. There is also a fire fighting facility, banking facilities and a cafeteria. The Estate Management Group (EMG) runs the park. They enforce the Park's rules and regulations, and the project and construction management comes under their management.

CIP II management have instigated community outreach interface programs, holding regular meetings with the communities in the *barangays* near the park. These meetings address needs of the communities:

we help them in their jobs, if a locator would operate here we ask them for bio data or resumes and we help them. If they have fiestas, birthdays or basketball tournaments, we donate clothes, insurance. In return these people are our third wall of security other than the 24 hr security (Zaldariagga, 2004).

5.7 Conclusion

A country's bargaining power, especially that of a developing country, is a complex process that varies depending on a number of different factors, including the specific relationship with the MNC, the laws of the country, the length of the relationship, public opinion and the potential for change in the nature of the relationship between the two parties once the MNC is established in the country. These five case studies have provided a real-life example of the workings of a number of these factors.

The PEZA case study showed the importance of this institution in attracting FDI to the Philippines. PEZA gives the Philippines fairly strong bargaining power

particularly in private zones; however PEZA needs to also ensure that public zones are suitable to accommodate more investors who may prefer to locate in such zones.

The Samsung and Nestlé case studies showed the positive impact of an ongoing and entrenched relationship between the MNC and the government. This relationship provides increased bargaining power for both parties and allows disputes to be considered and settled without needing to resort to domestic or international courts. The biggest issue highlighted with both of these companies was tension caused by employee or union action, or lack of union action, against the MNC. However, in effect it is argued that MNCs can use their bargaining power to subdue union demands.

The benefits of a long-term relationship were particularly evident in the Nestlé situation which, together with the company's ongoing corporate social responsibility focus, further increase its bargaining power. The case study also highlighted that the close relationship with the government can itself be considered an incentive for the MNCs. Therefore Nestlé did not feel the need to search for other legal and economic incentives, such as the use of PEZA or BOI.

The Fraport AG and Marcopper Mine situations highlighted the importance that MNCs should place on following the national laws of the host country, and the detriment suffered if they neglect to do so. This reaffirms the idea that the host country is the only party that is able to change the national laws, and therefore can force MNCs to engage in negotiation, or worse, can break off the relationship. Whilst there are limited international remedies, these often do not prove effective. Therefore this legislative ability is one of the strongest aspects of a government's bargaining power. It has, however, been highlighted that the power should not be used indiscriminately, otherwise MNCs may be discouraged from negotiating with the government. The Fraport situation also highlights the detrimental impact that one incident can have to a government attempting to attract FDI.

An underlying theme of the five case studies was the importance of capital. The bargaining power of a country will always be linked to its need of capital and the MNCs' ability to provide it.

Chapter 6 Conclusion, Significance and Implications

6.1 Conclusion

The main purpose of this thesis has been to analyse the bargaining power of the Philippines and to demonstrate the importance of FDI to the country's economy. FDI is regarded clearly as an impetus for the purposes of economic growth in the Philippines in that, by its very nature, it is a fairly stable form of capital. To further highlight and to gain an understanding of the importance of FDI to the Philippines' development and economy, this thesis also extensively analysed the country's policies towards attracting such investments. The advantages and disadvantages that accompany such inflows were also discussed.

It has been clearly identified and stated within the scope of this study that not only are MNCs and states the major agents that manage the international political economy, they are both fundamental in the process of economic development. In the case of the Philippines, this study has clearly demonstrated that the country cannot use its bargaining power fully unless it eliminates administrative and bureaucratic impediments, corruption and political problems. It is clear that the country is unable to realise a sound economic and political future unless it addresses the corruptive practices that continue to impede its progress. The ultimate goal of this thesis has been to understand the bargaining dynamic and the risks to investments between the host government and foreign firms.

The introduction to this study described the Philippines as a country that has weak bargaining power because issues such as political instability, corruption, high levels of poverty and insurgencies make it difficult to attract much needed FDI. There are also problems caused by the impact on the country of the actions of the government, which certainly raises concerns to investors when their investments are threatened. Governments, including that of the Philippines, are in the market for MNCs and much needed capital. In this context, however, it is important to understand Vernon, who has argued that the structures of MNCs have become more diverse and that the:

underlying danger, illustrated by the destructive nationalism of the 1970s, remains unchanged. To be sure, host countries and [MNCs] have come some way during the past quarter century in accommodating themselves to the existence of one another. But [MNCs] today are much more important in scope and weight than they were in the 1970s (2000:viii).

To analyse the ease of access into the host nation, the methodology applied in this thesis included a communication approach and a case study approach that showed the advantages and disadvantages for both the MNC and the host government. The methodology relied extensively on the responses of participants in interviews that were conducted in 2004 and followed up in 2006. The research indicated that the Philippines is still perceived as a risky destination for foreign investments. The thesis has pointed out that there is clear recognition by some Filipinos that the country has much bargaining power and has much to offer to MNCs. However, important and specific administrative, political and economic decisions will need to be taken because the overall environment for attracting FDI needs to be overhauled. Gregory Domingo (2004) from the Department of Trade and Industry emphasised that the business environment is really what counts more when talking about attracting FDI. The Philippines has many advantages, argues Gregory Domingo (2004): “it is much westernised, in that it understands western cultures well”. Furthermore, the country is unique in the sense that Filipinos understand Western and Eastern culture and “they understand it better than Japanese, they understand it a lot better than a lot of other Asian nations do, because the Philippines has been under western influence for a very long period” (Domingo Gregory, 2004). Moreover, Gregory Domingo stressed that the Philippines possesses a very well educated labour force and excels in many professions. In the last ten years, the infrastructure of the Philippines has improved tremendously in terms of telecommunications and power, as well as roads, bridges, modern buildings and the rail system. These are big improvements in infrastructure. Gregory Domingo comments that the “biggest problem right now is really the perception more than the reality. In many countries it is perceived Manila is a war zone. For example, in many parts of the USA ... executives ... always tell us ‘Manila is like a Lebanon’” (2004).

In furthering the argument of the thesis, definitions of MNCs, FDI and host governments were expanded on in Chapter 2. And, in furthering the understanding of each of these it has been shown clearly throughout this analysis that the focus on the importance of FDI is fairly substantial in the bargaining process between MNCs and host governments. In assessing the literature on the commitment of investors to locate in host countries, it is evident that their objectives are global and profit-driven. In effect, this global outlook by MNCs has influenced host countries to become more global in their decision making. As a result, through the liberalisation and deregulation of their economies, host countries become more attractive propositions to MNCs. There is, however, potential for conflict in the bargaining process as both parties determine their course of action in shifting the bargaining power more in their favour. MNCs, as has been indicated throughout this thesis, prefer an investment environment that will make their entry into a location and the life of their investment easy.

The theoretical framework developed within the thesis showed key issues and findings of authors such as Raymond Vernon and Theodore Moran, whose significance and expertise in the study of MNCs and FDI contributed to the overall analysis of the Philippines' bargaining power. Vernon's theories showed clear links to the Philippines' case, whilst Moran's qualifications of MNCs' roles in their overseas operations indicated the ability of firms to use their bargaining power, particularly in countries that may even pose risks to their investments. The literature review demonstrated that many governments are still reluctant to allow the market to set the rules of business and investment. Grosse and Behrman (1992) argued, for example, that governments are still very much in control of MNC activities within their countries. Vernon showed that demands from host governments often put pressure on MNCs for more much-needed resources. However, Penrose (1976:51) found that "coercion, deception, the ruthless elimination of competitors" in many instances influence governments to either stand strong in the negotiations, or accept whatever terms the MNC may offer.

In establishing the commitment of governments to pursue sustained economic growth, the roles of both the MNC and the host government are demonstrated in the works of several other authors who have contributed immensely to the understanding of the

relationships of the two parties. It is clear that both the MNC and the host government are committed to their stakeholders in the negotiations for FDI and that each look at using their bargaining power whilst focussing on their own self interest. Because of the fact that the Philippines' bargaining power is not strongly highlighted in the literature, the need for field interviews and an analysis of the findings was essential to clarify and to put into perspective the country's position. One of the clear indications of the potential decline in bargaining power was shown to be political issues, as these affect both parties in the negotiations.

In adding to the current knowledge on FDI, the study realised the need to expand on Vernon's "obsolescing bargain theory". This theory is applicable to the Philippines, as was demonstrated with the Fraport AG and the Marcopper Mining Corporation case studies. However, the thesis recognises that investors are protected by domestic and international law that is in place to prevent expropriations of investments. These laws are meant to make it very difficult for countries to engage in such practices. In critically reviewing Vernon's theory, clear insights into the relevance of this theory to the Philippines were evident in the discussions. This demonstrates that, whilst the MNCs may have more bargaining power to begin with at the initial stage of the investment, it is possible that this may shift in favour of the host government, particularly in sectors such as mining and infrastructure, and it may envisage a need for renegotiations. In applying the "obsolescing bargain theory", the thesis proposed the significance of political risks relating to investments at the point of investment or after the investment has already sunk.

At the outset the thesis emphasised through a number of questions the need for effective bargaining and use of bargaining power. These have been expanded on further in Chapters 3, 4 and 5. In so doing, the research critically investigated, in Chapter 3, the processes of economic and social development in the Philippines and the need for FDI in that process. Comparisons of FDI inflows were made and indicated in figures that highlighted how the Philippines compares with some other Asian states. Whilst the Philippines presents as an environment for investment that is not attractive to potential investors, it was, however, demonstrated that considerable effort has been made since the Marcos era to reinvigorate the economy by a series of reforms implemented by the Aquino and Ramos administrations. This was

demonstrated more clearly by Roberto De Ocampo, the former Secretary of Finance in the Ramos administration. But there is still a long way to go before the alleviation of debt and poverty permits the country to shift from a CDC to being a fully developed economy. The thesis demonstrates how important FDI is to the processes of economic and social development of the country. American occupation and the pre- and post-Asian currency crisis periods highlighted the implications for the Philippines as it struggles to establish the country as a safe destination for investment.

Significantly, it has been demonstrated that, in negotiation processes, bargaining power is very important for both the MNC and the host government. Managing the bargaining process and who the key actors are and their effectiveness in negotiations was the subject of much analysis in this research. In chapter 4 the analysis of the advantages and disadvantages to both parties revealed several areas of concern to both. The issues of corruption and political problems were identified, pointing out the difficulties that they pose to both the government and the negotiators as they aim to attract FDI into the country. The chapter also explained the importance of the mining industry to the Philippines' economy and its bargaining power. Moreover, it was stressed that only some MNCs are operating within the framework of Philippine law and those that were not, needed to be aware that the government can intervene where it is believed that laws are not being followed.

In the course of furthering the analysis on negotiation, the research demonstrated in Chapter 5 the role of PEZA in these processes and how it promotes the Philippines as a sound destination for investments. A case study was done on PEZA showing clearly the importance of this institution in attracting FDI to the Philippines with its strong focus on public and private Special Economic Zones (SEZs). MNCs and their subsidiaries are representatives of parent companies that operate in foreign locations. In doing so, the MNCs become subject to the laws of the host governments, including those relating to investment, trade, expropriation, labour laws etc. In determining their effectiveness in managing their operations and investments in the Philippines, case studies on four companies were done and presented in this research demonstrating several issues that impact on these companies' investments. Bargaining power is a very complex and dynamic process and can determine the strength and/or weakness of

MNCs or governments in dealing with each other, particularly after an investment has been put in place.

In the case of Fraport AG and Marcopper Mining Corporation, the companies have been the target of the Philippines' government and interest groups for their failure to abide by the national laws within which they were contracted to operate. Both these cases demonstrate the weakness of international law in respect to investments where a country uses its power to disengage from a contract with an MNC. Whilst there are several institutions in place to settle disputes between parties, these can only be effective if the judgement passed is acceptable to both parties. One would argue that a country needing to attract FDI is in a dilemma if an MNC were to break the law and the government decided to pursue legal avenues to remedy the situation. Therefore, even if the outcome favours the host country, it will somehow still be viewed as a risk for investors.

In the Nestlé and Samsung cases, it was evident that the larger the MNC is internationally the more bargaining power it has and the more prepared it is to maintain good corporate citizenship. In many ways this permits both parties to engage in a long-term relationship that have clear benefits for both. Nestlé is fairly well entrenched in the Philippines and clearly demonstrates sound practices in its dealings within the laws of the country. However, Samsung, whilst following a similar trend, needs to engage in more appropriate practices in its employment relations.

It has been clear throughout this research that the need for capital in many ways impinges on the bargaining power of the Philippines. It appears that, in order to safeguard the capital coming into the country, the government often shows itself to be very weak in addressing issues that concern the malpractice of MNCs within the sovereign state. At the same time, the government continues to fail in tackling corruption and political instability, thus reducing its potential bargaining power.

6.2 Significance and implications

This analysis is very significant for three important reasons. Firstly, it considered factors influencing the bargaining power of the Philippines and MNCs and the implications for the Philippines in its ability to attract FDI, particularly from the larger MNCs, for its economic and social development. The result of this thesis' findings are consistent with the presence of corruption at all levels of society and within the government as well as political problems that affect the decision-making process of a very weak government unable, for example, to control threats from insurgents and from within the military. The discussion argued clearly that the Philippines possesses bargaining power, but the government is in a weak position to use its bargaining chips to its advantage to further gain the benefits from much needed capital from investments.

Secondly, the concept of bargaining power has been extensively reviewed to shed light on why the Philippines has been ineffective in consistently managing and increasing the flow of FDI into the country. In analysing the concept of bargaining power, it has been argued thoroughly that the processes of negotiation are relevant to explaining how the parties come to the bargaining table, and how one party gains the upper hand. The notion of power was used in part to explain why the very issue of bargaining power is not used to its full potential by the Philippines' government. As explained by Bacharach and Lawler (1981), at times in the process whereby a host government feels that the costs of exercising their bargaining power can be negative in the negotiation process, the negotiators may consider that the best alternative is to show restraint just to get the investment into the country.

Thirdly, and most significantly, the thesis demonstrated that, contrary to current views Vernon's "obsolescing bargain theory" is not an obsolete theory and needs to be further researched in light of trends that are consistent within many nations with the expropriation of MNCs' assets and the nationalisation of certain sectors of industry. Some of the countries that have engaged in these practices are Zimbabwe, Bolivia, the Russian Federation and, of course, the Philippines. The implications of the trends currently being experienced are that a return to the nationalisations experienced in the 1970s may be viewed as events that will never happen again in light of International

and Regional Institutions that have emerged since to protect investors from such actions by governments. Notwithstanding that, however, it is clear that governments are the legislators and they are what make up the international regimes. Whilst domestic law can be enforced, the thesis recognises that international law is not enforceable due to the nature of the international system where there is no world government.

This research is significant and important because it has applied the bargaining power theory to the Philippines and its interactions with MNCs. The importance of discussions related to the main argument of this thesis is highlighted in the literature, which has explained the impact of the interactions of the MNC and the host government to the socio-economic and socio-political environment of the Philippines. The research also indicated that few academics have aimed their examination of bargaining power and the “obsolescing bargaining theory” to the Philippines’ case.

6.3 Recommendations for further research

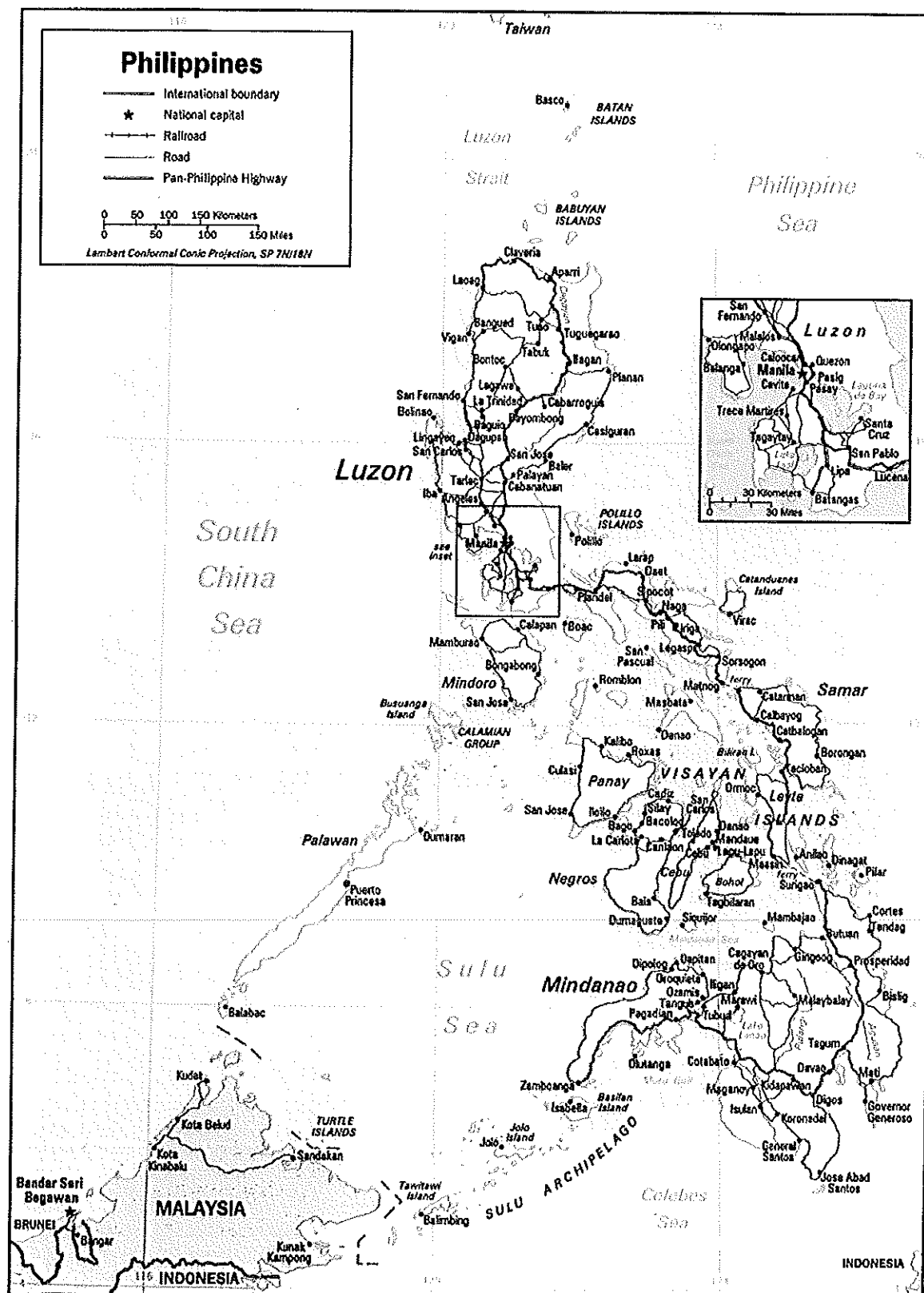
The theoretical framework developed in this research should be viewed as a critical analysis of the Philippines. This was necessary to give a clear understanding of the effects of a weak government in the process of improving the overall socio-political environment of the country as it aims to gain the confidence of foreign investors searching for alternative locations and availability of resources, particularly mining and human resources. Nation-states and MNCs are both important agents in the processes of FDI, and they both in many ways control the international political economy. It is recognised from this research that very few academics have put together conceptual models that provide a clear and concise explanation of how these two parties depend on each other. Perhaps the most recognised of all those who have contributed research in this area is Raymond Vernon, who developed the concepts that identify this relationship, which some may argue is crucial to the survival of both parties. It is proposed that some future research projects of significance could be undertaken to contribute further to the processes and uses of bargaining power by researching the following propositions.

First, the role that the mining sector could play in the socio-economic development of the Philippines if the government were to open this sector fully to foreign investors, would be worthy of further research. As well, it would be interesting to find out if the removal of restrictions to mining licences could increase the Philippines' bargaining power or perhaps even reduce it. The Supreme Court's decision in December 2004 to overturn the ruling on the restrictions to foreign companies engaging in mining activities within the Philippines served as a powerful indication of how restricted the Philippine government is in removing the influence of the oligarchy and the church in the Philippine' socio-political affairs. While the oligarchy may not have directly been involved in preventing FDI in mining, their ownership of vast areas of land and influence in provincial affairs certainly raised some concerns. The powerful forces that these two main actors play in Filipino society and politics are perceived by Filipinos and foreigners as impediments to the growth of the Philippines as a strong state that can exercise the fundamentals of democracy to overcome the ills of a history that has restricted the country to fulfil its potential as a major economic force within the Asian region.

Secondly, the Philippines must put an end to the continuity in insurgencies caused by what could be described as the symbiotic relationship of separatist movements, particularly the Abu Sayyaf along with the MILF in the south of the country and the communist movement and its military arm, the NPA. Mindanao, the second largest island, has been mentioned extensively as the food basket of the Philippines and, as has been shown in this thesis, it is very important for the economic growth of the country and could be instrumental in increasing its bargaining power. However, whilst several positive reconciliatory measures were taken by the Ramos administration towards both rebels and the communists on the island, it appears though that the continuing conflicts still pose a huge burden on the government. Further research could be conducted to establish why the government has failed to address these issues which are obviously affecting the bargaining power of the country.

Appendices

Appendix 1: Map of the Philippines⁴⁵



⁴⁵ Source: Philippine Government. 2006. The Official Website of the Republic of the Philippines, available at <http://www.gov.ph/aboutphil/images/bigmap.gif>, accessed on 1 August 2006.

Appendix 2: List of Interviewees

Alburo, Florian Professor. 2004. *Interview*, 23 January 2004, School of Economics, University of the Philippines, Diliman, Quezon City, Philippines.

Angping, Harry Congressman 2004. *Interview*, 31 January 2004, Paranaque City Office, Philippines.

Antonio, M L. 2004. *Interview*, 30 January 2004, Senior Vice President, Nestlé Philippines, Rockwell Centre, Makati City, Philippines.

De Ocampo, Roberto., *Interview*, 04 February 2004, President, Asian Institute of Management, Makati City, Philippines

Domingo, Gregory L. 2004. *Interview*, Department of Trade and Industry (DTI), Makati City, Philippines.

Domingo, Pam. 2004. *Interview*, 22 January 2004, Promotions and Public relations Group, Investments and Promotions Department, PEZA, Roxas Boulevard, Pasay City, Philippines.

Ilagan, Jonjie. 2004. *Interview*, (21 January 2004) HR Manager, Samsung Electronics Philippines Manufacturing Corporation, Calamba City, Philippines.

Interviewee 1. 2004. *Interview*, AMCHAM, Manila. (see appendix 3)

Interviewee 2. 2004. *Interview*, Samsung Electronics Philippines, Calamba City, Philippines. (see appendix 3)

Interviewee 3. 2004. *Interview*, Austrade, Manila, Philippines. (see appendix 3)

Naguiat, Anton. 2004, *Interview*, 27 January 2004, Executive Director, ANZCHAM Philippines, Manila Office, Makati City, Philippines.

Ocampo, Satur C. 2004. *Interview*. Member House of Representative, Congressional Office, Constitution Hill, Quezon City, Philippines.

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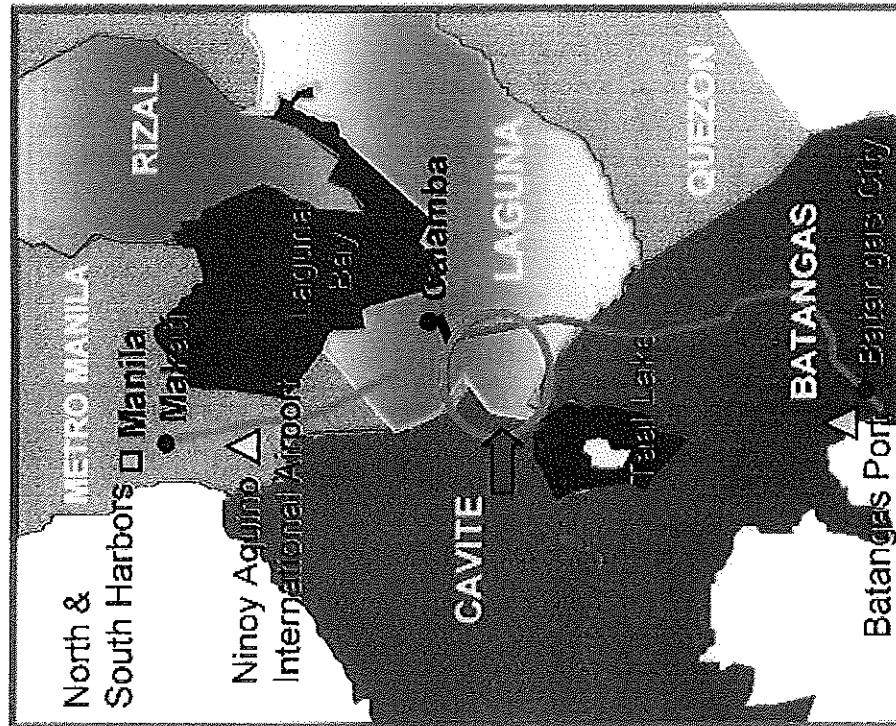
San Pascual, Elmer. 2004. *Interview*, 22 January 2004, Manager Investments and Promotions Department, PEZA, Roxas Boulevard, Pasay City, Philippines.

Zaldariagga, Chito. 2004. *Interview*, 04 February 2004, Carmelray Industrial Park II, Province of Laguna, Philippines.

Appendix 4: List of Interview Questions used during 2004 Field Study in the Philippines.

Question No.	Question
Q1	Do you believe that the technology transfer from MNCs have been beneficial to the Philippines?
Q2	Were the types of technology brought in by MNCs appropriate for the Philippines?
Q3	Why is FDI important for the Philippines?
Q4	Were MNCs screened prior to their getting entry to the Philippines?
Q5	Are the current entry requirements fair to all MNCs?
Q6	When the Philippines liberalised the economy post-Marcos was it prepared to accept the loss of local industry to foreign investors?
Q7	In your view what have been the benefits for the Philippines from FDI?
Q8	If you had the opportunity to restructure the laws governing FDI since you were in office, what would you seek to or change?
Q9	Do you believe that the instability in southern Philippines is a major factor why Foreign investors are not seeking to invest in the Philippines?
Q10	Local industry is expected to compete on an equal footing to MNCs. Do you think there is not enough incentives being offered to local producers, manufacturers etc?
Q11	Does the Philippines have bargaining power when dealing with MNCs? Give reasons why you believe they do or not.
Q12	What can the Philippines government do to get some bargaining power over MNCs?
Q13	What industry do you believe the Philippines should focus on?
Q14	How crucial is US FDI to the Philippines? Japanese? European?
Q15	Do you think that technological parks are an essential component for attracting FDI?
Q16	Do you think that the current government is doing a better job at attracting FDI as opposed to your government?
Q17	Is the war on terror having an impact on FDI finding its way to the Philippines?
Q18	Raymond Vernon believed that certain negotiated agreements between the host-country and MNCs could become obsolete once the MNCs have established their operations in the host-country. His “obsolescing bargain theory” where the host-government takes control of the MNCs operations and assets has been proven right particularly in some countries in Latin America. Do you think that this is possible in the Philippines?
Q19	How important is economic development when assessing MNCs entry to the Philippines?
Q20	Does the government expect MNCs to contribute to economic development? If so, in what way? What are the monitoring processes?

Q21	Do you think that the MNCs have the best interests of the host-country in mind when they apply to get access to the Philippines market?
Q22	Do you think that the Philippines give up (incentives, etc) too much for MNCs?
Q23	Do you believe that MNCs work towards making Philippines industry more competitive? In Asia, in the world.
Q24	Do you think that MNCs have too much political power in the Philippines?
Q25	If so, what is the current government doing to address this issue?
Q26	Do you think that some MNCs have in the past or in most recent times influenced political and legislative outcomes in the Philippines?
Q27	In your own words do you think Philippine business people think negatively or positively of MNCs ?
Q28	Do you think most Filipino employees prefer to work for a local company?
Q29	Suppose the Philippines agrees to grant favourable tax rates to a MNC if the MNC builds a manufacturing facility in the country. What prevents the Philippines from reneging and imposing full taxes. Or worse, what prevents the Philippines from just expropriating the facility?
Q30	In any bargaining situation, there is a cost to not concluding a deal. However the cost of waiting may be greater for one party than for another. Do you agree that the party that has the lowest cost of waiting has more bargaining power, because it is more willing to refuse a deal than the other party?
Q31	Some FDI may provide technological spillovers or training for workers. Do you think that spillover will be greater if the foreign-owned firm hires more local people for key positions in the firm?
Q32	It can be argued that the Philippines
Q33	Do ASEAN, APEC and the WTO have an impact on the ability of the Philippines to attract MNCs and FDI?



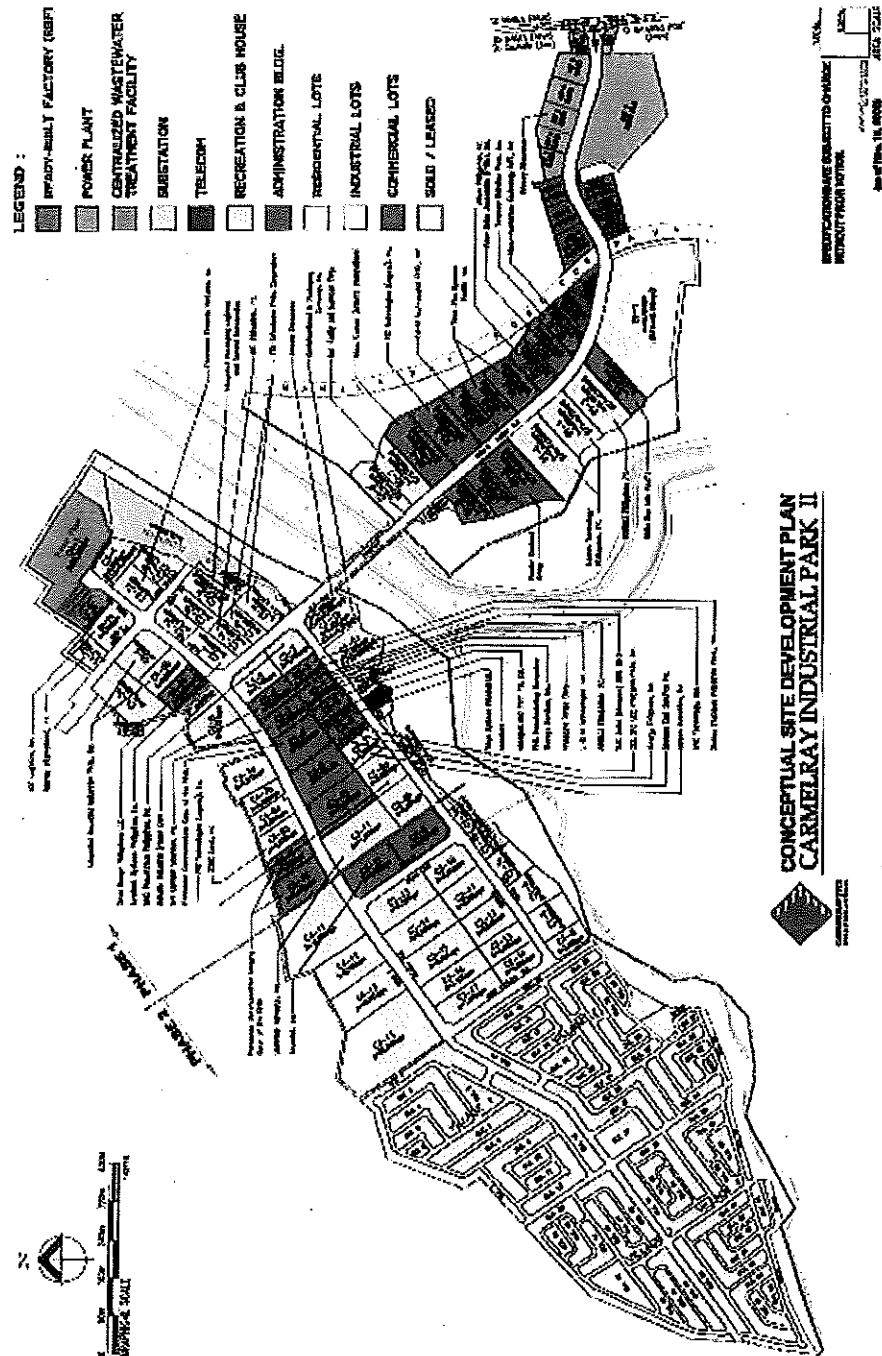
THE LOCATION : PROVINCE OF LAGUNA

- At the heart of CALABARZON
- 45 minutes from Metro Manila
- 50 kms. from the airport
- 54 kms. from the Makati Central Business District
- 62 kms. from Manila North and South Harbors
- 64 kms. from Batangas Port

⁴⁶ Source: Carmelray Industrial Park II Overview Presentation Handbook, January 2004.

Appendix 6: CIP II MASTER PLAN⁴⁷

CIP II MASTER PLAN



⁴⁷ Source: Carmelray Industrial Park II Overview Presentation Handbook, January 2004.

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