15 PRIVATIZATION IN THE PHILIPPINES

The Philippines' efforts in privatization have taken place in three waves since the mid-1980s.

By Lauro A. Ortile
Project Manager, BOT,
Coordinating Council of the Philippine Assistance Program

Introduction

Privatization, involving the sale or lease of government assets – power companies, banks, water companies, telecommunications, etc. – and in the infrastructure sector, can be achieved through various means in a public/private partnership, as follows:

- *BOOT or BOO systems*: where there would not be a transfer of ownership;
- *rehabilitate-operate-transfer (ROT)*: if there is an existing facility or infrastructure;
- *build-transfer-operate (BTO)*: if there is a restriction on ownership of the facility – for instance if it is still owned by the state but the private sector operates and maintains the facility; and
- *joint venture*: If the government wants to participate as an equity holder or investor in a financially viable project that would give a good return.

There are many reasons why countries choose a program of privatization. It may be because a country wants to take advantage of the private sector's efficiency and to save money in implementing infrastructure projects. It may be out of a budgetary concern or part of an economic development program. Or perhaps privatization is seen as a global trend and therefore the "in" thing to do at that time.

The Philippine Experience

Privatization in the Philippines has taken place in three waves.

The first wave

The first wave started in 1986-1987 during a time of great political change in the country and involved the disposition of nonperforming assets owned by the Government. Mostly these properties had been foreclosed and taken over by government banks, which had lent large sums of money to them throughout the 1960s to early 1980s, including the economic crisis in 1981. Included in this first wave of privatization were the surrendered and sequestered assets from the friends and relatives of deposed president Ferdinand Marcos. The Government ended up funding all these operations at a loss. With the country at this time experiencing an economic crisis – double-digit inflation, a deficit in the balance of payments, gross international reserves below $1 billion – the Government, in its dire need of cash, decided to cut its losses and resell these companies.

The second wave

The second wave started in 1990 with the power sector and the success experienced there was then replicated through an expanded BOT law in other areas of infrastructure, such as roads, airports, seaports, water, and even information technology.[1]

The third wave

This is the Philippines' present stage and involves services such as housing, health, postal services, and pension funds. These are very delicate areas, so now the Government is undertaking studies on how best to implement these social services.

Landmarks in Privatization

The 1987 Constitution states that it is a policy of the Government to recognize the indispensable role of the private sector as the main engine of growth for national development. There are various elements in the legal framework.

- *Assets Privatization Trust (APT)***:** Basically pertaining to the first wave, APT concerns the disposition of nonperforming assets.
- *Executive Order No. 215*: This was the first legal framework for power and was passed by President Corazon Aquino in 1987, resulting in the implementation of about 20 power projects.

- *Republic Act No. 6957*: Congress passed this Act in July 1990. However, only two projects were implemented under this law: the Light Rail Transit (LRT) Line 3, an overhead railroad along a key route, EDSA; and a public market in Mandaluyong City, in the north of Manila.

When Fidel Ramos took office as president in 1992, the original BOT law was amended to make it more flexible, allowing nine types of scheme – not only BOT – including bill transfer, bill lease transfer, and BOO. As a result, two new schemes were created by the private sector: a build-rehabilitate-operate-transfer scheme for hydropower projects and a build-transfer-swap. Under APT, everything was carried out through public bidding. In some cases where the bid or the offer by the private sector was low and failed to reflect Government estimates, a fail of bid was declared. So the emphasis has been on getting the right price rather than generating revenue immediately.

Unsolicited Proposal

When the Republic Act or the original BOT law was amended in May 1994, the Office of the President was involved in providing technical support to lawmakers. A new provision was included called the Unsolicited Proposal, which allows private sector initiatives to propose projects to the Government, but subject to certain conditions, which have to be set in the final draft of the bill. The conditions are as follows:

- Unsolicited Proposals from the private sector must not require direct government equity, meaning the Government will not be a part of the project company that will finance the project;
- the Government will not provide a direct guarantee, meaning the Government will not repay loans incurred by the private sector; and
- the Government will not provide direct subsidy and will not be the source of revenue, so projects initiated by the private sector should be already financially viable. However, the Government will give support to make the project financially viable by providing credit enhancements. These could be incentives provided by the Board of Investments, such as income tax holidays for six years, or imposing duties as low as 3 percent on importation of capital equipment. This law allows a 50-year concession period.

This BOT Law basically covers all the provisions required by the private sector in terms of financing. It even allows provision for *force majeure* in case of disaster, political change, or change of circumstances. It provides an escalation formula should there be a need to adjust the rates if inflation has reached double digits or interest rates have increased.

It also provides for arbitration in case there is a dispute between the Government and the private sector.

The Government always goes for a win-win situation because this is a public/ private partnership that is important to the economy. The private sector should be able to expect a reasonable return on investment reflective of the capital market plus the risk.

Role of NEDA

All projects in the Philippines amounting to more than ₱300 million ($7.5 million) are reviewed and approved by the Investment Coordination Committee of the National Economic and Development Authority (NEDA) board. Basically, it reviews the project as a whole; its financial viability; and the economic returns to the local economy, to the area covered, and to the national economy. It also looks into the impact of the project in terms of foreign exchange and on the balance of payments. This same committee looks into risk sharing proposed by the private sector or the Government in the case of public bidding. The mandate of the Investment Coordination Committee is written into the BOT Law to approve projects for implementation through BOT. The committee is one of five under the NEDA Board, which is chaired by the president.

There is no official discrimination between local and foreign financing for the private sector implementing a given BOT project. This is because the question of whether the project finance is foreign or local is a responsibility of the private company and not a responsibility of the Government. The same is also true for the equity component of a project. The equity and debt financing of an infrastructure project are sole responsibilities of the private sector and this in a way relieves the Government from sourcing financing to implement a project.

Because it is a new legal framework and there is a certain amount of unfamiliarity with the new law, the Government has conducted extensive training sessions for its own officials as well as the private sector to explain how it all works. It has also provided advanced training that includes financial modeling, contract negotiation in the Philippines and overseas, and cost models.

The result of this training is that it has produced a core of BOT professionals in national and local government agencies. In each agency there is one BOT project development officer of at least the rank of director or assistant secretary, who would be the contact person for BOT implementation in the agency. Unfortunately, some of these trained staff members have been subsequently poached by the private sector, necessitating the training of replacements. The Office of the President was mandated by law to monitor and coordinate these projects, and help in development, technical assistance, and evaluation of the conduct of public bidding and negotiation. Multilateral agencies gave a lot support in terms of technical assistance because these are expensive undertakings.

The Philippines privatization program was begun at a time of economic crisis and the second wave was undertaken during a power crisis. It has to be said that such schemes are best undertaken when there is not a crisis, otherwise the Government will be racing against time. Financing will be more expensive because the political and economic risks are high and the credit rating low.

Work in Progress

The Philippines legal framework can be said to have worked and despite various problems, it is on the right track. The rules and regulations of the BOT Law are being amended and public hearings are going to be conducted. These are important because they address another issue – social acceptability. A legal framework must not only be bankable, but must be something that can withstand scrutiny by the public over a long period – say, 30 to 40 years.

Power sector

Completed operational projects and those in the pipeline in the power sector amount to about $11 billion.

Transport sector

About 52 projects in transport total about $6.9 billion. The Government is negotiating two rail projects and two toll roads. Unlike the case of EDSA LRT Line 3, the Government will take the market risk on subsequent transport projects.

Water and waste sectors

This is a remarkable sector of infrastructure development. Two concessions for the Metropolitan Water Sewerage contract were awarded in 1997 to two consortia headed by two local companies. The Government is at the negotiation stage for a $400 million bulk water supply in Cebu, central Philippines.

Information technology

The Government is trying to computerize the country’s passport system, civil registry, car registrations, and land titling, as well as other smaller projects. These are but some of the achievements of a legal framework written into the Constitution, which specifies the private sector as the engine of growth for national development.

Notes

[1] The development of the energy sector is covered in Chapter 11.