Philippine Journal of Public Administration, Vol. XXXIX, No. 4 (October 1995)

Philippine Privatization: Lessons and Difficulties

EPICTETUS E. PATALINGHUG*

Major lessons can be drawn from the privatization experience of other countries. These lessons are applied in the Philippine context as the various approaches made by the Philippine government in privatizing certain non-performing assets are described. To illustrate the difficulties encountered in the privatization process, six specific cases are cited. Policy implications are also drawn out of the country's experience in privatization.

Introduction

Privatization policies have been embraced by many countries for a variety of purposes, namely, to improve industry efficiency, promote competition, encourage private entrepreneurial behavior, broaden the ownership base, and raise capital. In the Philippines, proceeds from the privatization efforts have contributed a significant portion of the non-tax revenues since 1986. However, since privatization proceeds are non-recurring, they may tend to distort the long-run fiscal picture of the national government (Diokno 1995). For instance, the sale of government assets has been able to contribute a major bulk of the government revenues in the last three years, and is partly responsible for the budget surplus achieved in 1994 (Neri and Taduran 1995). But since it is a non-recurring revenue source, the government would likely face a less robust position to service fiscal deficits in the future as the number of vendible public assets decreases in the midst of continually rising government budgets.

This paper examines the lessons and difficulties of the Philippine experience in privatization. It illustrates specific lessons of experience in other countries and applies them to the Philippine situation. It analyzes the various approaches made in privatizing major state assets. And to illustrate difficulties encountered in the privatization process, six specific privatization cases are described.

Lessons of Experience

As long as it is properly structured, privatization can yield substantial and enduring benefits. An analysis of twelve cases of privatization in four

*Professor, College of Business Administration, University of the Philippines.

countries concluded that disposition of public assets led to higher productivity and faster growth in all but one case (Kikeri, Nellis and Shirley 1992). An analysis of 20 assets that have been privatized by the Philippine Asset Privatization Trust (APT) concluded that the privatization efforts were a remarkable success in terms of generating ₱4.3 billion in additional revenues as well as in transforming these depressed assets into productive ones (Bustos 1993b).

One of the key lessons of the privatization experience in countries that borrow from the World Bank is that "privatization works best when it is part of a larger program of reforms promoting efficiency" (Kikeri, Nellis and Shirley 1992). Applying this dictum to the privatization experience of the Philippine Airlines (PAL) implies that privatization efforts would have produced more desirable results if they were accompanied by reforms to make the airline industry more competitive, and if free entry of other private carriers were encouraged.[1] A privatization scheme that tries to maximize selling price (revenue maximization) satisfies only the capital-raising objective of privatization, but ignores the other objectives with long-run effects — to improve industry efficiency, promote competition, and encourage private entrepreneurship. A privatization scheme that tries to maximize revenue without altering the structure of the market towards a more competitive and market-oriented environment would not be as effective. Most probably it would simply transform a public monopoly into a private monopoly.

Another key lesson of privatization experience is the critical role of transparency. This criterion was ably satisfied by the Fort Bonifacio sale, but not quite satisfied in the privatization of PAL and PETRON. In the case of the latter, the Philippine National Oil Company (PNOC) did not peg the minimum bid price before the bids were submitted. Moreover, the bid of Westmont Holdings Berhad of Malaysia was not opened. PNOC's explanation for not opening the bid was Westmont's alleged failure to meet the technical requirements of the bidding. Westmont protested that it made a detailed technical presentation on its capability and expertise before the technical bidding committee two days before the auction date.

While APT insisted on sticking to the bidding rules in the case of Domestic Satellite Corporation (DOMSAT), the sale of Philippine Shipyard and Engineering Corporation (PHILSECO) raised some questions on the soundness of APT's bidding rules. In December 1993, JG Summit Holdings, Inc., along with Sembawang Shipyard Ltd. of Singapore and Jurong Shipyard Ltd. of Malaysia won the bidding for PHILSECO with an offer of ₱2.03 billion. Philyards Holdings, Inc., originally composed of Kawasaki Heavy Industries, Ltd. of Japan and Magsaysay Shipping Corporation decided to exercise its right to top by five percent the winning bid and offered ₱2.13 billion to APT. But Philyards had included new members: Keppel Corporation, Mitsui

Engineering and Shipbuilding Corporation, International Container Terminal Services, Inc., Insular Life Assurance Co., and SM Investment, Inc. The objection raised by the consortium led by JG Summit Holdings, Inc. was that most members of the Philyards consortium formed part of the SM Investment Group that lost to JG Summit Holdings, Inc. during the original bidding. It therefore argued that "allowing the original losing bidders to band together and tie up with Kawasaki and Philyards will make a mockery out of the APT's bidding rules to the prejudice of the real winning bidders" (*Manila Bulletin*, 4 January 1994: B-3). Transparency here requires that bidding rules are not misinterpreted.

Still another lesson from privatization experience is that ownership matters. Privatizing management without privatizing the ownership of assets (e.g., management contracts, leases, concessions, etc.) can benefit in the short-run, but is not suitable in the long-run as observed by the experience of public enterprises on the road to recovery which have either stopped improving performance or suffered deterioration. Privatization or a change in ownership becomes necessary to sustain performance gains from privatizing management (Kikeri, Nellis and Shirley 1992).

In the Philippine experience, this lesson implies that private management of public enterprises like the Philippine National Bank (PNB) and the Philippine National Oil Company (PNOC) is likely to work best when it is simply a transition toward full privatization.

Big Ticket Items

Bustos (1993a) has documented that asset dispositions in sugar, cement, and textile industries are considered to be privatization successes because the average recovery against transfer price was 32 percent compared to an overall rate of 14 percent. The revenue generation impact of recent privatization is dramatized in Table 1 which shows the value of major corporate assets which have been successfully disposed of. The sale of Fort Bonifacio whose bidding procedures were supervised by the Bases Conversion Development Authority (BCDA), is the most transparent in the history of Philippine privatization and can be an eye-opener for APT and COP.[2] This means that a transparent and open bidding is not only politically correct, but can likewise generate the best sale price for the asset in the market. Had the bidding rules of Manila Electric Company (MERALCO), PETRON, and PAL been structured in the same manner as those of the Fort Bonifacio sale, there would have been less controversy and political flak.

One objective of privatization policy that is not revealed by the impressive revenue figures in Table 1 is the goal to broaden the ownership base. Bustos

(1993b) also pointed out that while the Philippine privatization program enhanced economic efficiency, it failed to broaden public ownership of enterprises because APT sales were usually conducted through sealed bidding instead of through public offering. APT apparently opted for speed of privatization at the expense of broadening the ownership structure. Recent privatizations have attempted to address the ownership issue. Despite its shortcomings, the recent privatization of PETRON addressed the ownership goal by allocating 20 percent of outstanding shares to the public. PNB opted to emulate PETRON's example when it finally sells at least eight percent of the bank to the public.

Table 1. Privatization of Philippine Public Corporations: 1989-1995 (Major Assets)

Asset	*Sales (Billion Pesos)*
Fort Bonifacio	39.2
Petron Corporation	25.0
National Steel Corporation	15.1
Manila Electric Company	13.6
Philippine Airlines	10.7
Philippine National Bank	4.6
Union Bank	2.9
Paper Industries Corporation of the Philippines	2.4
Philippine Shipyard & Engineering Corporation	2.1
Marina Properties	1.8
Philippine Plaza Hotel	1.5
Oriental Petroleum and Minerals Corporation	1.5

Source: Committee on Privatization (COP)

The choice between efficiency and ever-broadening spread of the ownership of property was encountered in the United Kingdom privatization experience. When the competition and efficiency justifications came under increasing criticism during the second term of Prime Minister Margaret Thatcher, the government emphasized the spread of ownership of housing and corporate shares. As a result, "owner-occupied housing as a percentage of all housing in England and Wales rose from 54 percent in 1979 to approximately 66 percent by the end of 1987, with upwards of one million housing units sold by 1987" (Rukstad 1992: 417). Share ownership grew because of various promotional efforts undertaken by the government such as employee share ownership schemes (ESOPs), changes in the tax treatment of some assets, public offerings of nationalized firms which allowed payment of shares in installments for a given period and employed maximum purchase provisions to encourage wide participation. The UK experience is not different from the procedures followed by PETRON. The difference, however, lies in the negative public reaction to PETRON's policy of allowing its employees to purchase larger allotment of shares than the general public at highly concessionary prices. Employees of British Telecom and British Gas Corporation were given the same privileges but with no political outcry.

Although the number of Britons owning shares increased from three million in 1979 to 8.5 million in February 1987, by mid-1987, however, the extent of small holder withdrawals from earlier privatization offerings was widespread (Rukstad 1992). This casts doubts on the desirability of emphasizing redistributional effects of privatization.

Specific Cases

Another aspect of the Philippine privatization experience that needs to be elaborated upon deals with major difficulties encountered in the disposition of some assets. Table 2 presents six assets that faced some difficulties, namely: Pantranco North Express, Inc. (PNEI), Domestic Satellite Corporation, Inc. (DOMSAT), Real Estate Assets of Filoil Refinery Corporation (FRC), North Davao Mining Corporation (NDMC), Philippine National Bank (PNB) and Associated Bank (AB). Of these six cases, only AB overcame various difficulties was finally privatized in 1993.

Pantranco North Express

Pantranco North Express, Inc. (PNEI) is a bus company sequestered by the Presidential Commission on Good Government (PCGG) in 1986. When the courts decided that PNEI was legitimately owned by the government, it was taken over by the Department of Transportation and Communications (DOTC) before it was turned over to the APT in 1991 in a run-down condition. By that time PNEI's franchises in various provincial bus routes were awarded by the Land Transportation Franchising and Regulatory Board (LTFRB) to other bus companies. And to top it all, PNB, which owned PNEI before 1986, claimed ownership of most of PNEI's terminals in Metro Manila. Leases of provincial terminals also expired and were not renewed by lessors. Because of these difficulties, PNEI's assets could only command at most ₱190 million in September 1993, and have since depreciated in value.

DOMSAT

Domestic Satellite Corporation, Inc. (DOMSAT) was bidded by APT on 13 August 1993 for a maximum price of ₱560 million. The bidding failed. It was

Table 2. Summary Information on Assets Facing Some Difficulties

Asset	*Status*
Pantranco North Express, Inc.	PNEI lost market value due to the following: the DOTC returned it to APT in a run-down state; PNEI's area franchises were awarded to other bus companies; leases of PNEI's bus terminals expired, and ownership of property located in Metro Manila was claimed by PNB.
DOMSAT	Two failed biddings occurred in August 1993. Minimum bid price was lowered from ₱560 million to ₱308 million. Negotiated sale to Morton Holdings, Ltd. was cancelled in November 1993 because of its failure to settle ten percent of purchase price by end of October 1993. Metro Pacific Corporation's offer to buy DOMSAT was rejected by APT because it requires changing the privatization rules for DOMSAT.
Real Estate Asset of Filoil Refinery Corporation	PNOC's bidding in April 1993 failed. A farmer group claims portion of 58.3 hectare asset under the Agrarian Reform Program.
North Davao Mining	APT conducted two biddings in May 1993 and March 1994 which failed due to a slump in world metal prices.
Philippine National Bank	PNB is planning to sell at least eight percent of the remaining state-owned shares to the private sector. However, COP opposes PNB's plan to sell as much as 20 percent to a foreign strategic partner. The last phase of PNB's privatization was delayed by the issue of transferred liabilities which was finally cleared, however, by the Commission on Audit.
Associated Bank	APT encountered difficulties in the disposition of AB because its former owner blocked its sale before the courts, SEC, and the Monetary Board. Finally, APT sold AB to its former owner in November 1993 for an upfront cash of ₱50 million, the infusion of at least ₱750 million for its rehabilitation, and the assumption of the ₱300 million loan with Philippine Deposit Insurance Corporation (PDIC). AB is now a viable entity called Westmont Bank.

again bidded on 31 August 1993 at a minimum price of ₱510 million, and again the bidding failed. After these two failed biddings, APT was able to complete a negotiated sale of DOMSAT to Morton Holdings Ltd. of the United Kingdom for ₱308 million, but this transaction was cancelled by APT in November 1993 because Morton Holdings Ltd. failed to settle the ten percent of DOMSAT's purchase price by 31 October 1993. DOMSAT's attractiveness to bidders is low because it faces several cases involving legal claims to its assets and earth stations. In early 1994, Metro Pacific Corporation offered to buy DOMSAT for ₱210 million in cash. APT preferred to sell DOMSAT at the original price of ₱308 million, but was amenable to a longer repayment of the remaining balance, apart from the immediate payment of the ten percent downpayment (₱30.8 million). The other obstacle that makes DOMSAT less attractive is the requirement that the buyer should settle DOMSAT's obligations to P.T. Telecom of Indonesia for the use of its Palapa satellite.

FRC Real Estate Assets

PNOC owns the real estate assets of the former Filoil Refinery Corporation (FRC) located in Rosario, Cavite. But the bidding on 20 April 1993 for FRC's 58.3 hectare real estate assets failed. After this setback, some complications surfaced. A farmer group claimed a portion of the real estate of FRC. Thus, a clearance from the Department of Agrarian Reform (DAR) was needed before the property was to be disposed of. PNOC has pegged the worth of these assets to be at least ₱175 million.

North Davao Mining

North Davao Mining Corporation (NDMC) was bidded in May 1993, but the bidding failed. In March 1994, APT set the base price of NDMC at ₱474 million, which included a ten percent loss recovery charge. The slump in world metal price, however, has mainly contributed to the absence of qualified bidders for NDMC's assets. The assets of NDMC offered for sale include the following: buildings, machinery and equipment, transport and mobile equipment, furniture and fixtures, office equipment, and spare parts.

Philippine National Bank

The privatization process of the Philippine National Bank (PNB) was initiated by the Aquino government which sold 43 percent of PNB to the public in May 1989 and in March 1992. The Ramos government expressed its intention to go ahead with the next phase of PNB privatization, despite some hesitation of some sectors, citing the need to use the bank to help develop the countryside. Earlier in 1994, the passage of the Sugar Restitution Law had stalled the next phase of PNB's privatization. This law requires that all sugar loans incurred between 1974 and 1986 at an interest rate of 36 percent would be restructured with carrying costs of only twelve percent. PNB insisted that anything above twelve percent would have to be absorbed by the national government.

The government is planning to sell at least six percent of PNB shares to the public. But the last phase of PNB's privatization was further delayed by the issue of transferred liabilities. This problem arose from the rehabilitation of PNB by the government in 1987. The government assumed ₱3 billion worth of liabilities, but "many of these obligations were left with the PNB, with the agreement that the government will pay it back at a future date" (*Philippine Daily Inquirer*, 15 May 1995: 17). The Department of Finance (DOF) and PNB have come to an agreement on the repayment scheme on the government's liabilities to PNB. By 1996, a majority stake of PNB should be privately owned.

Associated Bank

Associated Bank (AB) is an example of an asset finally disposed of despite various difficulties facing it. AB was awarded to Rizal Commercial Banking Corporation (RCBC), but the former owner of AB blocked the sale through the courts, the Central Bank, and the Securities and Exchange Commission (SEC). After successive failed biddings, the APT sold AB in November 1993 to its former owner, the Leonardo Ty Group, for ₱50 million in cash. Pledging the bank's shares as collateral, the bank was infused with at least ₱750 million for its rehabilitation and its ₱300 million loans from the Philippine Deposit Insurance Corporation (PDIC) was assumed. AB is now named Westmont Bank after Westmont Holdings of Malaysia. The Edgardo B. Espiritu Group infused additional equity, while the Ty Group controls 20 percent of Westmont Bank.

Policy Implications

Like in other countries, the experience in the Philippines with privatization started with strong intentions and is showing some success. The sale of major assets at a fairly good price has demonstrated that a "super agency" in charge of privatization does not need to have a large and bureaucratic staff. The current APT/COP setup seems to be organizationally adequate. On the other hand, the illustration of six cases facing various difficulties shows that the existence of a central authority with little legal and political clout visibly slowed down the process of privatization. Present legislation has tried to protect APT and COP from preliminary injunctions used to prevent the speedy dispositions of assets.

The lessons of experience that are applicable to the Philippine experience are: transparency, privatization as an integral part of a broader liberalization policy, and the need to emphasize privatization's effect in enhancing efficiency instead of maximizing short-run revenues.

The difficulties encountered in the disposition of assets are in the form of ownership claims of opposing parties that led to protracted litigation, the requirement that the prospective buyer assume the debt liability of the asset to be purchased, the divergence between book value and actual market value of assets to be disposed of, and the problem of settling government liabilities on specific assets.

Although the performance of Philippine privatization is one of success rather than failure, lessons learned from past experience here and in other countries would be helpful in refining and adjusting certain privatization rules and policies in the future. Obviously, Philippine privatization has been a fiscal success. But it remains to be seen how it can be restructured to guarantee that it creates a more competitive and efficient market structure.

Privatization can be viewed as satisfying various objectives. First, it can be a solution to the persistent fiscal deficit problem. The size of the privatization proceeds had a significant positive effect on the fiscal deficit. Second, it has the potential to improve the efficiency of state-operated enterprises. Third, it can reduce the degree of government involvement in the private sector. Fourth, it can serve as an instrument to broaden the ownership of property. Fifth, it can promote a market-oriented competitive environment. And sixth, it can encourage private entrepreneurial behavior. The Philippine experience is an exercise, to a large extent, satisfying the first objective. But, dependence by the government upon privatization proceeds should not become permanent, and future expenditure programs should not be planned on the basis of short-run revenue gains.

Endnotes

[1]British Airways (BA) was successfully privatized through a public offering. However, the British government instituted regulations to protect BA's routes from competition. In addition, BA was allowed to purchase its major competitor — British Caledonian Airways (Rukstad 1992).

[2]The Committee on Privatization (COP) is a cabinet-level body chaired by the Secretary of Finance, and composed of the Secretary of Justice, Secretary of Budget and Management, Secretary of Trade and Industry and the Director-General of the National Economic and Development Authority. APT is the marketing arm of the privatization policy, and COP is mandated to oversee and monitor the privatization program.

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