THE ANTI-DEVELOPMENT STATE:

The Political Economy of Permanent Crisis in the Philippines

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CHAPTER 5

The Panacea of Privatization

Introduction

Privatization, or the transfer of ownership from the public sector to the private sector is currently the topic of many intense debates both in the Philippines and in the international arena.

In the Philippines, the issue of privatization has been brought to the fore because of the current debacle over water services in the Metro Manila area and the ripple effects it will have on the rest of the economy. In the international arena, the current negotiations on the General Agreement on Trade in Services (GATS) under the World Trade Organization (WTO) have put privatization of government services in the spotlight.

Privatization has also been at the core of several struggles and disputes around the globe. In Bolivia it triggered a civil uprising where many died, and the multinational corporation that had taken over water services in the city of Cochabamba was forced to leave the country. In South Africa it has become an issue of human rights. In Europe it has become a rallying point of various campaigns ranging from anti-globalization to labor rights.

In this sense, privatization in the Philippines cannot be understood without seeing the larger picture and how different factors, both external and internal, have contributed to the current situation.

This chapter will discuss privatization in the Philippines in the context of the global debates. It will begin with a discussion of the international context, followed by a brief history of privatization in the country. It will then move to a discussion of the two most controversial cases of privatization in the Philippines—water and power.

This chapter will not cover all aspects of privatization as it is too diverse a topic, and many other books and studies have already discussed theories and practices of privatization in great detail. Instead, this chapter will focus on the expectations and actual consequences of privatization

in the Philippines. It will also link this paradigm to the current system of globalization and the institutions that support it, mainly the World Bank, the International Monetary Fund (IMF), and the WTO.

Privatization in the Era of Globalization

Privatization is not a new practice. It has been around since the 1940s. Many historical accounts of this era cite examples of this process of transfer of ownership or control of enterprises and services from the public sector to the private sector. It was not until the 1980s, however, that privatization as an economic tool gained people's interest and concern.

A Brief History

From the 1940s to the 1980s a distinct type of political economy was prevalent. In Japan, Europe, and the United States, state-assisted capitalism was the dominant paradigm with varying levels of state intervention in each country.

The theoretical underpinnings of state-assisted capitalism were provided by Keynesian economics, an approach developed by John Maynard Keynes in the early 1930s in response to the economic depression of the time. Keynes explained that the reason for the depression was insufficient demand. Government expenditure or intervention in the market could correct this and, therefore, avert such crisis.

In the post-World War II period, governments played an active role in the market by coordinating with the private sector, either by supporting the development of industries, regulating them, or nationalizing them. In Britain the railways, iron and steel, and other industries were nationalized. In Japan the economic bureaucracy worked closely with management to promote the development of steel, the auto industry, and electronics. In the US the state ironed out the business cycle with fiscal and monetary tools, and played a direct role in technological innovation in the military-industrial complex.

By the 1970s, however, economic stability gave way to a combination of stagnation and inflation, and a new ascendant school in economics—"neoliberalism"—saw the state as no longer the solution but the

problem. State regulation stifled entrepreneurship, state ownership was inefficient, heavy taxation discouraged investment. In Britain privatization of nationalized industries became the cutting edge of the new political economy when Margaret Thatcher came to power. In the US radical deregulation became the norm when Ronald Reagan assumed the presidency in 1981.

As the First World was changing loyalties, state-assisted capitalism in the Third World was running into problems. Encouraged by US and other international banks that sought to profitably recycle the massive amounts of cash deposited by the oil-rich countries after the oil price hikes of the 1970s, many developing-country governments went on a borrowing spree to fund not only their development needs but also arms purchases and, in many cases, conspicuous consumption by corrupt elites. The result was virtual bankruptcy for many by the early '80s, the same moment that the neoliberals came to power in the US and Great Britain. Taking advantage of the Third World debt crisis, the neoliberals, working through the World Bank and the IMF, made the adoption of a comprehensive set of liberalizing measures a condition for bailing out governments in debt trouble. "Structural Adjustment," as this program was termed, had the privatization of state enterprises and services at its core, along with deregulation and trade liberalization.

The Great Coherence

By the 1990s almost all the countries in the Third World had restructured their economies to adhere to these programs. The resurgent doctrine of free trade had triumphed nearly everywhere, as Keynesianism and state-assisted capitalism ceased to be the orthodoxy.

The era of free trade reached its peak in 1995 when the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) gave birth to the WTO. The WTO replaced the GATT and formed a far more comprehensive set of rules to govern world trade not only in goods but also in services.

Together with the IMF and the World Bank, the WTO issued a "coherence" document during the first WTO Ministerial Meeting in Singapore in December 1996, stating that the policies of the three institutions would be articulated closely to achieve global growth

and economic stability on the basis of liberalized trade and capital flows. The unstated assumption was that this would not be a major problem since free market and free-trade principles had already been institutionalized in many countries by structural adjustment programs (SAPs).

Trade in Services

As discussed in chapter 4, the WTO encompasses all forms of trade whether in goods or in services. The rules of the WTO on trade in services impact directly on the issue of privatization. One of the agreements in the Uruguay Round was the General Agreement on Trade in Services (GATS).

The GATS agreement establishes a multilateral framework of principles and rules for all forms of trade in all services. Services under the GATS framework include 160 service sectors including health, education, water, utilities, energy, transport, and childcare.

The aim of the GATS is to promote unrestricted trade in all types of services and to remove all forms of governmental intervention that may be viewed as "trade restrictive." Article 1 of the GATS states that the agreement does not apply to services "supplied in the exercise of governmental authority." This is followed with the caveat that such services must be supplied neither on a commercial basis nor in competition with other service providers. This condition effectively puts all services under the scope of the GATS, as it is very rare that government-provided services are neither provided on a commercial basis nor in competition with other providers.

But by this time, most countries in the Third World had already liberalized their services through the structural adjustment programs. What more could the GATS ask governments to do? On closer inspection, one will see that the GATS, said to be the most far-reaching agreement under the WTO, covers much more than just liberalizing a service.

The GATS key principles are as follows:

1) National Treatment: As the name implies, host countries are to accord foreign companies the same treatment they do national companies. This means doing away with performance requirements usually asked of foreign companies such as establishing joint partnerships with local firms, hiring local staff, and transferring technology. Governments must also provide the same tax privileges they would grant a domestic firm.
2) Most Favored Nation Status: A core principle in the WTO, host governments must not discriminate between countries. It must grant equal privileges to all fellow WTO-member countries.
3) Least trade-restrictive business environment: Host governments must ensure a "level playing field" for foreign companies even if it means curtailing established standards for the environment, labor, and health.

And most important, the GATS is virtually irreversible. The GATS uses a "bottom-up" approach, which means that countries can choose which services they will "offer" to liberalize. However, GATS works on the principle of "progressive liberalization"—with each round of negotiation, the sectors that a government commits to liberalize must open up more than before. Liberalization may be incremental, but cannot be fully reversed. Once it is offered and implemented, it can no longer be reversed regardless of the impact of such liberalization.

This also covers services previously liberalized through SAPs. In the GATS, countries are allowed to count services they had already opened up through SAPs and add it on a score card of progressive liberalization. Doing this, however, will automatically put these services under the mandate of the GATS, including the principle of irreversibility.

What makes this liberalization under the WTO different from the IMF-World Bank is the dispute settlement body of the WTO. The WTO has legally binding rules, and if governments are proven to have disobeyed these rules they can be penalized with economic sanctions.

And this, some argue, is the main reason why corporations are keen on placing the rules of privatization under the WTO. According to Tony Clarke, director of Canada's leading policy and advocacy organization, Polaris Institute, placing agreements such as investment and trade in services under the WTO will make them enforceable because of the threat of escalating economic sanctions. "In other words, there is a whole system of economic punishment built into it."

Framed in this context, the principles of free trade, especially that of privatization, are difficult to evade, advanced as they are by loan agreements governments enter into with the World Bank and the IMF, or trade accords they sign up to in the WTO.

Services—For Profit or for People?

The critique of these policies of the IMF-World Bank and the GATS agreement of the WTO is that the eventual privatization of all state-owned assets including those of public utilities and services would exacerbate further the inequality between the haves and have-nots. The concept of government-provided services is that it will allow for the poor in the country to still avail themselves of basic services vital to decent living such as water, health, and education. This is achieved through the subsidization of services to the poor by the government while recovering costs through transfer payments from the middle class and the rich.

The sale of these services to the private sector, however, will close off this access of the poor. Under the free-market model of corporations, services will be run for profit. The privatization of the water sector has generated the most debate because according to the United Nations (UN), access to water is a human right and everyone is entitled to a basic lifeline of at least fifty liters a day.

Many argue that when corporations take over the water service and other basic services, only those who can afford will be able to avail themselves of these services. In Malaysia, for example, according to economist Charles Santiago, when the water privatization comes into full effect, people will only be able to avail themselves of water by first purchasing prepaid cards. Santiago explains that the money will have to be provided up front if one wants to receive water at home.

In Cochabamba, Bolivia, privatization raised the prices of water to an unaffordable level for the people. The prices rose to $20 a month—an unimaginable cost when compared to the minimum wage, a meager $100 a month.[1]

Corporations justify this rise in prices by citing the costs of improving infrastructure and infusing capital. Operating on a principle of cost recovery, corporations pass on these costs to the consumers, i.e., through price adjustment.

This obviously does not follow the UN-mandated basic lifeline of free fifty liters a day for the people, especially that of the poor. Under the WTO, though, water is defined as a human need and not a human right. "This," according to leading water activist, Maude Barlow, "is not a semantic thing." Barlow expounds, "If water is a human need, then anybody can deliver this water, the private sector, anybody. But if it's a human right, you can't market or trade or sell a human right."

Another issue related to this debate is the fact that most corporations which take over the government-provided services are foreign transnational corporations whose profits do not revert back to the local economy. As Patrick Bond of the University of Witterstrand of South Africa explains, "We see French and British water companies, especially German and American, coming in now, taking in the water and adding a 30-percent or more profit, and then taking that money out of the country."

This global debate on services being provided for profit instead of for the people is one of the reasons why privatization, especially that of water, in the Philippines has generated much debate and controversy. As a vice president of the World Bank, Ismail Serageldin, aptly put it, "If the wars of this century were fought over oil, the wars of the next century will be fought over water."[2]

Privatization in the Philippines

The Philippines, a recipient of nine SAPs, three standby programs, two extended fund programs, and one precautionary standby arrangement with the IMF, has undergone severe economic restructuring.

It began in 1984 when, after signing a $300-million World Bank loan, the Philippines agreed to legislate new laws for the privatization of state-owned assets.[3] President Marcos issued Presidential Decrees 2029 and 2030, paving the way for privatization. This was followed by President Aquino's Presidential Proclamation 50, which created the Committee on Privatization (COP) and the Asset Privatization Trust (APT).[4] The two programs would lead the country's privatization program. The COP identified the assets that could be sold and the APT took charge of disposing them. President Ramos would reinforce this with Executive Orders 37 and 298, Republic Acts 7661 and 7886, all of which supported the country's privatization program.

According to the Management and Organizational Development for Empowerment (MODE), privatization in the Philippines consists of three waves. The first wave was the selling off of enterprises expropriated from cronies of Ferdinand Marcos. The second wave was the selling off of profitable assets such as Petron, the Manila Hotel, Fort Bonifacio, and power and water industries. The third wave, yet to be accomplished, will be the disposal of public-service institutions like hospitals, state colleges, housing, and postal services.[5]

The disposal of these assets can take various forms. The first is the outright sale of these assets, which has been the most common mode of privatization in the country. The second is through build-operate-transfer (BOT) schemes in which corporations spend on capital and infrastructure, operate the business for an agreed period of time—recovering investment and receiving profit—and then return it to the government. The third is through joint partnerships in which the government enters into joint ventures with corporations, the rationale being that corporations would revive the industry by pumping in fresh capital.

All the administrations cited the same reasons for selling off state-owned assets. The justification used by Marcos, Aquino, Ramos, and the succeeding governments of Estrada and Arroyo fell into these general themes:

- privatization would make the industries efficient
- the profit from the sale of these assets would help augment the government's budget
- the sale of these assets would eliminate government subsidies and thereby lessen the drag on the national budget[6]

The sale of the crony assets by the Aquino administration did not meet much opposition as it was generally viewed as a taking back of assets from the crony-associates of Marcos. Most of the assets, however, were no longer profitable by the time the Aquino government auctioned them off to the private sector. In most cases, the government had to absorb the debt incurred by these corporations or infuse fresh capital to make them marketable. This meant that the government was selling at a loss of around Php 42 billion.[7]

It was also during the Aquino administration that the second wave of privatization began. The privatization of the power sector saw its

early stages under Aquino's watch. It was at this time when the infamous eight-hour blackouts enveloped the country. The blackouts literally debilitated entire industries whose products or management depended on electricity. The government drew much flak as it failed to manage the crisis.

The government's response was to privatize the power sector. Through Executive Order 215, the power-generation sector was deregulated and left to the private sector. Though energy privatization began under Aquino, it was the Ramos administration that pushed it furthest, entering into deals with both local and foreign "independent power producers" (IPPs). The Ramos government also sold off profitable assets such as the oil corporation Petron and the vast real estate of Fort Bonifacio. It was also under the direction of Ramos that the two most controversial of all privatization deals were made, the selling of the water utility, the Metropolitan Waterworks and Sewerage System (MWSS), and the power sector, the National Power Corporation (Napocor or NPC).

Watery Deals

The time of the Ramos administration was the height of the climatic phenomenon known as El Niño. The unforgiving heat caused severe droughts and negatively affected both the agricultural and metropolitan sectors of the country. In response to the crisis, the government quickly enacted Republic Act 8041 or the National Water Crisis Act of 1995.

This law gave the President the power to privatize the state-owned water utility, the 119-year-old MWSS. But while the President used the water crisis as the rationale behind the new legislation, it is important to note that the privatization of the MWSS was actually listed as one of the conditionalities of the 1995-1997 SAP agreement with the IMF.[8]

The process of auctioning off the water utility began with the passage of the law but it was not until 1997 when the awarding to the winning bidders took place. The privatization of the MWSS was at the time the biggest water-sector privatization in the world.

It was, however, not an outright sale of MWSS assets. As Jude Esguerra of the Freedom from Debt Coalition (FDC), a leading ex-

pert on the issue of privatization, explains, "The physical assets are still owned by the government but the transaction gave the private sector the right to use them, and the obligation to maintain them and expand them in exchange for the private sector's right to collect a regulated fee from users."[9] Esguerra further explains that at the end of the twenty-five-year agreement, the government takes over the operation and control of the assets. The private concessionaire, on the other hand, will by then have fully recovered its investments and reaped projected profits.[10]

The privatization of the water utility, despite its massive scale, did not meet much opposition from the Congress or from the general public. This, analysts attribute to the fact that the quick resolution of the power blackouts in the '80s by the private sector gave people the impression that a similar process would resolve the water crisis.

Furthermore, whereas in the power crisis people agreed to pay higher rates for better service, the water privatization offered to bring better service for lower prices. In his study, Esguerra notes that the winning bids offered prices that were one-fourth and one-half of the existing rates of the state-run facility.[11]

This really promised to be a privatization success story. Not only did it relieve the government of the water utility, which serviced twelve million customers, it also relieved it of the crippling debt—$880 million. The privatization was hailed as a success in international circles.

A few years later, however, the success story would turn sour as water prices rose exponentially and Maynilad, one of the winning concessionaires, declared that it was walking out of its twenty-five-year contract.

To understand how the success turned into failure in barely three years, a closer inspection of the entire process is required, beginning with the bidding and ending with the current debate surrounding the controversial pullout of Maynilad.

A Tale of Two Bidders

The bidding process began on a good note as the government decided to follow the "Paris model," in which the service area was split into two and each assigned to a separate concessionaire. Experts believe that this measure would break up the monopoly and allow regulators to

check the performance of one concessionaire against that of the other.[12]

The government also took steps to ensure that they got the best advice from experts before opening up the bidding process. The experts offered by "friends" came from the World Bank's private-sector lending agency, the International Finance Corporation (IFC).

The IFC consultants were tasked with, among other things, identifying the concessionaire service obligations, the tasks of the MWSS, setting up of a regulatory office and setting up of a dispute-resolution mechanism. They also gave information to prospective bidders to assist them in profit forecasts and, finally, they played the role of identifying eligible bids and winning bids.[13]

At the advice of the IFC experts, the contracts were designed to maximize the benefits for all parties—the government, the concessionaires and the consumers. The concession agreement was carefully crafted, covering all possible scenarios, from extraordinary events to requiring concessionaires to put up a performance bond of $200 million.

The contract also required concessionaires to improve the quality of service by investing in infrastructure and capital. To achieve this, it detailed a number of obligations:[14]

- increase the number of water and sewerage service connections
- gradually increase water pressure
- eliminate service interruptions
- maintain water-service quality
- implement projects for new sources of water supply
- establish a sewerage network

The contract also took into consideration the concessionaire's need to recover its capital investments and costs. While it was ideal for prices of the water service to stay low, it was acknowledged that events such as inflation and currency devaluation would need to be factored in if concessionaires wanted to keep their businesses running. To address these events, the concession agreement provided three measures by which a concessionaire could adjust their prices:

- inflation
- extraordinary price adjustment (EPA)
- rate re-basing

The first is self-explanatory. The agreement allowed for automatic price adjustments in accordance with the inflation rate of that year. The second is designed to address events such as currency devaluation. The third is a more complicated process done at the beginning of every five-year period. Esguerra explains this process as a review of tariffs to ensure that given the rates, the concessionaire is still able to recover costs and investments.[15]

When everything was set the bidding process began and by January 6, 1997, the winning bids were announced.

The two winning bids were from Manila Water, headed by the Ayala group of companies, offering only 26.39 percent of the MWSS rate, and from Maynilad, headed by the Lopez group of companies, offering 56.59 percent of the MWSS rate.[16] Manila Water was awarded the East zone while Maynilad, the second-lowest bidder, was awarded the West zone.

It is important to note that both the Ayalas and the Lopezes are key players in the Philippine business sector, owning, controlling, and managing a great number of industries from telecommunications to media to real estate. Both these families are known oligarchies that are not only well connected in business but also in politics. It is also important to know that both companies, while owning significant capital on their own, bid for the water utility together with foreign partners. Ayala bid jointly with International Water Limited, an international consortium including corporations such as Northwest Water and Bechtel. Lopez bid together with Lyonnaise des Eaux, a French transnational corporation with businesses spanning almost all continents.

The rates offered by the two concessionaires were unbelievably low and the promises were great. This caused many to suspect that the bids were in fact "dive bids" designed to win the concessions at whatever cost. In the cutthroat world of the free market, "dive bidding" is a common practice. It is therefore the responsibility of those reviewing and awarding the bids to identify these dive bids and cancel them out of the race. In this case, it was the responsibility of the IFC consultants to assist the government in identifying the unrealistic bids and rejecting them. Their main role, however, seemed to begin and end with closing a deal. And so even if they suspected the dive bids, they did nothing.

Orville Solon and Steven Pamintuan, two economists of the University of the Philippines, detail these suspicions in a report assessing the privatization of the MWSS. They list the following telltale signs of a dive bid that the IFC consultants themselves recognized:[17]

- Manila Water's consumer-demand projections were 45 percent higher than the earlier study by a French consulting firm hired by the Philippine government.
- Manila Water details a highly capital-intensive endeavor—reducing non-revenue water to half in just five years.
- Manila Water assumed it would get a yen-denominated project finance at a very low real rate of 2.79 percent—and subsequently basing its projections on this.
- Compared to other bidders, its capital spending was 25 percent less.
- Its projected internal rate of return was 3.6 percent—a very low figure compared to other bidders whose rates were set between 9 percent and 11 percent.
- If Manila Water followed all its promised performance targets, it would suffer a negative cash flow for the first ten years—a deficit to the tune of $496 million. (The IFC even notes their uncertainty on how Manila Water intended to secure debt funding with these terms.)

Maynilad's figures caused some concern. It also projected too aggressively and optimistically, casting doubt on the feasibility of such forecasts. It was also discovered later on that Maynilad's figures on the debt burden it was taking from the government was in fact Php 3.9 billion short of what bidders were instructed to assume.[18]

The bidding process, on closer inspection, reveals many flaws and signs of an impending disaster—signs that were discovered early on and yet ignored. The rush with which the bids were finalized, despite better judgment, calls suspicion to the type of advice the World Bank offers—to privatize at the soonest time possible, regardless of consequences.

This major flaw in the process formed the basis of the disaster that the water privatization became. Because the bids were not feasible, all the rest of the promises made by the concessionaires were therefore

not feasible either. All the promised improved services and increase in water pressure cannot be logically achieved with unrealistic rates and forecasts. Unrealistic bidding triggered the events that came to pass: the requests of concessionaires to raise their rates, pass on foreign currency adjustments to consumers, and eventually the bailing out of one concessionaire from the twenty-five-year contract.

Spiralling into Disaster

Both Maynilad and Manila Water, after careful analysis, can be said to be guilty of dive bidding. The two, however, differed in the aftermath of the declaration of winning bids.

Maynilad

By 2000 Maynilad was clearly suffering from its own miscalculations. It won the bid by projecting rosy profits and minimal costs, but three years into the contract their skewed projections were catching up with them.

To illustrate, its figures were off the mark by more than 30 percent. First, it projected operating costs for the first three years at Php 4,369 million—a figure 43 percent off mark as their actual operating costs clocked in at Php 6,259 million.[19] Second, their projected revenues for the same period was Php 7,255 million, again a figure off target, this time by 33 percent, as their actual revenues only amounted to Php 4,729 million.[20]

Maynilad, however, attributed its poor performance to force majeure—the Asian financial crisis. Maynilad borrowed heavily using hard currency and assumed a significant amount of the debt of the MWSS, denominated in US dollars. This made it vulnerable to the crash of the Philippine peso. At the beginning of the concession the peso had relative strength to the dollar, pegging in at Php 26 to $1. After the Asian financial crisis, the peso had crashed to a low of Php 50 to $1.

But this argument is difficult to sustain. First of all, Maynilad should have hedged its borrowings or borrowed at higher interest rates that guaranteed against foreign-exchange fluctuations, a standard practice in international financial transactions. Second, it is important to note that

even without the foreign-exchange losses, Maynilad's losses already amounted to a crippling Php 2.7 billion.[21]

Furthermore, as was discussed in the previous section, the concession agreement had required concessionaires to factor in currency depreciation. It had also in fact installed measures to ensure that concessionaires would be able to adjust prices accordingly.

Manila Water

The case of Manila Water differs from that of Maynilad in that, even though it had the lower bid, it was in better shape than Maynilad. This could be attributed to the fact that Manila Water, unlike Maynilad, was able to secure loans from financial institutions despite performance that deviated significantly from projections. Esguerra explains that this was due to the difference with which the two concessionaires negotiated debt financing.[22] Maynilad took the path of "limited recourse financing" or a type of borrowing that used the projected profits as the collateral. Manila Water, together with Bechtel, on the other hand, used the more traditional and secure way of borrowing, that of putting up its own assets as collateral.

Access to loans of this magnitude mattered greatly to companies in a highly capital-intensive industry. It is important to remember that these companies were committed to certain performance targets such as improvement of infrastructure and the reduction of nonrevenue water. If they were to renege on these agreed targets, the government could call on their performance bonds of $200 million.

Despite its slightly better situation, however, Manila Water was still in bad shape. It had also projected revenues too aggressively and underestimated costs too conservatively. Their tack, though, was to change the parameters of the bid.

The parameter Manila Water wanted amended was the appropriate discount rate (ADR). The ADR, as Esguerra breaks down in his study, determines the interest rate that consumers must pay for the deferred recovery by the concessionaires of costs that are approved during the EPA petitions.[23]

This translates to Manila Water wanting to change the terms it agreed to in the concession agreement. In its bid, it based its projec-

tions and rates on an ADR of 5.2 percent whereas other bids set theirs at 10 percent.[24] Manila Water wanted it raised to 18 percent. If this were approved after the awarding of the bid, this would be unfair to the losing bidders. Even without the actual figures, it would logically mean that the rate that Manila Water would operate on would in fact be a lot higher than those of the losing bids. If concession agreements could be altered after the fact then all future auctioning would see corporations offering dive bids because they would be confident that they would be able to change the terms it offered after it won the concession.

In the end, both concessionaires had one thing in mind: adjusting the prices. And in October 2001 they got what they wanted—the concession agreement was amended. Price adjustments were made and Maynilad, the more dismal of the two, was given a lifeline.

Nonexistent Regulation

Another factor in this sordid mess was the regulatory function—or rather the lack of it. According to a study done on behalf of the Friedrich Ebert Foundation, the lack of proper regulation was a key factor in explaining the failure of the privatization of the water utility. It goes on to recommend that in future cases, the regulatory agency should be established independently through a separate legislation rather than the current setup of putting up a regulatory agency on the basis of the concession agreement.[25]

In hindsight a strong regulatory agency would have been able to maximize the ideal setup of splitting the concession into two zones. It should have been able to gauge one's performance against the other and used that as a basis for granting or rejecting appeals for price adjustments. Also, a strong agency would have at the outset discouraged dive bids as corporations would not be so confident of future amendments to the agreement.

Unfortunately, the regulatory agency for the water concessionaires was established as a sort of afterthought. It only came into being after the agreement was signed, and to make matters worse, it took its funds from both concessionaires.

A Not-so-Happy Ending

In the end, the success story of the biggest water-sector privatization turned sour barely three years into the program. Water prices have risen by up to 425 percent[26] and consumers ended up with the raw end of the deal. Because of the amendment to the concession agreement, concessionaires were allowed, through a mechanism called foreign-exchange cost recovery, to pass on the foreign-exchange costs directly and immediately to the consumers.

Despite this adjustment though, Maynilad still backed out of its twenty-five-year agreement with the government. Citing the government's refusal to approve its bid for a further hike in rates, it has tried to walk out of the concession agreement. But it is not walking away scot-free. In a recently concluded arbitration case in the Paris-based International Court of Arbitration, the court ruled that Maynilad's unilateral termination of the concession agreement was "baseless" and it ordered the concessionaire to pay the MWSS Php 6.77 billion. Several advocacy groups are also demanding the return of overcharging costs to consumers.

The beginning of 2004 found the government saddled with a bankrupt concessionaire and faced with the daunting task of assuming management for Maynilad's zone of operations while waiting for a qualified bidder to take over. This means that the government would have to assume the costs and debts and at the same time run the facility to service the millions of customers in its zone. MWSS's troubles were magnified by the courts' delayed ruling on its effort to draw from a $120 million performance bond that creditors had drawn up to cover Maynilad's liabilities to the government.

As if to console itself, after all this, the government still refuses to acknowledge this as a failed case of privatization. As an official of the Arroyo government told a newspaper reporter, "This is not a failed privatization."[27]

The final arrangment worked out between the government and Maynilad were worse than expected. It was a massive sellout of the interests of the public. Maynilad's Php 8 billion debt to MWSS in unpaid concession fees was turned into equity in a new reorganized corporation, effectively cancelling it. Benpres, the controlling conglomerate of Maynilad,

was also effectively released from its commitment to guarantee payment of at least $47 million of Maynilad's debts in the event of default.[28] The essence of the deal, one newspaper editorialized, was that

> ...while the Lopezes will be able to cut their losses, the Filipino cosumers and taxpayers will be left to shoulder most of the burden. All those debts, both those handed down to Maynilad by the MWSS under the original concession agreement and those incurred by the private firm, are going to be paid either by consumers through higher water rates or by taxpayers should its earnings not be enough. Thus, it is again the Filipino people who will have to pay for decisions they had no hand in making.[29]

Power Deals

On July 28, 2003, when President Arroyo declared in her State of the Nation Address that Filipinos were now enjoying lower electricity rates, the general reaction was to ask, which Filipinos?

The Crisis of Blackouts

As mentioned in earlier sections of this chapter, the early 1990s saw the country enveloped in darkness. The country was suffering from eight-hour blackouts, crippling several key industries and putting some institutions, like hospitals, in critical condition.

Againt this backdrop the Aquino government authorized the beginning of the privatization of the power sector. Private generation companies—IPPs, in the jargon of energy economics—came into the scene and basically saved the day during the Ramos administration.

The IPPs entered the power sector and, according to technical reports, yielded an additional 8,000 MW, supplying more than 50 percent of the country's energy needs. This seemed to solve the power crisis.

Buoyed by this "success" the Arroyo administration completed the privatization process in 2001 with Republic Act 9136 or the Electric Power Industry Reform Act (EPIRA). This paved the way for the full privatization of the electric-power industry in the country.

With a Little Help from My Friends

The government though did not go about this process by itself. It had a little help from its friends; in fact, more than just a little.

As a report studying the privatization process of the power sector concludes, the World Bank and the Asian Development Bank (ADB) were in this process of privatization since day one. It details how the World Bank, using its "carrot and stick" theory, bundled lending for institutional reform with lending for investments in the power sector.[30] This means that tranches would only be released on condition of targets met in the program it specifies.

The author of the study, Nepomuceno Malaluan of the Action for Economic Reform, a leading authority on the issue, further details the heavy-handed involvement of the World Bank, the IMF, and the ADB. Malaluan cites the following:

- In 1998 the ADB intensified the pressure to privatize Napocor by extending a $300 million loan for the power-sector restructuring program that culminated in the passing of the EPIRA.
- In 1998 an ADB loan was also provided in the context of a joint standby assistance program with the International Monetary Fund and the World Bank.

ADB intervention was particularly crucial. "As a condition to the government's accessing a $300-million energy sector loan from the Bank and a $400-million loan from the Miyazawa Fund from the Japanese Government, the ADB wanted the state energy enterprise privatized as quickly as possible. The ADB's Power Sector Restructuring Program document dated November 25, 1998, was blunt: release of the second tranche of the loan was contingent on the condition that the "borrower shall have enacted a law, the Omnibus Power Industry Law, to govern the power industry."[31]

What is disconcerting is that in their rush to privatize, the international financial institutions (IFIs) did not have a clear sense of the impact of the process on power rates. The 1998 ADB Power Sector Restructuring Program document admitted that "the impact of the restructuring and privatization process on electricity consumers has not yet been quantified, nor has the need to retain safety nets to protect the poor and the underprivileged."[32] As for the World Bank, Malaluan cites a 1994 World Bank

study that noted that the average price of some thirteen projects it analyzed was $0.652/kwH, which the World Bank conceded was "quite high" compared to the $0.637/kwH bulk energy tariff of the NPC at the time. He adds that it is important to note that the NPC rate already covered generation, transmission, subsidies for rural and small-island consumers, peak capacity, and a provision for reserve energy.[33]

The report points out, though, that the IFIs were not the only ones pushing for the passage of the power bill. At the time of the deliberations in Congress, two House members went public and revealed that they were offered a large amount of money from an unknown source in exchange for the passage of the power bill.[34] The claims were never formally investigated, despite the fact that the ADB's own Anti-Corruption Memorandum issued in June 1998 states: "Particular care must be taken in dealing with issues of privatization. Preliminary research indicates that, when done properly, privatization can help to lower the level of corruption." However, in many countries, the privatization process has often been fraught with allegations of bribery, theft, and embezzlement. It continues: "To avoid this problem, it is critical that transparent, unbiased, and fully contestable procedures be utilized in the sale of state assets. When the sale involves a natural monopoly, it is also important that capable independent regulatory agencies be established to provide adequate oversight prior to privatization."[35] None of these safeguards were put in place prior to the move to fast-track legislation privatizing Napocor.

Not a Hero After All

With the privatization of Napocor becoming a controversial issue in the late 1990s, the government was forced to review the performance and impact of the IPPs that had been contracted to generate power by the Ramos administration during the blackouts earlier in the decade. The main finding of a government Inter-Agency Committee investigating thirty-five IPPs was that they delivered electricity but at an exorbitant rate to both consumers and the government. After the initial euphoria of having electricity again, consumers began to see the catch. The IPPs did deliver the electricity but at an exorbitant price. Furthermore, the deals turned out to be onerous for the government and for the consumers.

Among the findings, which were not made public,[36] were the following:

- There are some IPP contracts that are evidently more costly to the government in relation to other Philippine and international contracts in terms of "levelized" IPP-adjusted rates.
- The IPP projects that account for the biggest share in the cost of undispatched energy are those with the biggest capacities and those with high costs of fuel.
- The IPP contracts were generally entered into on the basis of lowest bid cost but subsequent adjustments over time have yielded steep increases arising from escalation clauses.
- Certain IPP contractors have exhibited high rates of return on investment and short payback period.
- There have been amendments and additions to several Power Purchase Agreements (PPAs) and Energy Conversion Agreements without passing through the same rigors as the original proposal i.e., review of the Investments Coordination Committee.

The report further details that a number of the contracts had legal and financial issues and needed renegotiation, with some requiring legal action.

Another subsidiary of the Lopez Group that figured in the Maynilad fiasco was engaged in questionable practices in the energy area. Meralco, the country's largest distributor of electricity that was also involved in setting up the IPPs, had passed the increased costs to consumers as "PPA charges" in their monthly electric bills. But public opinion had turned critical by the beginning of the century. An attempt by Meralco to raise power rates by Php 0.12 while its petition for a higher rate hike was under study by the Energy Regulatory Commission was stopped on January 14, 2004, by the Supreme Court, acting on a petition filed by the FDC and a number of progressive political parties.

The Supreme Court decision followed an earlier ruling by the body ordering Meralco to desist from including income tax payments in its operational costs and passing this on to consumers. In line with this, the court ordered the utility to return to both residential and industrial consumers Php 30 billion in overcharges between 1994 and 2003. Critics of privatization saw this as a necessary move to curb the private sec-

tor since effective regulation of the private sector by the executive had all but collapsed.

The impact of these positive measures, however, has been quite limited. As one report documents, consumers, despite energy-saving measures, still receive very high electricity bills. As one distressed consumer complained, "We don't turn on our electric fans anymore. My children have stopped watching cartoons in the afternoon... But despite all these, our monthly bill still went up above Php 3,000" (as compared to an old bill of Php 1,000+).[37]

Dismantling Napocor

The strategic aim of privatization in the Philippines was the dismantling of Napocor. According to proponents of privatization, this was urgent owing to the massive debts of Napocor, which came to Php 1.3 trillion or $23.5 billion by 2004.[38]

What proponents appear to have forgotten was that Napocor's travails were not only of its own making and that the private sector was part of the problem. As even the ADB admitted, Napocor had a good financial management record between 1992 and 1997.[39] Napocor's current crisis was a conjunctural one, brought about not by the inherent inefficiency of the public sector but by the Asian financial crisis, a crisis created by the lack of regulation of the private sector. The crisis brought about the deterioration of the agency's foreign debt-service burden and a hemorrhage of dollar-denominated payments to the IPPs that had raked off high-profit contracts to provide power during the energy crisis of the early 1980s. Failure to appreciate the conjunctural character of Napocor's crisis led government technocrats not to pay attention to an alternative route to solving the crisis, which was to renegotiate the terms of payment to foreign creditors and the IPPs to make them more favorable to the government and to the people as a whole.

Offloading Napocor from government seemed to have become, however, the one and only rationale for privatization, with little regard for its impact on consumers. As noted earlier, the move to privatize began with no study of the impact of privatization on consumers, especially the poorer sectors of the population. Privatization was expected to result in higher electric rates. Moreover, as finally provided in the EPIRA passed in 2001, consumers would have to pay for the recovery of Napocor' s "stranded costs" via a universal levy or tax, meaning they would be subsidizing the sale of Napocor's assets to the private sector.[40]

Nor were the negative consequences in terms of oligopolistic control considered. The EPIRA split the generation and transmission functions of Napocor, with its transmission functions given to a private sector contractor operating on a concession basis and its power plants sold off to a few big buyers—to about seven buyers, as originally envisaged in the original government plan. Given the concurrent fiasco with price-gouging IPPs and the crisis of water provision by two giant concessionaires, this lack of attention was inexcusable.

During the heated debate over EPIRA, one of the authors of this book offered the following wager:

> Let me...put my money where my mouth is: I bet ten years of my salary at UP [University of the Philippines] (my only marketable asset) that a rush to privatization at this stage will result in the following:
>
> -The seven private "generating companies" (GENCOs) into which Napocor will be hung, drawn, and quartered will evolve into a cartel of seven sisters and not into competitive ventures.
>
> -Most of these oligopolies will eventually devolve into the control of the usual powerful groups, some of them closely allied to the administration, most of them with foreign partners (some of them now madly sniffing around Makati for "strategic alliances").
>
> -Electricity rates will escalate instead of leveling off—which is not suprising given the control of the market by profit-maximizing giants.
>
> -Millions of poor consumers will find themselves deprived of access to affordable energy.
>
> -The network of rural electric cooperatives that now distribute electricity will wither away, replaced by profit-oriented operators that will focus on serving principally the needs of *poblaciones* and industrial and commercial users rather than rural households.[41]

Nothing has changed to make the writer withdraw his offer.

The Crisis of Privatization

By 2003 privatization was in deep crisis, a fact noted even by its proponents. As Gilberto Llanto, vice president of the Philippine Institute of Development Studies, a bastion of neoclassical economic thinking, acknowledged, "There is a crisis of confidence in privatization and in public-private partnership in infrastructure provision."[42] Among the causes of the failure of privatization Llanto pointed to was the government's short-sighted perspective on privatization, which was simply to use the proceeds to improve its fiscal position.[43]

While Llanto was unwilling to clearly acknowledge the private sector's role in the matter, he indirectly attributed part of the blame to aggressive corporate actors: "The experience with IPP contracts drove home a lesson: No government guarantee should be given to shield private investors from commercial risk."[44] He also noted that "[u]nfortunately, in the rush to privatize, the government forgot to deal with the need to have an independent regulatory capacity, leaving regulatory institutions open to opportunistic political intervention."[45] What he failed to mention, however, was that the rush to privatize was instigated by the IMF, World Bank, and ADB using the power of the purse.

The Maynilad collapse, Meralco's overcharging, and Napocor's short-sighted privatization were but three of many instances that dimmed the star of privatization throughout the world at the turn of the century. The privatized railways in Britain experienced a marked deterioration, a condition brought home to the public by a succession of train derailments and collisions that took many lives. In California energy deregulation created a situation ripe for corporate abuse, the most egregious of which was Enron's effort to create an electricity shortage in order to profit from its speculative, energy-trading activities.

Meanwhile, in Asia, state-run enterprises were turning in performances that contradicted the stereotype that private is efficient and public is inefficient. Petron was one of the Philippines' most profitable enterprises—which was precisely why it was snapped up by the Saudi firm Aramco once it was put on the shopping block. Petron was not alone. In 1998 the Pohang Iron and Steel Company (Posco) dislodged long-time industry leader Nippon Steel to become the world's number-one steel producer for the first time in history. That year, while the private sector in Korea collapsed in the aftermath of the Asian financial crisis, Posco's net profit of $946 million in 1998 was 54 percent higher than the 1997 level. In the annual list of Asia's 200 top companies, Posco is, in fact, often at the top of the list for Korea. So are other state-run enterprises: Hong Kong's Mass Transit Railway, Singapore's Mass Rapid Transit, Malaysia's Petronas, and Indonesia's Indosat.

So if the efficiency stemming from privatization is increasingly a suspect argument, why does the privatization express continue to run? Increasingly, the answer lies in the area of interests and power. Privatization is pushed because the private sector is eager to get its hold on successful public companies. In effect, these enterprises and services allow the private sector to get hold of effective public enterprises like Petron and Posco without committing the enormous investment that brought these firms into existence. Privatization, in effect, is nothing more than a seemingly neutral term for subsidizing the private sector. As for money-losing firms, they are either ignored or, as in case of Napocor's assets, the private sector is waiting for a fire sale.

Moreover, local firms are not the only interested parties. Transnational corporations have been scouring Asia for good buys, and in this they have the support of their governments. Former US Trade Representative Charlene Barshefsky revealed one of the essential reasons for Washington's aggressive support for privatization when she told the US House of Representatives a few years ago that the IMF program that Thailand was forced to adopt in the aftermath of the Asian financial crisis deserved close support from the US because the government's "commitments to restructure public enterprises and accelerate privatization of certain key sectors will enhance market-driven competition and deregulation [and] create new business opportunities for US firms."[46]

Conclusion

Initially promoted as a panacea for underdevelopment, privatization has notched up a checkered record not only in the Philippines but globally. This is not to say that it has not had successes. Yet, like all doctri-

naire people, partisans of privatization have overreached, applying it to inappropriate situations. At the same time, there is now a greater appreciation of the role of the public sector and of how public services and enterprises can, in fact, be run as effectively, if not more than private firms. Because the public welfare is not something that should be subjected to doctrinal experimentation, privatization should be considered not a first but a last resort. Instead of selling off public enterprises or turning over public services to private conglomerates like Maynilad at the drop of a hat, Filipino technocrats would do well to study how Posco and other successful state-run or state-owned firms were able to create a formidable formula of effective management, high corporate autonomy, and dynamic technological innovation.

Notes

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13. Ibid., 4.
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