Technical Assistance Consultant's Report

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Republic of the Philippines: Policy and Advisory Technical Assistance (PATA): Government Owned and Controlled Corporations Reform (GOCC)

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For The Department of Finance

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Asian Development Bank

PHL: TA 4809 – GOVERNMENT OWNED AND CONTROLLED CORPORATIONS REFORM TECHNICAL ASSISTANCE

Summary of Findings

1. Objectives and Scope of Study

The Government of the Philippines obtained technical assistance (TA) from the Asian Development Bank (ADB) to improve its monitoring and management of the Government Owned and/or Controlled Corporations (GOCCs). The primary objective of the TA is to support the Government's fiscal consolidation through reforms in the monitoring and financial performance of the GOCCs. The technical assistance covered the: (i) identification of areas for improvement in the operations of selected GOCCs to enhance their financial performance and reduce their dependence on the National government (NG); (ii) development of performance evaluation criteria, targets, and guidelines for selected GOCCs; and (iii) strengthening of financial performance review and monitoring of the GOCCs, as well as improvement in the Department of Finance (DOF)'s data banking system for the GOCCs.

2. Reform Context and Challenges

Over the years, the Philippine Government has made significant progress in dealing with GOCCs, including privatizing a large number of GOCCs, consolidating/closing many others. It has put in place a comprehensive regulatory framework for GOCCs and private sector participation (e.g., Proclamation 50, BOT Law). However, there remain some gaps, such as lack of clarity in government's role as "owner", poor corporate governance environment (mandates, board structures, accountability) and weak oversight system. The study recommends that a new phase of GOCC reforms in the Philippines should concentrate on complementing past reforms for building a strong, modern, efficient, and well focused enterprise sector that can provide, at reasonable cost and with minimal subsidy, goods and services of high quality and adequate quantity, in areas where private providers either will not or should not enter. The goal of reducing the financial burden of the GOCCs on the State by minimizing subsidies, unpaid taxes, loan arrears, and guarantees can best be achieved through a systemic and sustained process of institutional change.

Key reforms should include further privatization of non-essential GOCCs (e.g., NDC, HGC and some others), sound corporate governance with clear accountability including well defined rules of conduct and independence, hard budget constraints (with no easy government guarantees or advances), systematic and periodic review of GOCC roles and mandates (including limited and well defined and limited mandates) and effective central oversight and monitoring system. Good governance should start with the Government spelling out a clear role for itself -- that of the "owner" -- and a well defined vision and mandate for each of the companies. A systematic review of all GOCC mandates starting with the four selected GOCCs to be followed by 14 monitored GOCCs (and ultimately to cover all GOCCs) should be undertaken by the DOF to resolve underlying conflict in roles or policies that impact the financial viability of the GOCCs as

well as their relevance in the prevailing macro-economic environment. Appropriate reforms for the appointments of Board members and CEOs as well as their qualifications, training, responsibilities and accountabilities should also be implemented. Key recommendations are summarized in the following sections.

3. Key Recommendations on the Sector and Oversight Function

(i) ***Improving Corporate Governance*** through: (a) further clarifying/emphasizing the role of the Government as mainly that of the “owner”. This is essential to minimize external political as well as bureaucratic interventions, (b) updating charters of key GOCCs which, by and large are outdated. This is required to ensure that the mandates of concerned GOCCs are current/relevant and conflicting and multiple objectives are minimized. In case a GOCC is required to provide a particular “social service”, it should be so recognized and funded in a transparent manner, and (c) rationalize the structure and composition of the Boards of Directors to ensure adequate outside representation of technical/professionals and stakeholders and to introduce a transparent process for the selection of board members that ensures qualifications and expertise, possibly through the establishment of an independent professional body.

(ii) ***Rationalization of GOCC Portfolio.*** The Government has a long standing policy (Proclamation 50) defining under what circumstances a corporation should be in the public sector. In line with this policy, a GOCC should be disposed off if it does not have a clear rationale on the basis of a careful analysis of its social/ public good role. In this case, it is important to differentiate between the need to provide a public good and who should provide it. The driving force behind this decision should be government’s already stated policy (Proclamation 50) of having a GOCC only in cases where the private sector is not able or willing to provide such goods or services. If full cost recovery is not possible, subsidies can be provided but to the extent possible, actual delivery of goods and services should be left to the private sector in order to minimize cost to the government by leveraging the private sector’s flexible and efficient operating capability, financial resources and risk taking as well as management capacity. The Study Team recommends the Government to expedite the privatization/disposal program for the GOCC sector, especially for GOCCs that have been selected for disposal for quite some time.

(iii) ***Creating Effective Oversight Mechanism*** through: (a) enactment of the Implementing Guidelines for the proposed PES, (b) creation of a Corporate Governance Council to ensure coordination and support of other concerned departments, (c) strengthening of staff capacity in CAG through: activation of the Policy and Research Unit; filling in vacant positions with competent staff in CAG; a vigorous training program for CAG staff, adequate IT infrastructure support, and provision of adequate budget support for CAG to augment its limited staff resources with outside consultant/ experts as needed for the performance agreement negotiations, monitoring and evaluation.

(iv) ***Re-establishment of Performance Evaluation System*** starting with the four selected GOCCs (e.g. PNR, LRTA, NDC and HGC), and more to be added later depending on CAG's capacity. The basic framework for a proposed PES has been developed by the Team, including preliminary recommendations for possible performance indicators and targets.

4. Key Recommendations on the Four Selected GOCCs

Metro-Manila Rail GOCCs

Metro Manila rail sector is fragmented both in terms of institutions and technologies; the system comprises three separate rail lines operated by different corporations/entities:

- ***PNR:*** Currently truncated to about 40 km of Manila commuter service of about 6 trains/ day, equivalent to passenger load of 100 jeepneys. PNR is heavily losing money. It can only recover a small portion (15-25%) of the total O/M costs. The annual Government operational subsidies to PNR have averaged about P235 million per year. The commuter system is being rehabilitated through a major Chinese loan (US$400 million) for the North Commuter Rail (by a new entity, North Luzon Rail Corporation), and a Korean loan (US$50 million) for the South Commuter Rail (PNR), each covering about 30 km. The latter investment is of doubtful impact, as it does not alter the competitive disadvantage of the commuter system configuration.
- ***LRTA:*** Operates Line 1 (15 km, completed in 1984) and Line 2 (13 km, completed in 2003). LRTA is able to recover its O&M costs, despite the fact that fares have not been adjusted for the past 3 years. LRTA, however, is not able to meet current debt obligations; major financial restructuring of LRTA will be needed to meet fully its annual debt liabilities of P3-4 billion in the coming years.
- ***DOTC:*** Even though it is not its mandate, DOTC operates MRT3 (17 km) which was completed in 2004 with private sector involvement. The line has not paid for itself and subsidies in excess of P3 billion/year are required to meet debt obligations.

5. Major Recommendations

Metro Manila Rail Sector

The need to rationalize the Metro Manila Rail sector is widely recognized. It will require:

- DOTC to become an effective oversight agency focusing on sector policies, plans, monitoring and regulation.
- Gradually shifting responsibility for management of rail lines to one entity. The "buy out" of MRT3 and transfer of its operations to LRTA should be the first

welcome step. The arrangements for operations of the North and South Commuter Rails under reconstruction/rehabilitation should be unified; separate operating entities should be avoided for these two small lines.

- As planned, under a unified framework, the operations and maintenance of all rail lines should be transferred to the private sector through the grant of concessions.
- Proliferation of rail entities through new rail lines under consideration should be avoided.
- A prudent review mechanism should be put in place for design review and viability of new projects to avoid the past mistakes, and ballooning of liabilities.

Light Rail Transport Authority (LRTA)

- The financial restructuring needs of LRTA which is currently being reviewed should be finalized. It is estimated that LRTA will require government help of P30-35 billion (estimated) to meet its debt obligations over the next 7-8 years.
- LRTA should be allowed to make adjustments in rail tariffs, otherwise nearly P800 million/year in subsidy to year 2015 would be required (thereby burdening all taxpayers for Metro Manila commuters' convenience).
- Shifting of the rail operations and maintenance, not just maintenance, to the private sector should be expedited.
- Unification of rail ticketing system for various lines should also be expedited.
- The design of the proposed LRTA Line 1 loop extension should be revised as to extend from Line 3 instead of Line 1, keeping in mind its eventual handover to LRTA.

Philippine National Railway (PNR)

- All operations of PNR should be temporarily suspended for two years while the South Commuter Rail line is being rehabilitated. It will reduce government subsidy by as much as P400 million/year, provided required staff reductions are also carried out. This period should be used to restructure PNR organizationally and financially.
- PNR urgently needs about P300 million, in addition to the P700 million disbursed in 2007, to complete its staff retrenchment program (from 1500+ to about 350-400). PNR would also require about P4-5 billion over the next 5 years to meet its debt obligations.
- Arrangements should be made for private sector operation of the North and South Commuter Rails proposed under both the Chinese and Korean loans. This should be done as unified operation under one entity.
- North Rail and South Commuter Rail projects are headed towards technical incompatibility and separate operations, unless something drastic is done now. However, the PNR is in no position to alter the direction. DOTC and the government should take immediate steps to address this serious problem before it is too late.

Mass Rail Transit – 3 (MRT3)

- The “buy out” of MRT3 by the government is already under consideration; this should be expedited provided this results in better financing terms and lower costs. MRT3 operations should also be handed over to LRTA to achieve sector rationalization.
- Buy-out of MRT3 needs to consider smooth turnover of management to LRTA, but currently this aspect is not being addressed;
- DOTC should exercise its inherent powers and focus on sector policies, regulation, monitoring and review of new projects. It should urgently undertake a technical review of North and South Commuter Rail Projects designs to ensure technical compatibility and seamless operations.

National Development Company

Given that NDC is a holding company, recommendations can be divided into two levels: (a) what to do with NDC itself; and (b) what to do with NDC’s investments/ subsidiaries/affiliates? Recommendations on the NDC should start with a look at its current mandate, powers and privileges. Potential options on the strategic role and direction of NDC could be: (i) Limit NDC’s operation to its disposition/divestment function and ultimately close or privatize NDC; (ii) Allow NDC to continue investing in or funding ventures in highly selected areas, and ultimate divesture of NDC; and (iii) Transform NDC into an agency specializing in an advisory or catalytic role.

The Study Team recommends that the Government limit NDC operations to its disposition/divestment function pursuant to Proclamation 50 and expedite its privatization as planned for a long time (as far back as 1995 and reconfirmed in 2003).

Home Guaranty Corporation

The program for the reform of HGC should start with the overall housing policy. **At the sectoral level**, the Government may consider the following: (a) review and redefine linkages between HUDCC, key shelter agencies and other government offices involved in housing; (b) tap alternative instruments to spur private sector financing of socialized and low-cost housing; (c) focus subsidies clearly at target beneficiaries.

At the HGC level, major options include (i) privatize HGC, (ii) merge with housing agency performing complementary functions and (iii) reform HGC by itself preferably in conjunction with sectoral reforms. The Study Team recommends for the Government to consider privatizing HGC; it will cost the government over P10-15 billion (inclusive of cost of operations, NG equity, cost of equity and foregone taxes) to operate HGC at its current level for next five years. In the meantime, specific recommendations on HGC include the following:

- Expedite disposition of non-performing acquired assets by outsourcing this function to an external specialized private sector firm.
- Strengthen institutional capacity by hiring new staff, training of existing staff and external assistance when needed.

- Improve risk management procedures by carrying out proper due-diligence on guarantee operations, risk sharing with clients (by reducing to less than 100% guarantee cover in all products), and debt management.
- Improve profitability by modifying premium levels commensurate with risk, keeping default rates low and improving margins.
- Modernize information technology systems to meet its immediate needs only.