TOWARDS A COMPETITION-ORIENTED PRIVATIZATION OF GOVERNMENT OWNED AND CONTROLLED CORPORATIONS*

*Jose Maria L. Marella***

ABSTRACT

Privatizations of government owned and controlled corporations ("GOCC") have been undertaken to improve the entrepreneurial management of proprietary activities, rationalize public expenditures, and curb corruption and political patronage. This paper argues, however, that privatization of GOCCs can and should also be used as an *ex ante* measure to pre-empt competition-related ills such as market distortions brought about by entry barriers, uneven market conditions, unequal market shares, and anti-competitive conduct. Towards such ends, this paper *first* proposes a methodology to identify which specific GOCC functions must be privatized; and *second*, propounds various mechanisms that can orient the privatization process towards competition enhancement.

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** J.D., University of the Philippines (UP) College of Law (2019); B.S. Economics, *summa cum laude*, UP School of Economics (2014); Policy Research Officer, Philippine Competition Commission (2016–2018); Editor, Student Editorial Board, PHILIPPINE LAW JOURNAL Volume 91; Member, Order of the Purple Feather (2015–2019).

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I. RECASTING GOVERNMENT PARTICIPATION IN THE MARKET ECONOMY

A. Privatizing State-Owned Enterprises

The sands continuously shift in the discourse concerning the wisdom of government ownership of business enterprises.[1] By competing directly with private counterparts, government owned and controlled corporations ("GOCC") were counted upon to imbue the market with morality, so to speak. Less than a century ago, the Framers of the 1935 Constitution adopted a provision sanctioning the State's establishment and operation of industries[2] as an ideological backlash to the then prevailing conservatism of *laissez faire*.[3] Complementing the shift in ideology were economic justifications such as "the need for economic planning, the advantages for stabilization policy of direct industrial intervention, and the redistribution of power, income or wealth."[4] In developing countries such as the Philippines, development initiatives "impelled governments to take a *direct hand* in responding to many social, economic and political problems."[5]

The trend has reversed as of late. Moves to privatize the business aspect of GOCCs find support in economic literature extolling the private sector's "comparative advantage" over government when it comes to certain economic activities.[6] Further discouragement is found in the recognition that GOCC operations pose a huge financial burden on public coffers and even induce schizophrenia in a government unable to demarcate between its roles

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[1] For literature that traces the evolving role of the government in a market economy, *see generally*, NICOLAS SPULBER, REDEFINING THE STATE: PRIVATIZATION AND WELFARE REFORM IN INDUSTRIAL AND TRANSITIONAL ECONOMIES (1997). *See also* Andrei Shleifer, *State versus Private Ownership*, 12 J. ECON. PERS. 133, 133–35 (1998); Diane Coyle, *Three Cheers for Regulation*, PROJECT SYNDICATE, July 17, 2018, *available at* https://www.project-syndicate.org/commentary/positive-effects-market-regulation-by-diane-coyle-2018-07.

[2] CONST. (1935), art. XIII, § 6. "The State may, in the interest of national welfare and defense, establish and operate industries and means of transportation and communication, and, upon payment of just compensation, transfer to public ownership utilities and other private enterprises to be operated by the Government."

[3] *See* Pacifico Agabin, *Laissez Faire and the Due Process Clause: How Economic Ideology Affects Constitutional Development*, 44 PHIL. L.J. 709, 722–23 (1969); Raul Pangalangan, *Property as a "Bundle of Rights": Redistributive Takings and the Social Justice Clause*, 71 PHIL. L.J. 141, 150–52 (1996).

[4] Colin Lawson, *The Theory of State-Owned Enterprises in Market Economies*, 8 J. ECON. SURV. 283, 284 (1994).

[5] Leonor Magtolis-Briones, *Issues on the Privatizaton Policy in the Philippines,* ASSET PRIVATIZATION: THE PHILIPPINE EXPERIENCE 1 (1989) (Emphasis supplied.)

[6] *See* RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 482–83, 521–23 (2010 ed.).

as regulator and competitor.[7] Among the biggest waves that toppled the foundations of government ownership was the "excessive proliferation"[8] of GOCCs under the Marcos dictatorship—GOCCs were apportioned among cronies to exact and reward loyalty.[9] Recently, competition law provided further reason to privatize the proprietary functions of GOCCs. Under the principle of competitive neutrality, economies must adopt a "framework within which no contact with the state brings a competitive advantage to any market participant."[10]

While the GOCC Governance Act of 2011[11] ("GOCC Act") establishes privatization as a legal remedy to minimize GOCCs' role in the economy, the same needs realignment with competition law and policy. A handful of scholars and policymakers have, on isolated instances, recognized the intersection between competition and privatization.[12] But largely, such convergence has heretofore been unarticulated, more lamentably undeveloped, in Philippine law; yet, privatization necessarily shapes industry structures, affects market incentives, and influences firm behavior. Hence, a competition-oriented privatization policy should be used as an *ex ante*[13] measure to anticipate market distortions that might hinder the efficient allocation of goods and services;[14] and towards such ends, even government entities, whether as market players[15] or as administrative bodies,[16] must collaborate.

Early in 2018, officials from the National Economic and Development Authority ("NEDA"), the Governance Commission for

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[7] *See* Senate Economic Planning Office, *Issues and Challenges with the Philippines' Public Corporate Sector*, Policy Brief 10-03, 1–3 (2010).

[8] Adm. Order No. 59 (1988), pmbl. ¶ 2.

[9] *See* GENIELLE ROMANO, PHILIPPINE PUBLIC ENTERPRISES AND PRIVATIZATION 31 (1996).

[10] ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT [hereinafter "OECD"], STATE OWNED ENTERPRISES AND THE PRINCIPLE OF COMPETITIVE NEUTRALITY 11 (2009), *available at* http://www.oecd.org/officialdocuments/publicdisplaydocuments.pdf/?cote=DAF/COMP(2009)37&docLanguage=En.

[11] Rep. Act No. 10149 (2011). [hereinafter "GOCC Act"].

[12] *See infra* Part III.B.

[13] In contrast, antitrust is conventionally utilized as an *ex post* measure to discipline businesses only after they have been privatized. *See, generally,* VENKATA VEMURIRAMANADHAM, PRIVATIZATION AND AFTER: MONITORING AND REGULATION (1994).

[14] *See* Rep. Act No. 10667 (2015) [hereinafter "PCA"], § 2. The Philippine Competition Act of 2015.

[15] *See* PCA, § 4(h).

[16] *See* PCA, § 12(k)-(l), (n)-(o), (r).

GOCCs ("GCG"), and the Philippine Competition Commission ("PCC") recommended the decoupling of the Philippine Amusement and Gaming Corporation's ("PAGCOR") regulatory and proprietary functions, and the eventual privatization of the latter aspect. PAGCOR is one among the more than 100 GOCCs sought to be divested of their proprietary functions in order to maintain a level playing field in their respective industries.[17] As the government embarks on this mass initiative, this paper provides circumspection, contributing to the crafting of government strategy.

B. Overview of the Paper

To more clearly navigate through the ideas developed in this paper, provided below is a depiction of the privatization framework as established in the GOCC Act.

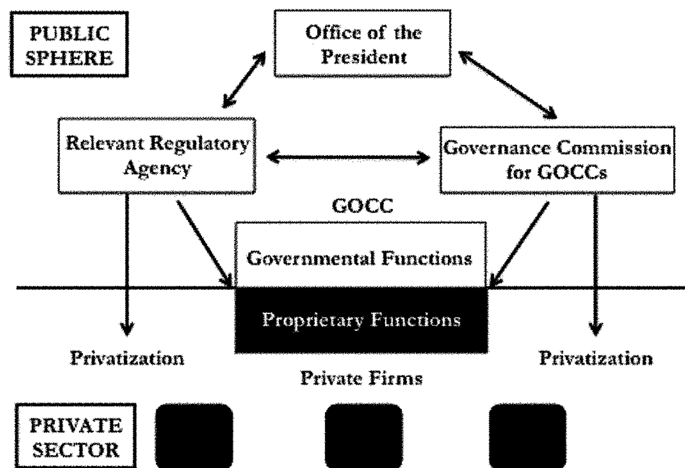

FIGURE 1. Privatization Framework Under the GOCC Act.

[17] *See* Ben de Vera, *State-owned firms face overhaul*, PHIL. DAILY INQ., Apr. 16, 2018, *available at* http://business.inquirer.net/249254/state-owned-firms-face-overhaul; GCG, *GCG Strengthens its Commitment to PDP 2017–2022*, GCG WEBSITE, Apr. 25, 2018, *available at* http://gcg.gov.ph/site/pressreleases/view/38; Elijah Tubayan, GOCC *Commission backs separation of PAGCOR casinos from regulator*, BUSINESSWORLD (PHIL.), Apr. 25, 2018, *available at* https://www.bworldonline.com/gocc-commission-backs-separation-of-pagcor-casinos-from-regulator/; Ted Cordero, *GOCC commission seeks to split PAGCOR into gaming regulator and casino operator*, GMA NEWS ONLINE, Apr. 25, 2018, *available at* http://www.gmanetwork.com/news/money/companies/651233/gocc-commission-seeks-to-split-pagcor-into-gaming-regulator-and-casino-operator/story/.

The GCG serves as the central advisory, monitoring, and oversight body that formulates, implements, and coordinates policies concerning GOCCs.[18] It specializes in GOCC governance, ensuring that the government corporate sector takes full advantage of the corporate form in dispensing goods and services.[19] Its functions are very specific compared to the all-around regulatory mandate of sector regulators. If the GCG finds that privatization is to the State's best interest, it shall recommend such action to the Office of the President ("OP") which, in turn, may assign the drawing up of a privatization plan solely to either the GCG or the relevant regulatory agency, or jointly to both bodies.[20]

Part II of the paper discusses the nature and functions of GOCCs. They are creatures of the legislature usually possessed of both governmental and proprietary functions. However, the exercise of the latter aspect presents numerous problems.

The paper, therefore, summarizes some of the criticisms against the GOCCs' exercise of proprietary functions, with emphasis on the argument of competitive neutrality. Other jurisdictions have resorted to a wide array of tools to correct GOCCs' market inefficiencies, but the Philippines, under the GOCC Act, has already embraced privatization as the solution.

The problems do not end there, however, because as Part III argues, privatization is a competition concern; and as economic literature can attest, omitting competition analysis in privatization efforts have left industries laden with competitive failures.

To pre-empt such market distortions, competition analysis must be infused in privatization. Hence, the paper proposes two reforms that recalibrate privatization to address competition concerns. *First*, the paper scrutinizes the standards used to delineate between GOCCs' governmental and proprietary functions. This is a crucial first step because it determines the scope of activities that ought to be performed by the private sector; yet, jurisprudence has laid out conflicting tests. Instead of relying on the governmental-proprietary distinction, the paper proposes an alternative framework to determine which of the GOCCs' functions ought to be privatized. *Second*, the paper discusses the various competition principles that privatization must assimilate. These principles find concrete expression

[18] GOCC Act, § 5.
[19] *See* GOCC Act, § 2.
[20] GOCC Act, § 5(a)(6).

through the recommendation of specific mechanisms, particularly privatization designs and inter-agency efforts.

By the end of the discussion, the paper will have articulated how the competition facet will be integrated into the current privatization framework. Part IV delivers concluding remarks and provides some recommendatory points for further action.

II. GOVERNMENT OWNED AND CONTROLLED CORPORATIONS

A. Nature and Functions

While the production of goods and services is conventionally conceived as a private undertaking, it is actually a joint effort between private entities and the government. This interface is best conceptualized as a continuum, setting out the different institutional arrangements incorporating both public and private participation.[21]

At one extreme of this spectrum is an arrangement of almost-purely private production.[22] Moving along the spectrum, one finds various intermediate arrangements that blend private and government efforts. These include instances where government permission is a precondition to operate, as when Securities and Exchange Commission ("SEC") approval is necessary to create private corporations;[23] when government nudges private entities to align their actions with public welfare, as in the case of subsidies to transportation utilities to mitigate price hikes;[24] in public utilities, where, not only is franchising a prerequisite to operation,[25] regulation is also more heightened as compared to other private entities;[26] and in public-private

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[21] *See* David Parker, *Ownership, Organizational Changes and Performance*, THE POLITICAL ECONOMY OF PRIVATIZATION 32–33 (Clarke &Pitelis eds., 1993 ed.); Jean-Jacques Laffont& Jean Tirole, *Privatization and Incentives*, 7 J. L. ECON. & ORG. 84, 86 (1991); David Sappington & Joseph Stiglitz, *Privatization, Information and Incentives*, 6 J. POL'Y ANAL. & MGMT. 567, 569 (1987).

[22] Considering the ubiquity of laws and regulations, even the corner eatery is subject to the slightest government intervention such as health and sanitation standards.

[23] CORP. CODE, §§ 16, 19.

[24] Aerol Pateña, *Gov't launches P5-K fuel subsidy for jeepney operators, drivers*, PHIL. NEWS AGENCY, July 11, 2018, *available at* http://www.pna.gov.ph/articles/1041160.

[25] CONST. art. XII, § 11.

[26] "When private property is used for a public purpose and is affected with public interest, it ceases to be *juris privati* only and becomes subject to regulation. The regulation is to promote the common good. Submission to regulation may be withdrawn by the owner by discontinuing use; but as long as use of the property is continued, the same is subject to public

partnerships, where government and private sector share responsibilities in building massive infrastructure projects.[27]

At the opposite end of the spectrum is the GOCC exercising proprietary functions—a special case of government as direct market participant.

The GOCC Act defines GOCCs as:

> [A]ny agency organized as a stock or nonstock corporation, vested with functions relating to public needs whether governmental or proprietary in nature, and owned by the Government of the Republic of the Philippines directly or through its instrumentalities either wholly or, where applicable as in the case of stock corporations, to the extent of at least a majority of its outstanding capital stock[.][28]

Included in this definition are Government Instrumentalities with Corporate Powers, or Government Corporate Entities,[29] and Government Financial Institutions.[30] GOCCs are typically imbued with both governmental and proprietary[31] functions.[32]

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regulation." Republic of the Phil. v. Manila Elec. Co., G.R. No. 141314, 391 SCRA 700, 706 (2002), *citing* Munn v. People of the State of Illinois, 94 U.S. 113, 126 (1877).

[27] *See* Rep. Act No. 7718 (1994) An Act Amending Certain Sections of RA 6957.

[28] GOCC Act, § 3(o).

[29] GOCC Act, § 3(n). "Government Instrumentalities with Corporate Powers (GICP)/Government Corporate Entities (GCE) refer to instrumentalities or agencies of the government, which are neither corporations nor agencies integrated within the departmental framework, but vested by law with special functions or jurisdiction, endowed with some if not all corporate powers, administering special funds, and enjoying operational autonomy usually through a charter.

[30] GOCC Act, § 3(m). "Government Financial Institutions (GFIs) refer to financial institutions or corporations in which the government directly or indirectly owns majority of the capital stock and which are either: (1) registered with or directly supervised by the Bangko Sentral ng Pilipinas; (2) collecting or transacting funds or contributions from the public and places them in financial instruments or assets such as deposits, loans, bonds and equity including, but not limited to, the Government Service Insurance System and the Social Security System."

[31] In the meantime, a thorough discussion on the notion of "proprietary functions" is withheld to give way to a more nuanced treatment in a later section of this paper. *See infra* Part III.C.1. For now, "proprietary functions" should simply be equated with business activities, as ordinarily understood.

[32] *See* GOCC Act, § 2(g). *See, e.g.* Nat'l Airports Corp. v. Teodoro, 91 Phil. 203, 207-08 (1952).

Beyond platitudes such as "interest of the common good"[33] and "economic development,"[34] GOCCs' functions are best appreciated when contrasted with private enterprise. The latter is primarily concerned with profit-maximization,[35] its goals set within the enterprise and intended to benefit private owners; externalities are often negligible in management decisions[36] unless legally enforced. GOCCs, on the other hand, concern themselves with more than profit-maximization. Their direct market participation presents opportunities to orient business decisions towards public considerations such as economic planning, industrial development, wealth redistribution,[37] quality control, and reduction of negative externalities,[38] among many other objectives.[39] The most distinctive feature is the government's resort to the corporate form. This affords a "tighter congruence of managerial and ownership goals,"[40] because GOCCs possess relative flexibility and autonomy in serving the public interest.[41]

Grounded on the foregoing virtues, the legislature has chartered entities such as the Philippine Postal Corporation ("PHILPOST"), the operations of which are geared towards economical and speedy transfers, broad-based information and communication, and reliable and secure exchange.[42]PHILPOST directly competes with the likes of LBC, Air21, and JRS Express, among other private entities. In broadcast communication, the People's Television Network, Incorporated ("PTV") was created to promote the vital role of information and communication in nation-building, to safeguard a participative democracy, and to promote national culture and values.[43] PTV competes with larger private sector counterparts such as GMA and ABS-CBN. Even in retail trade, the government operates the Duty Free Philippines Corporation ("Duty Free") as a means to keep up with

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[33] CONST. art. XII, § 16.

[34] GOCC Act, § 2.

[35] Laffont & Tirole, *supra* note 21, at 90.

[36] Romano, *supra* note 9, at 13.

[37] Lawson, *supra* note 4, at 284.

[38] Laffont & Tirole, *supra* note 21, at 90.

[39] Senate Economic Planning Office, *supra* note 7, at 1–2. Other instances that justify government's direct market participation are cases where the private sector is unwilling to undertake large-scale projects, such as infrastructure; when affirmative measures must be undertaken to empower disadvantaged sectors; to spur development in strategic sectors; and in the case of natural monopolies.

[40] Laffont&Tirole, *supra* note 21, at 90.

[41] *See* Josephine Avila, *Update on the Tax Privileges of Government-Owned and/or Controlled Corporations*, 12 NTRC TAX RESEARCH JOURNAL 25, 25 (2000).

[42] Rep. Act No. 7354 (1992), §§ 3–5. The Postal Service Act of 1992.

[43] Rep. Act No. 7306 (1992), §§ 2–3. Charter of the People's Television Network, Incorporated.

international trade standards, showcase Philippine culture, and effectively generate foreign exchange.[44]

Its advantages notwithstanding, several objections are levied against GOCCs' exercise of proprietary functions.

B. Problems with Proprietary Functions, Solutions Therefor

Issues concerning GOCCs' proprietary activities include the obscure interpretation and implementation of the GOCC's avowed objectives;[45] inadequate monitoring and non-profit objectives leading to the improbability that GOCCs will operate cost-efficiently;[46] overly centralized planning that is out of touch with market forces;[47] excessive strain on taxpayers' money;[48] and corruption, conflict of interest, and political patronage in the choice of managers, as well as their operation, of the GOCC.[49] Complicating these is the proper delineation between governmental and proprietary functions.[50]

Additionally, special emphasis must be devoted to the more recent criticism from competitive neutrality.[51] Understanding the problem through this lens is necessary as, generally, such would affect the choice of remedial measures; specifically, appreciating competitive neutrality will influence the appraisal of privatization as a competition-enhancing tool, in turn allowing the identification of reform areas.

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[44] Rep. Act No. 9593 (2009), §§ 89, 90. The Tourism Act of 2009.

[45] Laffont & Tirole, *supra* note 21, at 89.

[46] Lawson, *supra* note 4, at 296.

[47] Shleifer, *supra* note 1, at 136.

[48] Senate Economic Planning Office, *supra* note 7, at 3.

[49] Shleifer, *supra* note 1, at 143.

[50] This issue will be treated exhaustively later on. *See infra* Part III.C.1.

[51] Only recently has the principle of competitive neutrality between GOCCs and private firms gained significance, presumably due to the recent passage of the PCA. *See* NATIONAL ECONOMIC DEVELOPMENT AUTHORITY, PHILIPPINE DEVELOPMENT PLAN 2017–2022, at 245–49. However, as early as the 1980s, the private sector had already expressed concerns over the government's increasing encroachment into traditionally private business activities. Very telling are the following remarks given by John Cocuaco, then-Assistant General Manager of Finance, National Development Company, at a 1982 forum organized by the Commission on Audit [hereinafter "COA"]: "[T]here has been a nagging uneasiness among the members of the private business community that, as the government becomes more involved in private proprietary functions, the private sector would be more and more at the disadvantage [...] there are still certain areas wherein the private sector feels that it is being threatened." COA RESEARCH & DEVELOPMENT FOUNDATION, INC., STATE CONTROL OVER PUBLIC ENTERPRISES 17 (1982).

1. From the Lens of Competitive Neutrality

Competitive neutrality entails a regulatory framework where public and private enterprises face the same set of rules and where no contact with the government brings competitive advantage to any market participant.[52] The principle is concretely expressed through policies such as tax neutrality, where private and government businesses are subject to the same tax regimes; regulatory neutrality, where the same sets of rules and guidelines govern the two types of entities; or debt neutrality, where an entity's being public or private does not influence access to finance.[53]

The foregoing formulation has more or less been adopted in other jurisdictions. The European Union has adopted the above definition formulated by the Organisation for Economic Co-operation and Development ("OECD").[54] Australian government formulates the following principle: "[c]ompetitive neutrality requires that government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership."[55] The United States has adopted "notional principles" on competitive neutrality: (i) clear delineation between a state enterprise's commercial and regulatory functions; (ii) equitable competitive environment between private and state enterprises; and (iii) government investment in private corporation necessitated only by exigent and transitory circumstances.[56]

As understood internationally, the principle presupposes the presence of private and governmental market participants and requires that both compete on equal terms.

From the principle of competitive neutrality ensue several and more nuanced objections against the establishment and operation of GOCCs.

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[52] Organisation for Economic Co-operation and Development [hereinafter "OECD"], Roundtable on Competitive Neutrality in Competition Enforcement, Directorate for Financial and Enterprise Affairs, Competition Committee Series Roundtables, at 2, OECD Doc. DAF/COMP/WD (2015) 31, 2 (May 19, 2015).

[53] OECD, COMPETITIVE NEUTRALITY: NATIONAL PRACTICES 11 (2012).

[54] *See* OECD, State-Owned Enterprises and the Principle of Competitive Neutrality, Directorate for Financial and Enterprise Affairs, Competition Committee Series Roundtables, at 51, OECD Doc. DAF/COMP/(2009)37 (Sept. 20, 2010).

[55] AUSTRALIA, COMMONWEALTH COMPETITIVE NEUTRALITY POLICY STATEMENT 4 (1996).

[56] OECD, Discussion on Corporate Governance and the Principle of Competitive Neutrality for State-Owned Enterprises, Directorate for Financial and Enterprise Affairs, Competition Committee Series Roundtables, at 2–3, OECD Doc. DAF/COMP/WP3/WD(2009) 40, (Sept. 28, 2009).

For one, laws creating GOCCs might unwittingly encourage monopolistic or oligopolistic market structures. Islamic finance, for instance, is an industry served primarily by the Al-Amanah Islamic Investment Bank of the Philippines ("AIIBP").[57] In effect, AIIBP has carved its own market over which it would exercise a monopoly. The flaw in this statutory design is it enabled a single entity to serve a very specific market, instead of providing a general framework where numerous players can enter and compete.[58] Legislators recently pushed for "greater financial inclusion" through a more liberal establishment of Islamic banks, as well as the authorization of conventional banks to engage in Islamic finance.[59]

Another issue concerns entry barriers. In creating some GOCCs, some statutes vest the entity with functions that hinder market participation. The National Food Authority[60] ("NFA") is a source of both trade and regulatory barriers as it controls the importation of rice and corn. While the NFA can authorize farmers and other retailers to import, it still controls importation through the imposition of quantitative restrictions.[61] The NFA's monopoly had even engendered further market distortions such as inefficiencies, leading to the undersupply of rice; and corruption, in order to secure favors in the supply of rice.[62]

One other problem is posed by the duality of GOCCs as both regulator and market participant. Take the case of the Philippine Ports Authority ("PPA"): it assumes numerous, and often conflicting roles, as planner, coordinator, developer, and controller of port operations.[63] These overlaps have led to conflicts of interest where the PPA adopted policies that support its operations at the expense of its own competitors. For instance, because of its mandated share in cargo handling revenues,[64] the PPA is almost

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[57] Rep. Act No. 6848 (1990), § 2. The Charter of the Al-Amanah Islamic Investment Bank of the Philippines.

[58] *See, generally,* Law Business Research, Ltd., *Islamic Finance & Markets*, GETTING THE DEAL THROUGH (Morales &Shiblaq eds., 2016).

[59] BusinessMirror, *House panel approves substitute bill on Islamic banking*, BUSINESSMIRROR (PHIL.), Aug. 14, 2018, *available at* https://businessmirror.com.ph/house-panel-approves-substitute-bill-on-islamic-banking/.

[60] Pres. Dec. No. 1770 (1981), §§ 3, 7. The National Food Authority Act.

[61] Rafaelita Aldaba, *Assessing Competition in Philippine Markets*, Phil. Inst. for Dev. Stud. Discussion Paper Series No. 2008-23, at 37–38.

[62] Mahar Mangahas, *End the NFA Monopoly!*, PHIL. DAILY INQUIRER, Apr. 22, 2017, *available at* https://opinion.inquirer.net/103381/end-nfa-monopoly.

[63] Pres. Dec. No. 857, § 6.

[64] Pres. Dec. No. 857, §§ 2(f), 11.

sure to approve any proposed hike in such handling fees.[65] However, such revenue-sharing favors tedious and inefficient processes of multiple cargo handling instead of the more compact option of roll-on and roll-off shipping, where no such fees are charged because no cargo is handled and vehicles merely board the ship.[66]

The preceding issue spawns the problem of regulatory capture which, in turn, breeds the more specific competition problem of abuse of dominance.[67] Capture occurs when an entity meant to regulate an industry ends up furthering the industry player's interests at the expense of consumers.[68] Market participants engage in rent-seeking, attempting to skew government policy in their favor. When the government sought to modernize ports,[69] the initiative was carried out through a negotiated contract of an entire bundle of services in favor of a consortium.[70] The PPA's close relations with certain industry players gave the latter incentives to maneuver their way into obtaining the project. In short, these structural flaws have corrupted some GOCCs into well-oiled syndicates, colluding with the interests they were mandated to regulate.

Finally, GOCCs heavily depend on government funds. The Philippine government has coddled GOCCs' inefficient performance through the grant of fiscal benefits, either in the form of tax exemptions or subsidies.[71] These benefits skew the playing field in favor of GOCCs, as compared to their private sector competitors, since the former are eased of some operational costs. Ironically, instead of pushing GOCCs to perform better, such privileges induce complacency,[72] allowing the private sector to still outperform GOCCs. Such issues notwithstanding, the government would still indulge GOCCs by

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[65] Enrico Basilio, *PPA: A Case of Regulatory Capture*, presented during the International Conference on Challenges to Development: Innovation and Change in Regulation and Competition, Edsa Plaza Hotel, pp. 2-3 (Oct. 13-15, 2003), *available at* http://www.ombudsman.gov.ph/UNDP4/wp-content/uploads/2013/01/PhilPortSector_Basilio.pdf.

[66] Gilberto Llanto et al., *Competition Policy and Regulation in Ports and Shipping*, Phil. Inst. for Dev. Stud. Discussion Paper Series No. 2005-02, at 22.

[67] PCA, § 15.

[68] Basilio, *supra* note 65, at 1.

[69] Exec. Order No. 59 (1998).

[70] Basilio, *supra* note 65, at 6–8.

[71] SENATE ECONOMIC PLANNING OFFICE, A PROFILE OF SELECTED GOVERNMENT OWNED AND CONTROLLED CORPORATIONS 26, 32, 41, 46, 53, 62, 75 (2007); Senate Economic Planning Office, *supra* note 7, at 4; Josephine Avila, *Update on the Tax Privileges of Government-Owned and/or Controlled Corporations*, 12 NTRC TAX RESEARCH JOURNAL 25, 25-27, 33–48 (2000).

[72] Shleifer *supra* note 1, at 137.

increasing their subsidies to compensate for recently lost value-added tax exemptions.[73]

In attempting to level the playing field and correct the above market distortions, other jurisdictions have resorted to various remedies such as outsourcing of GOCC management, restructuring and realignment of functions, withdrawal of advantages such as subsidies or tax exemptions, corporate governance, application of antitrust laws, and liquidation.[74] On the other hand, Philippine legislators have established privatization as the specific remedy to address the ills of GOCCs' proprietary activities.

2. Privatization as the Response Under the GOCC Act of 2011

The GOCC Act upholds competitive neutrality in a peculiar manner: it seeks to completely do away with the government's exercise of proprietary functions, leaving commercial activity solely to private entities.

The GCG's Ownership and Operations Manual Governing the GOCC Sector ("GCG Manual")[75] defines competitive neutrality thus:

> In order to achieve a level playing field with corporations in the private sector performing similar commercial activities for the public, the National Government shall ensure that there is a clear separation between the regulatory and proprietary activities of GOCCs.
>
> Unless justified by a greater public interest, Government Agencies that have the discretion to grant competitive advantages and benefits to GOCCs, shall avoid the granting of such advantages and benefits, especially to GOCCs that directly or indirectly compete with the private sector. The advantages and benefits mentioned herein include Government guarantees for debts incurred and special privileges such as partial or full exemption

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[73] Elijah Tubayan, *GOCC subsidies nearly double in July*, BUSINESSWORLD (PHIL.), Sept. 9, 2018, *available at* https://www.bworldonline.com/gocc-subsidies-nearly-double-in-july/; Ted Cordero, *DOF eyes adjusting tax expenditures fund once GOCC VAT exemption is scrapped*, GMA NEWS ONLINE, Aug. 23, 2017, *available at* http://www.gmanetwork.com/news/money/economy/23007/dof-eyes-adjusting-tax-expenditures-fund-once-gocc-vat-exemption-is-scrapped/story/.

[74] *See, generally,* Richard Kennedy & Leroy Jones, *Reforming State-Owned Enterprises: Lessons of International Experience, especially for the Least Developed Countries*, United Nations Industrial Development Organization SME Technical Working Paper No. 11 (2003).

[75] GCG Memo. Circ. No. 2012-06 (2012) [hereinafter "GCG Manual"].

> from the payment of taxes, duties, imposts, and other charges. This rule shall not apply when the GOCC concerned is organized solely for cultural, educational, civic or scientific purposes.[76]

Broken down, the GCG Manual describes competitive neutrality as a two-part process involving: *first,* the clear delineation between GOCCs' regulatory and proprietary functions; and *second*, the government's forbearance from granting any undue advantages to GOCCs exercising proprietary functions, unless justified by a greater public interest. At first blush, this proviso might seem consistent with the principle as internationally understood. However, synthesizing other pertinent provisions of the GCG Manual and the GOCC Act suggests otherwise.[77]

To begin with, the GCG is mandated to

> Evaluate the performance and determine the relevance of the GOCC, to ascertain whether such GOCC should be reorganized, merged, streamlined, abolished or privatized, in consultation with the department or agency to which a GOCC is attached. For this purpose, the GCG shall be guided by any of the following standards:
>
> * * *
>
> (5) The GOCC is involved in an activity best carried out by the private sector[.][78]

This provision establishes a precedence for private sector when it possesses a comparative advantage over the pertinent business activity. The GCG Manual takes this principle a step further, requiring that:

> The primary role of the private sector in the economy is recognized and that private enterprises are encouraged to undertake desirable economic activities. In pursuing this policy, and unless there is a greater public interest that may be served, GOCCs shall refrain from engaging in activities adequately serviced by the private

[76] GCG Manual, art. 11.

[77] Philippine Int'l Trading Corp. v. Comm'n on Audit, G.R. No. 183517, 621 SCRA 461, 469 (2010). "[E]very part of the statute must be considered together with the other parts, and kept subservient to the general intent of the whole enactment. Because the law must not be read in truncated parts, its provisions must be read in relation to the whole law. The statute's clauses and phrases must not, consequently, be taken as detached and isolated expressions, but the whole and every part thereof must be considered in fixing the meaning of any of its parts in order to produce a harmonious whole." (Citations omitted.)

[78] GOCC Act, § 5(a)(5).

> sector or adopt PPP schemes for operating enterprises and/or capital undertakings where such approach qualifies under existing laws, such as the Build-Operate-and-Transfer Law.[79]

Under this policy, the exercise of proprietary functions by the government is an arrangement of last resort, giving deference to private initiative or first exploring the intermediate scheme of public-private partnerships. Complementing these principles is another GCG function:

> Review the functions of each of the GOCC[s] and, upon determination that there is a conflict between the regulatory and commercial functions of a GOCC, recommend to the President in consultation with the Government Agency to which such GOOC [sic] is attached, the privatization of the GOCCs commercial operations, or the transfer of the regulatory functions to the appropriate government agency, or such other plan of action to ensure that the commercial functions of the GOCC do not conflict with such regulatory functions.[80]

However, as discussed above, GOCCs' duality of governmental and proprietary functions automatically produces a conflict of interest, bolstering the necessity of privatization.

Hence, the statute and GCG Manual suggest a framework which obviates "neutrality" in the sense of equal footing between GOCCs and private sector: no rules will apply neutrally since GOCCs will be completely kept out of the market. To cure the market of imperfections brought about by GOCC operations, the GOCC Act's solution is to privatize the proprietary aspect. The present administration's economic managers seem to adopt this unique approach to competitive neutrality as they move to decouple GOCCs' regulatory and commercial aspects and divest them of the latter function through privatization.[81]

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[79] GCG Manual, art. 4(4.1).

[80] GOCC Act, § 5(l).

[81] *See* Ben de Vera, *State-owned firms face overhaul*, PHIL. DAILY INQUIRER, Apr. 16, 2018, *available at* http://business.inquirer.net/249254/state-owned-firms-face-overhaul; GCG, *GCG Strengthens its Commitment to PDP 2017-2022*, GCG WEBSITE, Apr. 25, 2018, *available at* http://gcg.gov.ph/site/pressreleases/view/38; Elijah Tubayan, GOCC *Commission backs separation of PAGCOR casinos from regulator*, BUSINESSWORLD (PHIL.), Apr. 25, 2018, *available at* https://www.bworldonline.com/gocc-commission-backs-separation-of-pagcor-casinos-from-regulator/; *and* Ted Cordero, *GOCC commission seeks to split PAGCOR into gaming regulator and casino operator*, GMA NEWS ONLINE, Apr. 25, 2018, *available at* http://www.gmanetwork.com/news/money/companies/651233/gocc-commission-seeks-to-split-pagcor-into-gaming-regulator-and-casino-operator/story/.

III. PRIVATIZATION

A. Definition and Conventional Principles

The GOCC Act does not define "privatization," hence, resort should be made to related laws.[82] Proclamation Number 50, the forerunner law on privatization,[83] created the Committee on Privatization and vested it with the responsibilities of:

> (a) divesting to the private sector in the soonest possible time through the appropriate disposition entities, those assets with viable and productive potential as going concerns, taking into account where appropriate the implications of such transfers on sectoral productive capacities and market limitations, and (b) disposing of such other assets as may be transferred to it, generating the maximum cash recovery for the National Government in the process.[84]

The foregoing definition pertains to privatization more as a process. As a general concept, "privatization involves more than the simple transfer of ownership. It involves the transfer and redefinition of a complex bundle of property rights which creates a whole new penalty-reward system which will alter the incentives in the firm and ultimately its performance."[85]

Scholars posit that privatization "reflects a judgment that previous 'assignments' were incorrect—that some activities within the public sector

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[82] "Statutes are in *parimateria* when they relate to the same person or thing or to the same class of persons or things, or object, or cover the same specific or particular subject matter. [...] [A] statute must be interpreted, not only to be consistent with itself, but also to harmonize with other laws on the same subject matter, as to form a complete, coherent and intelligible system. The rule is expressed in the maxim, *interpretare et concordarelegibusestoptimusinterpretandi*, or every statute must be so construed and harmonized with other statutes as to form a uniform system of jurisprudence." Honasan v. Panel of Investigating Prosecutors of the Dept. of Justice, G.R. No. 159747, 427 SCRA 46, 69–70(2004). Resort to such privatization laws as interpretative supplement is further bolstered by the GOCC Act, § 31, providing for the transfer of some functions from the Privatization Council and Privatization Management Office to the GCG. Hence, the GCG has arguably assimilated the legal principles which once governed the Privatization Council's mandate.

[83] Subsequent privatization laws allude to Proc. No. 50 (1986). *See* Rep. Act No. 7181 (1992), Rep. Act No. 7661 (1993), Rep. Act No. 7886 (1995), Exec. Order No. 12 (1998), Rep. Act No. 8758 (1999), *and* Exec. Order No. 323 (2000).

[84] Proc. No. 50 (1986), § 4. Proclaiming and Launching a Program for the Expeditious Disposition and Privatization of Certain Government Corporations and/or the Assets Thereof, and Creating the Committee on Privatization and the Asset Privatization Trust.

[85] CENTO VELJANOVSKI, SELLING THE STATE 77–78 (1987).

might be carried out better within the private sector."[86] Once the "formal political link is broken,"[87] the State is able to "redraw the boundaries of the proper scope of state activity," in other words, to downsize government.[88] Economically, there is an expectation of improved technical efficiency.[89]

B. Privatization as a Competition Concern

Scholars and policymakers have broached the competition concern of privatization. They observe that:

> [P]rivatization may have counter-productive effects. This is particularly true in terms of its effects on the market structures. In a developing country, imperfections in market structures are prevalent. These are usually manifested through the presence of cartels, monopolies and oligopolies. While it is not the intended effect of privatization, its direct and immediate effect is to spawn cartels. This is due to the fact that in an environment of scarce capital, the buyer or winning bidder of the private assets are mostly those who can afford the cash payments and those entities who are already established in the business. [...] Instead of introducing higher efficiency levels, privatization could emphasize market distortions and imperfections. This has wide-ranging implications on prices and availability of supply of goods and services offered in the market.[90]

Privatization shapes not just external factors such as market structures and number of players, but also internal dynamics as it releases competitive forces within a firm's operations.[91] GOCCs, while assuming a corporate form,

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[86] Sappington & Stiglitz, *supra* note 21, at 567.

[87] Anthony Ferner & Trevor Colling, *Privatization of the British Utilities: Regulation, decentralization and industrial relations*, *in* THE POLITICAL ECONOMY OF PRIVATIZATION 127 (Clarke & Pitelis eds., 1993 ed.).

[88] Lawson, *supra* note 4, at 303.

[89] *Id.*

[90] Leonor Magtolis-Briones & Aileen Zosa, *Privatization in the Philippines: Policy, Experience and Impact*, ASSET PRIVATIZATION: THE PHILIPPINE EXPERIENCE 47–48 (1989). *See also* Leonor Magtolis-Briones, *The Role of Government-Owned or Controlled Corporations in Development*, 29 PHIL. J. PUB. ADMIN. 365, 388–89 (1985). "The magnitude of cost involved in the purchase of GOCCs further limits ownership of GOCCs to a few Filipino industrialists. It seems that the only ones who can really purchase GOCCs are the very businessmen who are already controlling the key corporations. Is this the intended effect of privatization?"

[91] *See* Laffont & Tirole, *supra* note 21, at 86; David Parker, *Ownership, Organizational Changes and Performance*, *in* THE POLITICAL ECONOMY OF PRIVATIZATION 32–33, 38–48, 50–51 (Clarke &Pitelis eds., 1993 ed.).

still operate in accordance with a statutory mandate. With such organizational structure, their proprietary operations still tend to be carried out hierarchically, deferring less to market forces and more towards bureaucratic dictates.[92] Privatization relaxes this rigidity.

Consistent with the foregoing principles, the Chilean Competition Authority once intervened in the privatization of air transport services. Emphasizing the importance of privatization as an *ex ante* measure to enhance competition in the industry, it scrutinized the allocation of licensed contracts to prevent the ownership structure of successful bidders from becoming anti-competitive.[93] Even the Korean Federal Trade Commission actively participated in the privatization of government-run enterprises so that public monopolies would not just be transformed into private ones.[94]

Interestingly, previous Philippine privatization laws incorporated competition-enhancing features. In laying down conditions that privatization must fulfill, the Committee on Privatization ensured that:

> [A]ssets for disposal shall not revert to previous owners who after final judgment by the proper agency or a court of law have been found to have mismanaged or diverted the resources of the assets which resulted in loss and bankruptcy: Provided, [t]hat if assets are to be reverted back to the previous owners, the price shall not be less than the original transfer price.[95]
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> * * *
>
> [A] minimum of ten (10) percent of the sale of assets in corporate form shall first be offered to small local investors including Filipino Overseas Workers and where practicable also in the sale of any physical asset.[96]

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[92] Matthew Uttley & Nicholas Harper, *The Political Economy of Competitive Tendering*, *in* THE POLITICAL ECONOMY OF PRIVATIZATION 153–57 (Clarke & Pitelis eds., 1993 ed.).

[93] OECD, Latin America Competition Forum: Competition Issues in the Air Transport Sector, Directorate for Financial and Enterprise Affairs, Competition Committee Series Roundtables, at 4, OECD Doc. DAF/COMP/LACF(2011)12, 13 (Aug. 25, 2011).

[94] Nam-Kee Lee, *The Role of Competition Policy in Economic Reform: Based on the Korean Experience*, Paper presented at the 1st OECD Global Forum on Competition, Paris, France, p. 5 (Oct. 17–18, 2001), *available at* https://www.oecd.org/daf/competition/prosecutionsandlaw Enforcement/2434995.pdf.

[95] Rep. Act No. 7181 (1992), § 2(b). An Act Extending the Life of the Committee on Privatization and the Asset Privatization Trust.

[96] Rep. Act. No. 7181 (1992), § 2(d).

Taken together, these provisions would have the effect of democratizing ownership in such enterprises, allowing new owners and managers to take novel approaches in running the business. In a later statute, the following principle, now more explicit as to a competition mandate, was to be adhered to in the process of privatization: "[i]n the disposition of assets, due regard for improving competition in business and preventing the creation or perpetuation of monopolies and cartels shall be made."[97]

Commenting on the functions of the Committee on Privatization and the Asset Privatization Trust, Professor Gonzalo T. Santos wrote that:

> [T]he guidelines for the privatization of government corporations promulgated by the Committee on Privatization categorically declare that all dispositions shall be conducted in such a manner as to prevent undue concentration of economic power in the hands of an individual or a small group of individuals. Consistent with such a policy, the Asset Privatization Trust has been considering the sale of government corporations thru the public offering of shares of stocks in view of the wide market that could be tapped. Corollarily, the Trust is also encouraging employees of government corporations to formulate their own stock ownership plans.[98]

Despite the foregoing features, it remains unclear whether and to what extent the preceding privatization authorities gave effect to competition-enhancing principles. Lamentably, these principles were not carried over in the enactment of the GOCC Act; neither does the GCG, through its GCG Manual, specifically infuse competition as a concern in its privatization efforts. Fortunately, such lacuna does not foreclose competition as an animating principle of privatization. The constitutional and statutory framework provide adequate legal basis.

Article XII, Section 19 of the 1987 Constitution provides that "[t]he State shall regulate or prohibit monopolies when the public interest so requires. No combinations in restraint of trade or unfair competition shall be allowed."

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[97] Rep. Act. No. 7181 (1992), § 2.

[98] Gonzalo T. Santos, *Economic and Legal Aspects of Privatization*, 66 PHIL. L.J. 374, 387 (1992). Unfortunately, the primary source material containing such guidelines is not readily available. It is also unclear whether the GCG, or at least the present Privatization Management Office, still refers to the same.

Competition, more than embodying government policy, is arguably a constitutional norm that must pervade all aspects of society.[99] Its thrust as a basic principle of the 1987 Constitution is even more pronounced when compared to the precursor text found in the 1973 Constitution: "[t]he State shall regulate or prohibit *private* monopolies when the public interest so requires. No combination in restraint of trade or unfair competition shall be allowed."[100]

The present Constitution makes no distinction between public or private sources of competitive distortions.[101] Discarding the term "private," signals the framers' recognition that even government, as a direct market participant, can produce anti-competitive effects. Moreover, the provisions of the Constitution, being the supreme law of the land,[102] are deemed incorporated into the mandate of regulatory agencies, such as the GCG, that are mere statutory creations.[103]

The policy of competition is further articulated under the provisions of the PCA. The law delineates an expansive scope and application of its provisions by defining entities as "[a]ny person, natural or juridical, sole proprietorship, partnership, combination or association in any form, whether incorporated or not, domestic or foreign, including those *owned or controlled by the government*, engaged directly or indirectly in any economic activity[.]"[104]

Thus, even GOCCs are explicitly subjected to competition law, even if giving effect thereto entails the privatization of their proprietary functions. Very cogent are the PCC's following functions:

> (k) Issue advisory opinions and guidelines on competition matters for the effective enforcement of this Act and submit annual and special reports to Congress, including proposed legislation for the regulation of commerce, trade, or industry;

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[99] *See, generally,* Allan Chester Nadate, Lee Edson Yarcia, April Joy Guiang & Ma. Lia Karen Magtibay, *The Public Welfare Dimension of the Competition Clauses: An Exposition and Application of the Proper Constitutional Treatment for Industries with Adverse Public Health Impacts*, 90 PHIL. L.J. 734 (2017).

[100] CONST. (1973), art. XIV, § 2. (Emphasis supplied.)

[101] "*Ubilex non distinguit nec nos distinguere debemus.* Where the law does not distinguish, neither should we." Spouses Plopenio v. Dep't of Agrarian Reform, G.R. No. 161090, 675 SCRA 537, 543 (2012). (Emphasis supplied.)

[102] Lambino v. Comm'n on Elections, G.R. No. 174153, 505 SCRA 160, 498 (2006) (Chico-Nazario, *J., dissenting*).

[103] "Administrative or executive acts, orders and regulations shall be valid only when they are not contrary to the laws or the Constitution." CIVIL CODE, art. 7.

[104] PCA, § 4(h). (Emphasis supplied.)

* * *

> (m) Conduct, publish, and disseminate studies and reports on anti-competitive conduct and agreements to inform and guide the industry and consumers;
>
> (n) Intervene or participate in administrative and regulatory proceedings requiring consideration of the provisions of this Act that are initiated by government agencies such as the Securities and Exchange Commission, the Energy Regulatory Commission and the National Telecommunications Commission;
>
> (o) Assist the National Economic and Development Authority, in consultation with relevant agencies and sectors, in the preparation and formulation of a national competition policy;
>
> * * *
>
> (r) Advocate pro-competitive policies of the government by:
>
> (1) Reviewing economic and administrative regulations, *motu proprio* or upon request, as to whether or not they adversely affect relevant market competition, and advising the concerned agencies against such regulations; and
>
> (2) Advising the Executive Branch on the competitive implications of government actions, policies and programs;[105]

These provisions concretize the PCC's advocacy arm as these require the promotion of a competitive environment through relationships with other government bodies.[106]

While Section 12(n) does not mention the GCG, this does not foreclose channels for inter-agency cooperation between the GCG and the PCC. The phrase "such as" has been held to connote an "illustrative and not

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[105] PCA, § 12.

[106] INTERNATIONAL COMPETITION NETWORK, RECOMMENDED PRACTICES ON COMPETITION ASSESSMENT 1 (2014), *available at* http://www.internationalcompetitionnetwork.org/uploads/library/doc978.pdf, *citing* INTERNATIONAL COMPETITION NETWORK, ADVOCACY AND COMPETITION POLICY 1 (2002), *available at* http://www.internationalcompetitionnetwork.org/wp-content/uploads/2018/07/AWG_RP_English.pdf.

exhaustive list."[107] Evidently, the proviso lists agencies that are statutorily vested with competition mandates;[108] hence, their mention signifies an immediate directive for the PCC to coordinate with them.

The more consequential language is "administrative and regulatory proceedings requiring consideration of the provisions of this Act[.]"[109] Competition concerns cut across various sectors, each of which is managed by its own sector regulator.[110]

Finally, while not legally enforceable, the NEDA's Philippine Development Plan sets the tenor of the government's medium-term economic policy. This medium-term plan clamors for the leveling of the playing field by addressing GOCCs' market distortions.[111]

Synthesizing the foregoing, it becomes clear that even privatization must assimilate the principles of market competition. Grounded on the existing competition framework, there is a need to craft an enhanced privatization policy that adjusts various stages in the privatization process such as its design and implementation.

C. Recalibrating Privatization

1. Determining Which Functions to Privatize

The GCG's privatization framework consists of a two-part process: *first*, the delineation between a GOCC's governmental and proprietary functions; and *second*, the privatization of the latter aspect. The first step is not straightforward: interactions between ideological, political, and economic factors,[112] coupled with the rapid pace of technological development, provide no bright demarcation between governmental and proprietary functions. Aggravating such difficulty, production of goods often fragments into multiple stages, each susceptible of public or private performance.[113] For

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[107] Central Bank Employees Ass'n, Inc. v. Bangko Sentral ng Pilipinas, G.R. No. 148208, 446 SCRA 299, 374 (2004).

[108] *See* Rep. Act No. 8799 (2000), §§ 36.4, 37; Rep. Act No. 9136 (2001) [hereinafter "EPIRA"], §§ 2(c), 2(j), 3; *and* Rep. Act No. 7925 (1995), § 4(f).

[109] PCA, § 12 (n).

[110] The bounds of the PCC's and GCG's joint exercise of jurisdiction will be addressed in a later portion of this work. *See infra* Part III.2.c.

[111] *See* NATIONAL ECONOMIC DEVELOPMENT AUTHORITY (NEDA), PHILIPPINE DEVELOPMENT PLAN 2017-2022, at 245–49.

[112] Lawson, *supra* note 4, at 305–06.

[113] Sappington & Stiglitz, *supra* note 21, at 579.

instance, other jurisdictions have opted to privately outsource certain phases in the provision of national security.[114]

Unfortunately, available GCG documents recommending privatization are not explicit on any specific test.[115] Neither is related jurisprudence unambiguous on the matter. In determining whether the subject entity is exercising governmental or proprietary functions, some rulings placed emphasis on the avowed purpose of the GOCC;[116] others looked into whether the activity was a necessary or incidental aspect of the GOCC's operations;[117] still, other cases attempted to determine the nature or essence of the function;[118] while some characterized as governmental those aspects which the government is obligated to perform, and as proprietary those which are merely optional.[119] These various conflicting standards provide little to no analytical or predictive power on how to properly delineate a GOCC's dual functions. Such cases, after all, contain pronouncements on governmental and proprietary functions which are merely incidental to the main issues of immunity from suit and employees' claims, among others; to this date, no

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[114] *See, generally,* ELKE KRAHMANN, STATES, CITIZENS AND THE PRIVATIZATION OF SECURITY (2010).

[115] *See* GCG, *MFP on the Privatization of Duty-Free Operations Through Public-Private Partnership*, Dec. 22, 2015; GCG, *Recommending the Abolition of AFP-RSBS and Privatization of its Subsidiaries*, Jan. 8, 2016; GCG, *Draft Memorandum for the President Recommending the Decoupling of PAGCOR Thru the Privatization of the Gaming Operations*, July 12, 2016; GCG, *Privatization of AIIBP Through the Divestment of Development Bank of the Philippines' 99.88% Shareholdings*, Nov. 28, 2017; GCG, *Privatization of the Credit Information Corporation Through the Divestment of the National Government's 24% Stockholdings*, Dec. 11, 2017.

[116] Angat River Irrigation System v. Angat River Workers' Union, 102 Phil. 789 (1957); *and* Agric. Credit and Coop. Financing Admin. v. ACCFA Supervisors' Ass'n, 141 Phil. 334 (1969).

[117] Bureau of Printing v. Bureau of Printing Employees Ass'n, G.R. No. 15751, 1 SCRA 340 (1961); Mobil Philippines Exploration, Inc. v. Customs Arrastre Serv., G.R. No. 23139, 18 SCRA 1120 (1966); Philippine First Ins. Co., Inc. v. Customs Arrastre Serv., G.R. No. 26951, 21 SCRA 49 (1967); Institute Company of North America v. Warner, Barnes and Co., Ltd., G.R. No. 24106, 21 SCRA 765 (1967); Equitable Ins. & Casualty Co., Inc. v. Smith, Bell & Co., Inc., G.R. No. 24383, 20 SCRA 1121, (1967).

[118] GSIS Employees Ass'n v. Alvendia, 108 Phil. 505 (1960); Arizala v. Ct. of Appeals, G.R. No. 43633, 189 SCRA 584 (1990); Malong v. Philippine Nat'l Railways, G.R. No. 49930, 138 SCRA 63 (1985).

[119] Nat'l Airports Corp. v. Teodoro, 91 Phil. 203 (1952); Dev. Bank of the Philippines v. Sarto, G.R. No. 28891, 24 SCRA 931 (1968); IDEALS, Inc. v. PSALM, G.R. No. 192088, 682 SCRA 602 (2012) (Velasco, *J.*, *dissenting*); SSS Employees Ass'n v. Soriano, G.R. No. 18081, 9 SCRA 511 (1963); Fontanilla v. Maliaman, G.R. No. 55963, 194 SCRA 486 (1991); NAPOCOR v. City of Cabanatuan, G.R. No. 149110, 401 SCRA 259 (2003); Air Transp. Office v. Spouses Ramos, G.R. No. 159402, 644 SCRA 36 (2011).

Supreme Court decision has interpreted "governmental" and "proprietary" within the parameters of the GOCC Act.

Since the governmental-proprietary distinction is hazy, this paper proposes instead that the GCG, or the relevant agency tasked to review the GOCC's functions, directly answer the question of whether a specific function of the GOCC should be privatized. To do so, the relevant government authority must follow the framework in Figure 2.

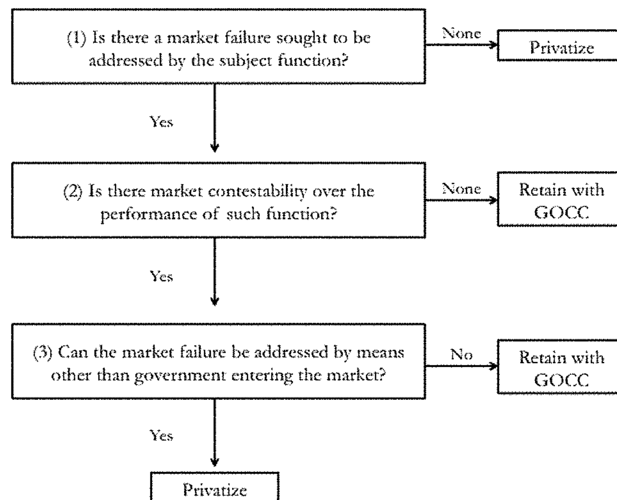

FIGURE 2. Framework to determine which functions to privatize.

Policymakers must comb through each of the GOCC's activities, testing them with the above questions.

Market failure is the first and foremost justification for government intervention.[120] It is "the inability of a market economy to reach certain desirable outcomes in resource use."[121] Failures occur because the private sector cannot be relied upon to produce public goods, like information;[122] because some firms exert monopoly power;[123] when the market is riddled with

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[120] *See* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 38–43 (2016 ed.).

[121] Mrinal Datta-Chaudhuri, *Market Failure and Government Failure*, 4 J. ECON. PERS. 25, 25 (1990).

[122] RICHARD POSNER, ECONOMIC ANALYSIS OF LAW 52 (2010 ed.).

[123] Aidan Vining & David Weimer, *Government Supply and Government Production Failure: A Framework Based on Contestability*, 10 J. PUB. POL'Y 1, 5 (1990).

externalities, such as pollution;[124] or information asymmetries abound certain industries,[125] as in the banking sector.

Since the private sector fails to "take the full social costs of their choice into account[,]"[126] the government must step in. Corollarily, without any market failure, government has no reason to intervene. Within the context of privatization, absent any market failure sought to be addressed by the GOCC's functions, such aspect must be privatized.

However, the complete absence of market failures is a theoretical aspiration. Hence, almost always, some form of government intervention is warranted. The only question is: in what form? The second and third questions in the above framework address this concern.

Market contestability determines whether or not prospective players are capable of entering a market.[127] Contestability analysis was developed to address the questions unanswered by the theory of perfectly competitive markets. Whereas the latter emphasized the desirable traits of an idealized market, the former focused on the conditions that would approximate such ideal. Using the contestability framework, the perfectly competitive market was understood as a special case wherein all elements of contestability supported perfect competition.[128]

These elements consist of (i) costs of market entry and exit, as such considerations would determine the ease and willingness to participate; (ii) the requirement of sunk costs, because the necessity therefor favors firms with exclusive access to limited resources; and (iii) the availability of industry information, since entities armed with more knowledge are better situated to assess possible market entry and performance.[129]

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[124] Ronald Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1 (1960).

[125] Vining & Weimer, *supra* note 123, at 5.

[126] Datta-Chaudhuri, *supra* note 121, at 25.

[127] *See* WILLIAM BAUMOL, JOHN PANZAR & ROBERT WILLIG, CONTESTABLE MARKETS AND THE THEORY OF INDUSTRY STRUCTURE (1982).

[128] Kenneth Kelly, *Book Review—The Theory of Contestable Markets: Applications to Regulatory and Antitrust Problems in the Rail Industry*, 27 BUSINESS ECONOMICS 70, 70 (1992).

[129] *See* William Baumol & Kyu Sik Lee, *Contestable Markets, Trade, and Development*, 6 THE WORLD BANK RESEARCH OBSERVER 1, 1 (1991); Elie Appelbaum & Chin Lim, *Contestable Markets under Uncertainty*, 16 RAND J. ECON. 28, 28–29 (1985).

Contestability is, therefore, a function of asset specificity;[130] scarcity of resources, which can limit the number of market participants,[131] technology, cost, and competition strategies.[132] If market conditions engender little to no contestability, thus making private participation unlikely, then the GOCC must perform the proprietary function in order to correct the market failure. This scenario is exemplified in the maintenance and operation of electricity transmission, since allowing for a single integrated government-run network is more superior than fragmented services under private competition.[133]

In industries where private entities already compete, asking the second question is superfluous. More apposite would be a forward-looking poser of such question. For instance, Islamic finance is a government monopoly due to legal restrictions rather than economic or technological constraints. In deciding whether or not to privatize a particular aspect of the AIIBP, the pertinent government authority may ask whether private actors might engage in such activities if given the chance, or if opening the industry to market competition will induce private participation. Still, an affirmative answer requires the confrontation of the third question.

The presence or possible entry of private competitors does not *per se* solve market failures; some form of government intervention is still warranted. On this note, the third question betrays a preference for other less intrusive means to correct the failure. This paper has articulated the difficulties of GOCCs' exercise of business functions. Even economic literature "point[s] to a rather narrow set of circumstances in which government ownership is likely to be superior[,]"[134] bolstering a hierarchy of preferences among

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[130] Vining & Weimer, *supra* note 123, at 5.

[131] "[T]he scarcity of radio frequencies made it necessary for the government to step in and allocate frequencies to competing broadcasters. In undertaking that function, the government is impelled to adjudge which of the competing applicants are worthy of frequency allocation. It is through that role that it becomes legally viable for the government to impose its own values and goals through a regulatory regime that extends beyond the assignation of frequencies, notwithstanding the free expression guarantees enjoyed by broadcasters. As the government is put in a position to determine who should be worthy to be accorded the privilege to broadcast from a finite and limited spectrum, it may impose regulations to see to it that broadcasters promote the public good deemed important by the State, and to withdraw that privilege from those who fall short of the standards set in favor of other worthy applicants." Divinagracia v. Consolidated Broadcasting System, Inc., G.R. No. 162272, 584 SCRA 213, 227 (2009).

[132] Jose Tavares, Jr., *Schumpeterian Competition and its Policy Implications: The Latin American Case*, 7 L. & BUS. REV. AM. 153, 155 (2001).

[133] *See* Tri-Tech Mach. Sales, Ltd. v. Artos Eng'g Co., 928 F. Supp. 836, 839 (E.D. Wis. 1996).

[134] Andrei Shleifer, *State versus Private Ownership*, 12 J. ECON. PERS. 133, 139 (1998).

alternative forms of government intervention where government ownership is a last preference. More importantly, the GOCC Act and GCG Manual already establish a precedence for private production of goods and services.[135] As held in *Agricultural Credit and Cooperative Financing Administration v. ACCFA Supervisors' Association*:[136]

> [t]he growing complexities of modern society [...] have rendered th[e] traditional classification of the functions of government quite unrealistic, not to say obsolete. The areas which used to be left to private enterprise and initiative and which the government was called upon to enter optionally [...] continue to lose their well-defined boundaries[.][137]

Amid such obsolescence and ambiguity, and on the strength of the arguments and framework developed thus far, it should be the policy of the State to exhaust all other alternative modes of government intervention[138] before directly competing in the market.

To summarize, when reviewing the GOCC's functions for possible decoupling and privatization, the function must be privatized when either: (i) there are no market failures in the relevant industry; or (ii) given market failures, and the market is contestable, other interventions short of government ownership can be resorted to. Correlatively, the GOCC must retain such function in cases where: (i) market failure is present and the market is not contestable; or (ii) given market failure in a contestable market, after considering alternative modes of government intervention, the GOCC's exercise of proprietary functions is the remaining solution.

Testing the above framework, consider the Asian Productivity Organization Production Unit, Inc. ("APOPU").[139] APOPU is a GOCC mandated to meet the National Government's needs for accountable forms and highly-sensitive security printing.[140] It produces authentication documents issued by the Department of Foreign Affairs,[141] certificates of

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[135] *See infra* Part II.B.1.

[136] G.R. No. 21484, 30 SCRA 649 (1969).

[137] *Id.* at 662. (Citation omitted.)

[138] *See supra* Part II.A, on the various "intermediate arrangements" blending private and public participation.

[139] *See* Ltr. of Inst. No. 197 (1974).

[140] GPPB Res. No. 05-2010, pmbl. ¶ 1.

[141] Department of Foreign Affairs, *DFA Inks MOA with APO Production Unit, Inc. for the Printing of Authentication Certificates*, DEPARTMENT OF FOREIGN AFFAIRS WEBSITE, Oct. 14, 2015, *available at* https://www.dfa.gov.ph/newsroom/news-from-our-foreign-service-

accreditation handed out by the Professional Regulation Commission,[142] and "sin tax" stamps placed on legally distributed cigarettes,[143] among other sensitive documents. For a time, APOPU could not keep up with increasing demands of government printing due to outmoded technology. To address such dismal performance, it revamped its production process.

Applying the framework's first question, privately outsourcing the printing of highly-sensitive papers would have produced market failures. The private sector does not possess critical infrastructure for mass information gathering, especially in view of privacy and security concerns. Fragmentation of information would produce asymmetries whereby some firms possess sensitive information excluded to others. Moreover, there would be difficulty coming up with a single unified security feature, e.g. bar codes, security stamps, if produced by different firms.

Note, however, that the market failures reside in the security and informational aspects. On APOPU's other operational aspects, other activities could very well be outsourced to the private sector.

Addressing the second question, when APOPU updated its operations, it identified various stages in the printing process, e.g. choice of machinery, paper supply, and design, which were contestable and could be privately supplied. Had APOPU continued these activities, it would have lost money and become unsustainable.

APOPU confined itself to the final and more critical stage, which is the security feature. On the third question, maintenance of security and integrity over the documents is not suited for government intervention in the form of taxation, as they are unrelated; or of supervision, as this entails a vast, efficient, and well-coordinated policing mechanism. As alternative forms of government intervention are ill-suited to address the security concern, APOPU had to retain this function.

2. Designing a Competition-Oriented Privatization

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postsupdate/7501-dfa-inks-moa-with-apo-production-unit-inc-for-the-printing-of-authentication-certificates.

[142] Memorandum of Agreement between the Professional Regulation Commission and APO Production Unit, Inc., MOA-06-2018-55, June 29, 2018, *available at* https://www.prc.gov.ph/sites/default/files/MOA%20201855%20PRC%20and%20APO%20Production%20Unit.%20INC.pdf.

[143] Rappler, *BIR to tap state-run printer for cigarette stamp tax*, RAPPLER, Oct. 29, 2012, *available at* https://www.rappler.com/business/15015-bir-to-tap-state-run-printer-for-cigarette-stamp-tax.

The next issue concerns the *manner* of privatization, particularly how privatization can be made more competition-oriented. At this point, various principles and best practices are borrowed from kindred fields of law, such as procurement, bidding, and corporate combinations. The proposals contained herein are not presented as all-encompassing and controlling dogma since privatization plans will vary according to each industry's peculiarities; they merely demonstrate specific aspects of privatization that can be tweaked to promote competition.

Returning to the overarching objectives in making privatization more competition-oriented, regard must be given to "cost" or "technical efficiency," by which market players expend the least production costs; "allocative efficiency," where only the most qualified participants endure in the market, while poorly-performing firms drop out; and "dynamic efficiency," in which industries constantly evolve technologically.[144]

Complementing the foregoing is jurisprudence on competitive bidding processes. Privatization ought to be "governed by the principles of transparency, competitiveness, simplicity, and accountability."[145] Furthermore, it must "protect the public interest by giving the public the best possible advantages thru open competition and in order to avoid or preclude suspicion of favoritism and anomalies[.]"[146] Competition must, therefore, be "legitimate, fair and honest[.]"[147] Hence, in order to lead the "transition to the desired competitive structure,"[148] privatization rests on the pillars of "offer to the public, an opportunity for competition and a basis for exact comparison"[149] among competitors.

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[144] Guy Callender & Judy Johnston, *Contracting Between Governments and the Private Sector: Private Haven or Public Risk?*, *in* PRIVATIZATION OR PUBLIC ENTERPRISE REFORM: INTERNATIONAL CASE STUDIES WITH IMPLICATIONS FOR PUBLIC MANAGEMENT 29 (Ali Farazmand ed., 2000). *See also* Paul Cook et al., *Competition, regulation and regulatory governance: an overview*, LEADING ISSUES IN COMPETITION, REGULATION AND DEVELOPMENT 5 (Cook ed., 2005); John Metcalfe et al., *Competition, innovation and economic development: the instituted connection*, *in* LEADING ISSUES IN COMPETITION, REGULATION AND DEVELOPMENT 64–65 (Cook ed., 2005).

[145] Philippine Sports Commission v. Dear John Services, G.R. No. 183260, 675 SCRA 712, 723 (2012).

[146] *Id.*

[147] Agan v. Philippine Int'l Air Terminals Co., Inc. 450 Phil. 744, 814 (2003).

[148] Franco v. Energy Regulatory Comm'n, G.R. No. 194402, 788 SCRA 251, 273(2016), *citing* EPIRA, § 3.

[149] Malaga v. Penachos, G.R. No. 86695, 213 SCRA 516, 526 (1992).

a. Mode of Disposition

As to the method of privatization, different jurisdictions have resorted to various mechanisms such as public offerings of shares, direct sale of assets, competitive bidding or auctions, management or employee buyouts, management contracts and leases, and contracting-out scenarios.[150] New Zealand, in particular had experimented, depending on the pertinent industry involved, with a wide array of privatization methods: sale by tender, partial stock flotations, sale of the entire entity, divestiture of physical assets, divestiture of financial assets, and sale of usage rights.[151]

Analyzing each mode of disposition, and their concomitant consequences for market competition, would be unnecessary as far as Philippine law is concerned. Two Commission on Audit ("COA") Circulars[152] have already established a predisposition to public auction as the mode of privatization,[153] with resort to negotiated sales sanctioned only under exceptional circumstances.[154]

While the foregoing COA Circulars were adopted long before the creation of the GCG, such Circulars ostensibly govern the GCG's privatization efforts: *first*, the 1989 Circular makes no distinction as to scope of applicability;[155]*second*, the GOCC Act repeals prior issuances only to the extent that the latter are inconsistent with the Act, and the COA Circulars more than complement the GCG's mandate;[156]*lastly*, a 2015 GCG privatization resolution appears to make reference to the principles of public auction laid down in the two COA Circulars.[157]

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[150] SPULBER, *supra* note 1, at 151.

[151] Alan Bollard & David Mayes, *Corporatization and Privatization in New Zealand*, *in* THE POLITICAL ECONOMY OF PRIVATIZATION 325 (Clarke &Pitelis eds., 1993 ed.).

[152] COA Circ. No. 86-264 (1986). General Guidelines on the Divestment or Disposal of Assets of Government-Owned and/or Controlled Corporations, and their Subsidiaries [hereinafter "1986 COA Circ."]; COA Circ. No. 89-296 (1989). Audit Guidelines on the Divestment or Disposal of Property and Other Assets of National Government Agencies and Instrumentalities, Local Government Units and Government-Owned or Controlled Corporations and their Subsidiaries [hereinafter "1989 COA Circ."].

[153] *See* 1986 COA Circ., art. 3.1; 1989 COA Circ art. V.1.

[154] *See* 1986 COA Circ., art. 3.2; 1989 COA Circ, art. V.2.

[155] *See* 1989 COA Circ., arts. II & III.

[156] *See* GOCC Act, § 32.

[157] *Compare* 1986 COA Circ., art. 3.1 *and* 1989 COA Circ., art. V.1, *with* GCG, Implementing the Divestment by GSIS of its 99.5% Shareholdings in GSIS Family Bank, Memorandum Order No. 2015-04, resolutory ¶ 1, May 11, 2015.

Pursuant to the Circulars, divestitures of government-owned property will be governed by the following principles:

1. Adequate publicity and notification so as to attract the greatest number of interested parties;
2. Sufficient time frame between publication and date of auction;
3. Opportunity afforded to interested parties to inspect the property or assets to be disposed;
4. Confidentiality of sealed proposals;
5. Bond and other prequalification requirements to guarantee performance; and
6. Fair evaluation of tenders and proper notification of award.[158]

Adherence to the foregoing principles ensures that the selection process is merit-based.

Bulgarian experience connects the importance of publicity and notification to post-privatization market competitiveness. In the 1990s, "quiet privatizations" allowed "experienced managers in state-owned companies [to transfer] assets to their own businesses at very low prices."[159] Evidently, competition was foreclosed at the outset.

Confidentiality of sealed proposals eliminates, if not reduces, the risk of bid-rigging. If bidders were aware of each other's bids, there would be an incentive to coordinate and artificially inflate proposals.[160] Besides the sealed bid requirement, policymakers could provide mechanisms that "[l]imit as much as possible communications between bidders during the tender process," and "[c]arefully consider what information is disclosed to bidders at the time of the public bid opening."[161]

Finally, a fair evaluation of tenders entails that the bidding be conducted with a uniform basis of comparison. That way, no participants are favored at the expense of others.

The remaining issue concerning the implementation of public auction is whether this ought to be designed as an auction of assets or shares of stock.

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[158] 1986 COA Circ, art. 3.1; *and* 1989 COA Circ, art. V.1.

[159] Snejina Michailova, *The Bulgarian Experience in the Privatization Process*, 35 EUR. ECON. 75, 90 (1997).

[160] *See* Agan v. Philippine Int'l Air Terminals Co., Inc., 450 Phil. 744 (2003).

[161] OECD, GUIDELINES FOR FIGHTING BID RIGGING IN PUBLIC PROCUREMENT 7 (2009).

Other jurisdictions' experience point to share auctions as better suited to foster more inclusive markets. In industrial economies, "open public offering of shares [...] permits widespread shareholding[.]"[162] The United Kingdom launched its privatization policy to broaden the base of shareholdings in telecommunications, gas, and electricity companies.[163] To further reinforce the point, block sales, negotiated sales, and trade sales—privatization methods that deviate from the generally preferred public auction—were found to increase market concentration, consolidating the clout of private competitors once their public rivals had transitioned into the former's sphere.[164]

It is possibly in acknowledgement of the preceding nuances that the Philippines' precursor privatization laws and issuances contained features which promoted broad-based share ownership.[165]

Granted, neither the GOCC Act nor the COA Circulars embody an absolute preference for share auctions over asset dispositions. Nevertheless, the above-mentioned virtues of share auctions should strongly be considered when crafting privatization plans.

Parenthetically, whether privatization share auctions would promote competition will also depend on the development of the capital market,[166] such that a wider scope of share trading is made available to prospective investors. Still, the GCG must do its part by building a "shareholder democracy"[167] through "socialized ownership"[168] of shares in previously government-owned enterprises.

b. Democratization of Post-Privatization Ownership

Previous iterations of privatization laws had incorporated ownership-democratizing provisos. Such features ensured that the post-privatization

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[162] SPULBER, *supra* note 1, at 152.

[163] Thomas Clarke, *The Political Economy of the UK Privatization Programme: A blueprint for other countries?*, *in*THE POLITICAL ECONOMY OF PRIVATIZATION 218-20 (Clarke & Pitelis eds., 1993 ed.).

[164] Venkata Vemuri Ramanadham, *The Monitoring and Regulatory Aspects of Privatization*, *in* PRIVATIZATION AND AFTER 17 (Ramanadham ed., 1994).

[165] *See supra* Part III.B.

[166] Saman Kelegama, *Privatization in Sri Lanka: An overview*, *in* HOW DOES PRIVATIZATION WORK 177 (Bennett ed., 1997).

[167] John Heath, *Monitoring and Regulatory Aspects of Privatization in Five Former Centrally-Planned Economies*, *in* PRIVATIZATION AND AFTER 185 (Ramanadham ed., 1994).

[168] Clarke, *supra* note 163, at 218.

scenario would induce the entry of new competitors and prevent the anti-competitive concentration of incumbents.[169]

Overlooking such considerations had, in fact, facilitated dominance by a few. For instance, when government-owned Island Cement Corporation ("ICC") was privatized, the Philippine Investments Management Consultants, Inc. ("PHINMA") already controlled 36% of the cement industry through six subsidiary cement corporations. Solid Cement Corporation, an affiliate of PHINMA, acquired the privatized ICC, increasing the PHINMA's market share to 46% of the industry.[170]

Recall Figure 1, depicting the GOCC Act's privatization framework. The GCG recommends privatization to the OP, which then draws up an Executive Order directing relevant agencies to coordinate in devising a privatization plan. The GCG will implement the mode of disposition, the result being a transfer from the government to private sector.

The process must account for two crucial and mutually reinforcing issues: *first*, determining the relevant market wherein the private entity will eventually compete; and *second*, screening the potential transferees of the privatized entity. The *first* is necessary to extrapolate the expected level of competition and identify the privatized entity's competitors. The *second* ensures that potential transferees do not represent incumbents' interests.

The PCC must lend its expertise to resolve the *first* issue. Privatization should include some analysis on relevant markets. If, for instance, a power generation business were being privatized, the absence of a bidder engaged in power generation does not automatically obviate competition concerns; for it might very well be that the participating bidders are engaged in upstream or downstream activities, thus raising concerns of vertical integration. By identifying the product and geographic markets which the GOCC will cater to, government will be better-informed regarding the anticipated level of competition.[171]

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[169] *See* Leonor Magtolis-Briones, *The Role of Government-Owned or Controlled Corporations in Development*, 29 PHIL. J. PUB. ADMIN. 365, 388-89 (1985). "The magnitude of cost involved in the purchase of GOCCs further limits ownership of GOCCs to a few Filipino industrialists. *It seems that the only ones who can really purchase GOCCs are the very businessmen who are already controlling the key corporations.* Is this the intended effect of privatization?" (Emphasis supplied.)

[170] Rosario Manasan, *Public Enterprise Reform: The Case of the Philippines, 1986–1987*, Phil. Inst. for Dev. Stud. Discussion Paper Series No. 95-01, 13 (1995).

[171] PCA, §§ 4(k), 24.

On the *second* concern, the GCG should coordinate with the SEC as it recently promulgated a Memorandum Circular ("SEC Circular") governing disclosures of control and beneficial interests over corporate entities.[172] Amid corporate layering and interweaving, the SEC Circular prescribes tests and requires the declaration of key pieces of information in a revised General Information Sheet. Apart from the SEC Circular, the GCG should also integrate analysis from the SEC on disclosures of related party interests;[173] and the PCC on determination of entity control for mergers and acquisitions.[174] Studying these features, if not directly tapping these agencies' expertise, will enable the GCG to formulate its own mechanisms that screen prospective transferees when privatizing a GOCC.

With the above features in place, other than giving preference to small time investors, the GCG, SEC, and PCC, will be able to closely scrutinize the participating bidders and their existing interests in the subject or related industry. If the agencies expect that a participating bidder would, in acquiring the privatized GOCC, emerge with competitively-suspect market power, then the government could either refuse disposition in favor of such participant, or at least impose commitments to safeguard against anti-competitive conduct.

While the issue in the case concerned interlocking directorates, *Gokongwei v. Securities and Exchange Commission*[175] sufficiently captures the competition concerns produced by corporate combinations among competing entities: "[r]eason and experience point to the inevitable conclusion that the inherent tendency of interlocking [...] between companies that are related to each other as competitors is to blunt the edge of rivalry between the corporations, to seek out ways of compromising opposing interests, and thus eliminate competition."[176]

Foreign experience also demonstrates the importance of such measures. The Chilean Competition Commission ("CCC") participated in their Ministry of Public Works award of airport concession licenses. To ensure that, post-privatization, the construction, maintenance, and management of airportswould be competitive, the CCC was heavily involved in the *ex ante*

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[172] *See* Securities and Exchange Commission Memo. Circ. No. 17 (2018).

[173] SEC. REG. CODE. Rev. Rules & Regs., r. 68.

[174] PCC Rules on Merger Procedure (2017), r. 1.3, 1.4(j).

[175] G.R. No. 45911, 89 SCRA 336, 344 (1979).

[176] *Id.* (Emphasis supplied.)

evaluation of the license awardees, providing input on the competitive allocation of licenses.[177]

Thus, as early as its recommendation, the GCG must propose the PCC's and SEC's participation. That way, the OP can properly direct the three agencies, along with other pertinent bodies, to plan the competition-enhanced privatization of subject GOCCs.

Failure to incorporate such mechanism could lead to one particular failure of the UK's early privatization policy: "the transfer of very substantial [businesses] from the public sector to large financial and multinational companies under the camouflage of 'popular capitalism'."[178]

c. Restrictive Covenants

Competitive concerns do not cease upon divestiture to the private sector; in fact, it is at this stage that a democratized ownership structure must be sustained. The desire to promote competition would be upended if ownership in newly privatized entities will eventually be held by a few.[179]

Opportunism by incumbents can be arrested through restrictive covenants that prevent new owners from alienating their stake in the newly-privatized business, especially if made in favor of an incumbent.

When the British government privatized Amersham International, a radiopharmaceutical manufacturer, it amended Amersham's articles of association to include a feature that would prevent any one person or group to acquire more than 15% of the company's voting capital.[180]

British authorities learned that restrictive covenants urged new owners to be more invested in the outcome of the company.[181] Owners were denied the opportunity to secure short-term speculative gains, and instead focused their energy and resources in securing the profitability of the

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[177] OECD, *Latin American Competition Forum*, Directorate for Financial and Enterprise Affairs Competition Committee, OECD Doc. DAF/COMP/LACF(2011)12, 4 (Aug. 25, 2011).

[178] Clarke, *supra* note 163, at 220.

[179] *See* John Moore, *British Privatization—Taking Capitalism to the People*, HARVARD BUSINESS REVIEW (1992), *available at* https://hbr.org/1992/01/british-privatization-taking-capitalism-to-the-people.

[180] *Id.*

[181] *Id.*

privatized entity. Additionally, such covenant will, as early as the privatization stage, weed out speculators and guarantee the participation of *bona fide* investors interested in seeing to the business' success.

The GCG could follow Britain's lead and incorporate restrictive covenants by amending the GOCC's articles of incorporation before privatization. More specifically, the amended articles can provide for a classification of shares that may not be alienated for a given period of time;[182] or, the articles could also decree an express forbearance from combining with related or competing entities.[183]

Another device that could embody restrictive covenants is the transfer instrument between the government and the private person. Whether it be of assets or shares of stock, the instrument should contain terms and conditions[184] to the effect that transfer of interest may not be done within a certain period or that the transfer may not be made in favor of the privatized entity's competitors. Else, the transfer will be treated as void, in which case it would still be held by the initial owner; or the transfer could trigger the reversion of interest to the government, in which case the transfer is subject to a resolutory condition.[185]

The Terms of Reference governing the selection of the third telecommunications player, albeit in the nature of an administrative rule, contained this feature:

> During the Commitment Period, or any extension thereof, the Participant will not merge or combine with, or become a Related Party to, any dominant telecommunications prayer. After said period, any merger, acquisition, or business combination, shall be subject to and shall comply with the Philippine Competition Act and other applicable laws[.][186]

As broached earlier, the covenant must apply only for a duration of time. Too lengthy a prescription could prove too onerous for investors; after all, the prospects of profiting from the sale of appreciated shares of stock also incentivizes quality company performance.

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[182] CORP. CODE, § 6.

[183] CORP. CODE, § 14.

[184] CIVIL CODE, art. 1306.

[185] CIVIL CODE, art. 1179.

[186] National Telecommunications Commission Mem. Circ. No. 09-09-18 (2018), § 6.2(i)(1). Rules and Regulations on the Selection Process for a New Major Player in the Philippine Telecommunications Market.

The duration within which the covenant or condition should remain effective cannot be the subject of a hard and fast rule. It would depend on a number of factors, but a useful yardstick would be the projected timeline within which the business can operate viably. The argument for such a yardstick is, returning to the British experience, that new owners should be given ample time to get invested in their new endeavor and learn the technicalities of the business. For example, a privatized telecommunications utility, due to the need for special equipment and radio communications expertise, deserves a longer covenant duration than, say, a privatized merchandise retailer.

If, after the duration, new owners cannot sustain the operations, then, in the spirit of competition, the possible turnover of ownership can guarantee that fresh entrepreneurial spirit pervades the business, or at least keep present owners on their toes due to the prospect of being bought out.

d. System of Inter-Agency Coordination

To recapitulate, the foregoing illustrations are instructive to the extent that they demonstrate how various aspects in the privatization process can be enhanced with competition-promoting mechanisms.

How to operationalize such mechanisms is a proper subject of inter-agency coordination. Under the current framework, GCG is the primary body mandated to privatize GOCCs while the PCC is the lead agency in implementing the PCA.

The two are co-ordinate bodies, with the parameters for inter-agency relations delimited by the PCC's advocacy functions. The PCC has operationalized these provisions by entering into memoranda of agreement ("MOA") with related bodies such as the Ombudsman, Department of Trade and Industry, and the Public-Private Partnership Center.[187]

These MOAs contain provisions on successive review:an initial determination by the BangkoSentral ng Pilipinas of the soundness of banks'

[187] *See* PCC, *Partnerships*, PHILIPPINE COMPETITION COMMISSION WEBSITE, *at* https://phcc.gov.ph/category/news-updates/partnership/.

mergers or acquisitions, subject to the final determination of the PCC;[188] mutual consultations regarding pending proceedings;[189] information-sharing as the PCC relies on industry data which other sector regulators are at the forefront of gathering;[190] and staff exchanges[191] and joint capacity-building[192] because, if other agencies are to be effective partners in the promotion of competition, they need basic competition training in order to identify issues which require joint efforts with the PCC.

Similarly, the PCC and GCG must craft their own MOA. Apart from the features mentioned above, the MOA must contain a specific section on privatization. This section must indicate that either the PCC can proactively provide input, arguing for a GOCC's privatization, even before the GCG makes such recommendation to the OP; or, that the GCG can solicit the PCC's opinion on whether a GOCC should be privatized. Recall that competitive neutrality, an issue for which the PCC is well-equipped to provide expertise, is an argument for privatization.

Thereafter, the MOA should indicate that, when the GCG recommends privatization to the OP, the GCG should also recommend the PCC's participation in the proceedings. That way, the OP can craft the proper directive, ordering the PCC and GCG to coordinate their efforts.

Once the crafting and implementation of the privatization process is under way, the PCC can provide input on the relevant issues necessary for the GCG to integrate competition analysis into privatization.

One anticipated issue is whether the PCC's input binds the GCG. Preferably, it should; else, efforts to promote competition would be wasted if the GCG were free to disregard the PCC's input. Crafting a competition-enhanced privatization plan is not a case where the GCG exercises primary jurisdiction and merely solicits the PCC's advisory opinion; rather, it involves joint exercise of jurisdiction, with the GCG taking the lead on privatization

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[188] PCC & Bangko Sentral ng Pilipinas, Memorandum of Agreement (Dec. 22, 2017), art. I, *available at* https://phcc.gov.ph/wp-content/uploads/2019/03/2017-12-22-MOA-Banko-Sentral-ng-Pilipinas_PCC-BSP.pdf.

[189] PCC & SEC, Memorandum of Agreement (Dec. 5, 2016), § 3, *available at* https://phcc.gov.ph/wp-content/uploads/2019/03/2016-12-05-MOA-Securities-and-Exchange-Commission_PCC-SEC.pdf.

[190] PCC & Department of Justice, Memorandum of Agreement (June 8, 2018), § 2.1, *available at* https://phcc.gov.ph/moa-pcc-doj/.

[191] PCC & SEC, *supra* note 189, at § 5.

[192] PCC & Office of the Ombudsman, *supra* note 190, at § 1.9.

efforts and the PCC exercising its mandate over competition issues that are inextricably linked to privatization.

The problem, however, lies in the fact that the two agencies are co-ordinate bodies and no statutory language in the PCA suggests that the PCC can exercise a "veto power" over the GCG's functions. Amid such dilemma, amendatory legislation that expressly requires the GCG to solicit and integrate the PCC's findings in the privatization plan would be ideal. In this manner, the PCC will have succeeded in its roles, vis-à-vis other specific sector regulators such as the GCG, as "consultant to the government" and "proponent at large for increased public recognition and acceptance of competition principles."[193]

IV. CONCLUSION: A CLAMOR FOR SMALLER GOVERNMENT

Privatization garnered acclaim when it was announced as a development priority, first under the term of President Corazon Aquino, then under President Fidel V. Ramos.[194] In privatizing critical sectors such as energy, oil, water, transportation and communications, President Ramos noted that there was "much potential for harnessing private initiative to undertake in behalf of government certain activities which can be more effectively and efficiently undertaken by the private sector[.]"[195] Regrettably, such sectors' competitiveness only marginally improved over the years, their evolution still hindered by anti-competitive constraints.[196] Studies can attest that such shortcomings are, in part, ascribed to the omission of competition analysis in privatization;[197] thus, bolstering the need to re-orient privatization towards the promotion of competition.

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[193] Gamze Aşçıoğlu Öz, The Role of Competition Authorities and Sectoral Regulators: Regional Experiences, Submitted to UNCTAD's Seventh Session of the Intergovernmental Group of Experts on Competition Law and Policy, Geneva, 12 (Oct. 30–Nov. 2, 2006).

[194] *See, generally,* Romeo Bernardo & Marie-Christine Tang, *The Political Economy of Reform during the Ramos Admin. (1992-98)*, Commission on Growth and Development Working Paper No. 39 (2008).

[195] Bagatsing v. Comm. on Privatization, G.R. No. 112399, 246 SCRA 334, 343(1995).

[196] *See, generally,* Aldaba, *supra* note 61.

[197] Manasan, *supra* note 170, at 13. "[B]ecause of the thinness of the capital market and the highly skewed distribution of wealth the privatization program may result in the emergence of cartels."; Trefor Jones, *Privatization and Market Structure in the UK Gas Industry, in* THE POLITICAL ECONOMY OF PRIVATIZATION 62 (Clarke &Pitelis eds., 1993 ed.). "[P]rivatization presents opportunities for restructuring industries to create competitive

Mass privatization is again gaining traction as a national agenda. Other than the announced initiative early in 2018, PCC Chairman Arsenio Balisacan recently delivered a talk on competitive neutrality among GOCCs, discussing the actions necessary to pursue the same.[198] Moreover, Duty Free is now entertaining the privatization of its operations.[199]

Of course, resistance might come from certain quarters, particularly sitting GOCC managers who, owing to the State's fiscal sustenance, can remain complacent in running the GOCC all the while indirectly obtaining benefits from it.[200] But privatization will force corporate managers to internalize the business' operations, incentivizing them to manage the company effectively as increased profitability means better compensation. At the very least, privatization will set *bona fide* managers, truly interested in seeing to the business' success, apart from the neglectful ones.

To orient privatization towards the enhancement of competitive markets, government authorities must *first* identify which GOCC activities must be privatized. To do this, government must screen various industries for market failures, determine whether such activities are contestable by the private sector, and consider the suitability of different modes of intervention. *Second*, to recalibrate privatization to promote competition, the GCG must solicit and consider the PCC's input before and during implementation, with focused analysis devoted to relevant markets, industry shares, and ownership structures.

The government's role in a market economy is an ongoing debate. Aptly expressed in *Antamok Goldfields Mining Co. v. CIR*,[201] "the political and philosophical aphorism of [one] generation will [...] be doubted by the next and perhaps entirely discarded by the third."[202] More particularly, "[t]he important question for developing societies is how to develop a mutually

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market structures by breaking up existing state-owned firms into smaller-sized enterprises, and by removing entry barriers to allow new entry competition."

[198] Arsenio Balisacan, *Towards Competitive Neutrality: The Role of Competition Authorities*, Speech delivered at the 2nd Meeting of High-Level Representatives of Asia-Pacific Competition Authorities, CC4 OECD Conference Centre, Paris (Nov. 28, 2018).

[199] Catherine Talavera, *Duty Free taps PPP Center for study on privatization*, THE PHILIPPINE STAR, Dec. 20, 2018, *available at* https://www.philstar.com/business/2018/12/20/1878353/duty-free-taps-ppp-center-study-privatization.

[200] *See* Richard Kennedy & Leroy Jones, *Reforming State-Owned Enterprises: Lessons of International Experience, especially for the Least Developed Countries*, United Nations Industrial Development Organization SME Technical Working Paper No. 11, 43 (2003).

[201] 70 Phil. 341 (1940).

[202] *Id.* at 356. (Citation omitted.)

supportive structure of market and non-market institutions, which is well-suited to promote economic development. This makes normative development economics a difficult art."[203]

Market failures demand government intervention, and these were initially redressed through direct participation as GOCCs. Having discerned the drawbacks of such model, it is time that government relinquishes its role as direct market participant, to recede into the backdrop of the market economy, and entrust industrial development to the private sector. This way, government will still fulfill its obligation to secure the nation's prosperity; just not in the capacity of a perennial interventionist but rather, through privatizing GOCCs in a manner that promotes competition, as a transitional reformist.

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[203] Datta-Chaudhuri, *supra* note 121, at 38.