

A Critique of Recent Governance Reforms of State-Owned Enterprises in the Philippines and Their Proposed Improvements*

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Introduction

In developing economies like that of the Philippines, where the investment climate is not conducive to private sector participation, state-owned enterprises (SOEs) are utilized by governments to perform not only vital governmental functions but also purely commercial activities for profit. Governments deliver basic goods and services to the public or engage in the business of public utilities or financing services and other profit-oriented undertakings through the SOE vehicle or balance their fiscal deficits through disposal or sale of SOEs in the market. These various purposes that the government assigns to the SOEs signify the significant and even pioneering role that SOEs play in the growth and development of developing economies.

In the Philippines, the rise to prominence of the SOE economy began when former President Ferdinand Marcos declared martial law in 1972.¹ In 1970, the total number of SOEs in the Philippines totaled 65, and grew to 303 in 1985,² and tripled to 604 as of August 2010.³ In 2009,

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¹ Victoria A. Bautista, *A Critical Look Into the Role of Public Enterprises*, 1 *Kasarinlan*; *Philippine J. of Third World Stud.*, n. 3 (1985), available at <http://journals.upd.edu.ph/index.php/kasarinlan/article/viewArticle/515>.

² This total number of 303 in SOEs in the Philippines in 1985 may be understated because the Presidential Commission on Reorganization (PCR), was still in the process of completing the list of SOEs at that time. See Bautista, *supra* note 1.

SOEs' assets totaled 125 Billion US Dollars, which exceeded the national government's assets of 65 Billion US Dollars.⁴

The irony is that the increasing number of these SOEs in the Philippines does not translate to increased contribution to economic growth but rather, the opposite. In fact, the deteriorating financial performance of SOEs significantly contributes to the large public sector deficits in recent years of 2000s,⁵ and to the over-all fiscal deficit of the country. This poor financial performance necessitates certain passage of SOEs' governance reforms on accountability, transparency, political interference, etc., that would help cure the current situation. The current government's introduction of SOEs' governance reforms through the passage of the Government-Owned and Controlled Corporations Governance Reform Act of 2011 (GOCC Governance Reform Act of 2011) addresses these governance problems but still fails to provide sufficient protection against political abuse.

This article exposes certain weaknesses in the governance structures and principles introduced by GOCC Governance Reform Act of 2011 using the Organization for Economic Co-operation and Development (OECD) Guidelines on Corporate Governance of SOEs ("OECD Guidelines") as a benchmark. Furthermore, this article proposes certain changes to the current governance reforms on SOEs, which are more compliant with the principles behind the OECD Guidelines. The changes are proposed with full consideration of the present legal and political system and structure of the Philippines. In doing so, this article shall focus

³ Senate Economic Planning Office Policy Brief, *Issues and Challenges with the Philippines' Public Corporate Sector* (August 2010), <http://www.senate.gov.ph/publications/PB%202010-08%20-%20Issues%20and%20challenges.pdf>. [hereinafter SEPO Policy Brief].

⁴ Senator Franklin M. Drilon, Recent Endeavors of the Philippines on Drafting a New SOE Act, Speech at the 6th Meeting of the Asia Network on Corporate Governance of State-Owned Enterprises, Seoul Korea, (May 17, 2011).

⁵ According to Benjamin Diokno, the increase in the consolidated public sector deficit in recent years is partly due to the heavy losses suffered by some of the monitored nonfinancial government corporations. See Benjamin E. Diokno, *Philippine Fiscal Behavior in Recent History*, 47 THE PHILIPPINE REVIEW OF ECONOMICS, n. 1, 39-87 (June 2010).

on the governance reforms on two types of SOEs: those operating purely on a commercial basis with a sole objective of value maximization and those with a mixture of commercial and social objectives.

The structure of this article is as follows: Section II provides a conceptual background of SOEs, which includes a brief discussion on the different theories justifying the creation of an SOE. Section III discusses the nature of SOEs in the Philippines, including the legal bases for their contribution to the government's fiscal condition. Section IV looks into the different theories that argue against the creation of SOEs. Section V applies these different theories on the problematic creation and maintenance of SOEs in the Philippines as demonstrated by the two broad categories of SOEs' governance issues. Section VI discusses the salient features of GOCC Governance Act of 2011 with regard to the governance structures it provides. This section likewise provides a critique of the GOCC Governance Reform Act of 2011 within the context of the principles embodied in the OECD Guidelines on Corporate Governance of SOEs and proposes improvements on the said reforms according to those principles. Section VII looks into the potential societal and political challenges that the government may face in the implementation of such reforms. Section VIII concludes the paper, which likewise enunciates the need for a paradigm shift with regard to who should be considered as the real shareholders of SOEs.

Conceptual Background of State-Owned Enterprises (SOEs)

A. Nature and Rationale for the Existence of SOEs

The World Bank has defined a state-owned enterprise as a “publicly owned entity with a separate legal personality and separate accounts that earns the bulk of its revenue from the sale of its goods and services.”⁶ Thus, in the concept of a state-owned enterprise, there is a

⁶ Mary M. Shirley, *The Reform of State-Owned Enterprises: Lessons From World Bank Lending* (1989).

cross-pollination of economics (state-ownership and sale of goods and services), politics (public entity) and law (separate legal personality).⁷

There are two broad categories of SOEs, based on the category of activities in which they engage. The first category are those engaged in the delivery of core public infrastructure services such as postal services, sanitation, power, airports, telecommunications, water, broadcasting, and telecommunications.⁸ SOEs of this type, however, could have a mixture of commercial and non-commercial activities.⁹ The non-commercial activities are geared towards the delivery of core services to remote populations or at a reduced cost to a sector of a public.¹⁰

The second category of SOEs is engaged in purely commercial activities such as air transport, banking, real estate development, retailing and shipping.¹¹ These commercial SOEs are principally key investors in the economy whose principal objective is to maximize the returns to the enterprise.

B. Theoretical Justifications for the Existence of SOEs

1. Natural Monopoly

The most frequently cited reason for the creation or existence of SOEs is the case of natural monopoly.¹² This refers to a situation where only one supplier exists in the market due to the technical requirements of

⁷ See generally Neil Efind, *The State-Owned Enterprise as a Vehicle for Stability* (2010), available at <http://www.strategicstudiesinstitute.army.mil/pubs/display.cfm?pubID=980>, (describing SOEs as hybrid creations of economics and politics).

⁸ Asian Development Bank, *Finding Balance 2011: Benchmarking the Performance of State-Owned Enterprises in Fiji, Marshall Islands, Samoa, Solomon Islands and Tonga* (2011) available at <http://www.adb.org/publications/finding-balance-2011-benchmarking-performance-state-owned-enterprises-fiji-marshall-isl>.

⁹ *Id.* at 8.

¹⁰ *Id.*

¹¹ *Id.*

¹² Ha-Joon Chang, *National Development Strategies Policy Notes: State-Owned Enterprise Reform*, U.N. Dep't for Econ. and Soc. Aff., (2007) available at http://esa.un.org/techcoop/documents/PN_SOERreformNote.pdf.

a given industry.¹³ As competition is absent in the market, a supplier is able to command profits by charging high prices to its customers or clients.¹⁴ In cases where the natural monopolist is the sole buyer of a certain input from its supplier, it can also command very low prices for such inputs.¹⁵ This occurs usually in the power sector, telecommunications sector, or others characterized as capital intensive, and therefore serves as a constraint to other potential entrants to market and compete. This behavior frustrates governmental policy with regard to market competition and economic efficiency.¹⁶ One way to address this situation is for the government to create an SOE to enter the market.¹⁷

2. *Capital Market Failure*

A capital market is any market in which a government or a company raises capital to fund their operations and long term investment.¹⁸ In economics, the long-held theory is that capital markets have an inherent bias towards short-term gains and against projects with long gestation periods as they carry high risks in the short term.¹⁹ Examples of these projects are alternative energy projects with long gestation periods, and other capital intensive and high technology industries such as the aircraft or steel industries. The government creates an SOE in the form of a government financial institution (e.g., development bank) to extend lending facility to these risk-averse companies, or sets up an SOE that would directly invest in these kinds of projects.²⁰

¹³ *Id.* at 12.

¹⁴ *Id.*

¹⁵ *Id.*

¹⁶ *Id.*

¹⁷ Chang, *supra* note 12, at 12.

¹⁸ Mike Moffatt, *What are Capital Markets?*, About.com Economics, http://economics.about.com/od/financialmarkets/f/capital_markets.htm (last visited May 29, 2012).

¹⁹ Chang, *supra* note 12, at 12.

²⁰ *Id.*

3. *The Problem of Externalities*

The basic concept of externalities in economics, that the creation of SOEs by the government attempts to address, refers to such situation where a private player derives returns that do not include the returns of others who have benefited indirectly from the operation of such business. This feature works as a disincentive for such player to enter the market.²¹ An example may be a company engaged in creating technology for solar power energy, derives returns to the company that does not include the returns of others who have benefited indirectly because of the use of the solar power by the company's client.

In some situations, goods and services are not offered in the market equally. The creation of SOEs on equity means that basic goods and services are made accessible to the public equally. Vulnerable groups such as women or the elderly or the poor people are assured of access to public goods and services such as health insurance, medical services, etc., because there is an SOE that would render these goods and services available to them.²²

Nature of SOEs in the Philippines

A. Constitutional Basis and Brief History

Article XII (National Economy and Patrimony), §18 of the 1987 Philippine Constitution provides: "The State may, in the interest of national welfare or defense, establish and operate vital industries and, upon payment of just compensation, transfer to public ownership utilities and other private enterprises to be operated by the Government."²³ It is likewise provides that "government-owned and controlled corporations may be created or established by special charters in the interest of the common good and subject to the test of economic viability."²⁴

²¹ *Id.*

²² *Id.* at 13.

²³ Const. (1987), art. XII, sec. 16

²⁴ *Id.*

The rise of public enterprises in the Philippines in the form of a corporate vehicle called government-owned or controlled corporations (GOCCs) began after World War II.²⁵ The phrase, “*in the interest of national welfare*,” however, could evoke the creation of enterprise for any or all purposes such as banks, nuclear plant, racehorses and gamecocks.²⁶ This was especially true during the time of former President Ferdinand Marcos, when only 37 GOCCs existed when he assumed office in 1965, and within ten years grew rapidly to 120.²⁷ While the policy was to establish GOCCs “for economic development, enhancement and protection of the national interest, and institutional response to specific problems,”²⁸ the corporate vehicle was used for other reasons, most notably to transfer public wealth to a few private individuals.²⁹

B. Definition and Rationale of GOCCs

GOCC is defined in Presidential Decree (P.D.) 2029 (Defining Government-Owned or Controlled Corporations and Identifying their Role in National Development),³⁰ as follows:

a stock or a non-stock corporation, whether performing governmental or proprietary functions, which is directly chartered by special law or, if organized under the general corporation law, is owned or controlled by the government directly or indirectly through a parent corporation or subsidiary corporation, the extent of at least a majority of its outstanding capital stock or of its outstanding voting capital stock. EO No. 64 of 1993

²⁵ Const. (1987), art. XII, sec. 18 (Phil.) (originally found in the 1935 Constitution which was enforced from 1935 to 1972).

²⁶ Leonor M. Briones, *Philippine Public Enterprise in the 80s: Problems and Issues*, 3 Phil. Inst. For Dev. Stud., Dev. Research News, no. 4, (July-August 1985) at 2, available at <http://publication.pids.gov.ph/details.php?pid=1086>.

²⁷ Drilon, *supra* note 4.

²⁸ Briones, *supra* note 25, at 2.

²⁹ *Id.*

³⁰ Chan Robles Virtual Law Library.
<http://www.chanrobles.com/presidentialdecrees/presidentialdecreeno2029.html>.

expanded the definition of GOCC as follows: “... a corporation created by special law or incorporated and organized under the Corporation Code and in which government, directly or indirect, has ownership of the majority of the capital stock

Thus, there are two (2) types of GOCC that could be established under P.D. 2029—one created under a special charter or special law, and another created under the Corporation Code of the Philippines. There is also a third type of GOCC called “acquired corporation,” where a majority of stocks are taken over by the government in the settlement of corporate debt with a government financial institution (GFI).³¹

Like other economies, the Philippine government’s direct participation in the economy is primarily grounded on the idea that the state must intervene to correct market failures such as where the private sector is unwilling or unable to provide goods and services vital to society such as the construction of large infrastructure.³²

C. GOCCs Contribution to the Government’s Fiscal Condition

Government derives a substantial amount of its revenues from GOCC operations. Republic Act (R.A.) 7656 requires all GOCCs to declare and remit at least fifty percent of their annual net earnings which may be in the form of cash, stock, or property dividends to the national government.

Another source of revenue from GOCCs are guarantee fees, foreign exchange risk cover, and interest on National Government’s advances extended to GOCC loans.³³ Certain GOCCs like the Philippine Amusement and Gaming Corporation and the Manila International Airport Authority likewise remit to the National Treasury the government’s share from their operations.³⁴

³¹ Bautista, *supra* note 1, at 5.

³² SEPO Policy Brief, *supra* note 3.

³³ *Id.*

³⁴ *Id.*

The positive contributions by certain GOCCs to the fiscal condition of the National Government is neutralized and even outweighed most of the time by the heavy burden that other types of GOCCs cast on the national treasury. Those GOCCs formed to create bias in favor of a disadvantaged sector like farmers are the top heavy fiscal drainers because of the financial support extended to them by the national government in the form of subsidies, equity infusion, and lending.³⁵

One of these GOCCs is the National Food Authority (NFA), which was created in 1981 by Presidential Decree 1770, to achieve and maintain adequate supply of food grains at mutually satisfactory price levels for both farmers and consumers.³⁶ In 2009, the NFA received the biggest government subsidy.³⁷

Another form of expenditures incurred by the National Government in behalf of GOCCs is in the form of sovereign guarantees.³⁸ In 2009, the government's net lending or advances for the servicing of the National Government (NG) guaranteed GOCC debt net of repayments amounted to Php5 billion³⁹ (or roughly 225 Million USD at USD1 = Php45). These expenditures comprise a large portion of the consolidated public sector deficit, which in turn negatively affects the overall fiscal condition of the country.

Arguments Against the SOE Model

The negative impact of GOCC's existence on the fiscal condition of the National Government may be partly explained by the following theoretical grounds formulated against the SOE model itself.

³⁵ *Id.*

³⁶ Senate Economic Planning Office, *A Profile of Selected Philippine Government-Owned and-Controlled Corporations (GOCCs)*, <http://www.senate.gov.ph/publications/A%20Profile%20of%20Selected%20GOCCs.pdf> [hereinafter SEPO Profile of GOCCs].

³⁷ SEPO Policy Brief, *supra* note 3.

³⁸ *Id.*

³⁹ *Id.*

A. The Principal-Agent Problem

The Principle-Agent problem is a theoretical criticism based on the efficiency in which SOEs are run. Critics argue, for example, that since an SOE is run by people who are not its owners, no SOE will be managed as efficiently as a private enterprise run by its owner-manager.⁴⁰ This problem proceeds from the assumption that it is the citizens themselves who are the owners (principals) of SOEs.⁴¹ The problem arises due to the difficulty on the part of the citizens or principals to monitor the performance of SOE managers resulting to inefficient management.⁴²

B. Free-Rider Problem

The free-rider problem gives another perspective on the principal-agent problem, and likewise proceeds from the assumption that the citizens are the principals of the SOE's managers (agents). Since the costs that may be incurred by the individual citizen in monitoring SOE managers are to be shouldered by him/her alone but the benefits of that monitoring will eventually accrue to the other individual citizens, the individual citizen is left with no incentive to do such task. The logical consequence is that managers are free to do whatever they want in their jobs.⁴³

C. The Soft Budget Constraint

This is another inherent difficulty in the concept of SOE model. The soft budget constraint is the SOE's distinguishable feature from a private enterprise. This means that being part of the government structure, SOEs have the ability to secure finances from the national government thus, bankruptcy or insolvency never poses a real threat to them.⁴⁴ SOEs can act as if their budgets are soft or malleable because of the "infinite"

⁴⁰ Chang, *supra* note 12, at 14.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

source of money they could secure from the national treasury in case they need it.⁴⁵

Case Against SOE Model as Applied in the Philippines GOCCs

The broad theoretical arguments against the SOE model could explain the poor performance of existing GOCCs in the Philippines. These theoretical arguments may be translated and categorized into two (2) general issues that Philippines' GOCCs are currently facing. These issues are: (1) inconsistent policy objectives of the government and (2) lack of sound and principled corporate governance policies.

A. Inconsistent Policy Objectives of Government for GOCCs

The National Government creates a GOCC to address a particular market failure, and thus dictates the mandate that such GOCC is tasked to perform. However, most of the charters and other governing documents of these GOCCs do not succinctly delineate the overarching mandate of these enterprises. They often contain inconsistent primary purposes for which such GOCCs should operate. This situation is demonstrated by those GOCCs authorized to engage in commercial activities and at the same time, authorized to undertake non-commercial activities such as promotional or regulatory activities.

These inconsistent policy objectives of GOCCs are exemplified in the case of Philippine National Oil Company (PNOC), a GOCC created in response to the energy supply crisis of the 1970s.⁴⁶ As a holding company, PNOC currently has five (5) subsidiaries in the oil and gas, alternative fuels, shipping and transportation, real estate development, and renewable energy sectors. PNOC's Charter, P.D. 334 (as amended by P.D. 927) states that its primary purpose is "to provide and maintain adequate and stable supply of oil and petroleum products for the domestic requirement and for that purpose to **engage in, control, supervise and regulate** the transportation, storage, importation, exportation, refining, supply, sale and

⁴⁵ Chang, *supra* note 12, at 14.

⁴⁶ ASEAN Council on Petroleum, *Philippine National Oil Company*. <http://www.ascope.org/about-ascope/member-countries/philippines.html> (last visited May 29, 2012).

distribution of crude oil, refined petroleum and petroleum-based products . . .”⁴⁷ (Emphasis added)

The law creating PNOC has thus authorized lumping its commercial activities (engaging in the transportation, storage, importation, etc.), with its promotional or regulatory functions (controlling, supervising and regulating the said activities in the domestic market). As a consequence, PNOC finds itself both as a player and as a regulator in the domestic oil and gas market. As an SOE, it is mandated to remit annual dividends to the national treasury under R.A. 7656, which signifies that it must operate on a profitable manner. On the other hand, it is also mandated to control, supervise, and regulate the business activities of other players in the market, including its own.

The government therefore has given PNOC advantages over other private businesses and incentives to act in an anti-competitive manner in the oil market. As a regulator, PNOC and its subsidiaries could potentially issue rules and directives on pricing, regulate market players, which, includes its competitors that would create an uneven playing field in the market. Moreover, as an SOE actively engaged in the market, it has an easy access to capital and “friendly” credit facilities from government financial institutions (GFIs). One example is §9 of P.D. 334, which authorizes PNOC to issue bonds or other securities which may be guaranteed by the government to finance its oil or petroleum operations.

This leads to the issue of competitive advantages that some GOCCs in the Philippines, especially those engaged in commercial activities such as public utilities, financial institutions and industrial GOCCs have over the private sector. These competitive advantages may be in the following form:

1. Outright subsidization – Subsidization may be in the form of direct subsidies from the National Government to sustain GOCCs’

⁴⁷ Presidential Decree No. 927, “Further Amending the Charter of the Philippine National Oil Company,(PNOC) as provided for in Presidential Decree No. 334, as amended, and for other Purposes”, Section 4. Available at http://www.lawphil.net/statutes/presdecs/pd1976/pd_927_1976.html.

commercial operations.⁴⁸ Another form of subsidy is favorable tax regimes such as given to Light Rail Transit Authority (LRTA) which is a wholly-owned government corporation created under Executive Order 603 to undertake the construction, operation, maintenance and/or lease of light rail transit systems in the Philippines.⁴⁹ Aside from government guarantees extended to its loans, LRTA is also exempted from paying all direct and indirect taxes, customs duties, fees, imposts, other charges and restrictions, including import restrictions.⁵⁰

2. Concessionary financing and guarantees – This form of subsidy allows certain SOEs to enjoy credits directly from governments or through state-controlled financial institutions such as GFIs in the Philippines at below-market interest rates.⁵¹ Examples of these GOCCs are LRTA where the National Government acts as the primary obligor on LRTA loans,⁵² and the Local Water Utilities Administration (LWUA), which is a stock GOCC where the National Government likewise acts as the primary obligor on LWUA's loans.⁵³

Other inconsistent policy objectives of the National Government on GOCCs may be seen in those GOCCs that are mandated to provide services with social objectives.⁵⁴ A notable example of this GOCC, which was previously cited, is the NFA. The inconsistent policy lies in the fact that while NFA is mandated to stabilize domestic price of basic food commodities, particularly rice, by lowering prices for the consumers, it is also mandated to protect and ensure profit margins of rice farmers by setting floor prices in purchasing rice from them.⁵⁵ The NFA inevitably

⁴⁸ Antonio Capobianco & Hans Christiansen, *Competitive Neutrality and State-Owned Enterprises: Challenges and Policy Options*, (OECD Corporate Governance Working papers No. 1, 2011), available at <http://www.oecd.org/dataoecd/29/43/46452890.pdf>.

⁴⁹ SEPO Profile of GOCCs, *supra* note 41.

⁵⁰ *Id.*

⁵¹ Capobianco & Christiansen, *supra* note 52.

⁵² SEPO Profile of GOCCs, *supra* note 41, at 46.

⁵³ *Id.* at 53.

⁵⁴ SEPO Policy Brief, *supra* note 3.

⁵⁵ *Id.*

suffers huge losses which leaves the National Government heavily subsidizing NFA's operations to help it maintain its social purpose. Moreover, the National Government likewise acts as the primary obligor on NFA's domestic and foreign loans.⁵⁶ NFA is currently one of the top GOCCs which has consistently sapped public money from the national treasury because of this subsidization that has contributed to the National Government's fiscal deficit.⁵⁷

These two general categories of inconsistency in the policy objectives of the National Government on GOCCs—the conflicting mandate of commercial GOCCs to act as regulator and player in the market and the mandate of certain GOCCs to provide services with conflicting social objectives—give rise to two problems. First, the obvious fiscal drain on the National Government's public money. Second, the strong possibility that it would lead to the free-rider problem, where there is a potential danger for the SOE managers to perform poorly as the managers would never face the threat of the enterprise facing any bankruptcy or insolvency problem.

B. Lack of Sound and Principled Corporate Governance Policies

A 1989 World Bank (WB) study on Africa defined governance as “the exercise of political power to manage a nation's affairs.”⁵⁸ Subsequently the WB defined governance as “the manner in which power is exercised in the management of a country's economic and social resources for development.”⁵⁹ The OECD has defined governance as “the exercise of authority in government and the political arena.”⁶⁰ Good public

⁵⁶ *Id.*

⁵⁷ Senate Economic Planning Office Policy Brief, *Subsidizing the National Food Authority: Is it a Good Policy?*, (December 2010), <http://www.senate.gov.ph/publications/PB%202010-12%20-%20Subsidizing%20the%20NFA.pdf>.

⁵⁸ Juzhong Zhuang, Emmanuel De Dios & Anneli Lagman-Martin, *Governance and Institutional Quality and the Links with Economic Growth and Income Inequality: With Special Reference to Developing Asia 6* (ADB Econ. Working Paper Series No. 193, FEBRUARY 2010), available at <http://www.adb.org/publications/governance-and-institutional-quality-and-links-economic-growth-and-income-inequality-sp>.

⁵⁹ *Id.*

⁶⁰ *Id.*

governance is therefore an aid “to strengthen democracy and human rights, promote economic prosperity and social cohesion, reduce poverty, enhance environmental protection and the sustainable use of natural resources and deepen confidence in government and public administration.”⁶¹

Corporate governance on SOEs started during the 1970s and 1980s, when policymakers, donors, and institutional financial institutions like the WB made some reforms to improve SOE performance.⁶² The current approach to corporate governance on SOEs conceives the latter as corporations driven by incentives that reward efficiency and transparency.⁶³ In this article, the working definition of corporate governance is the organization of decision-making in a public corporation,⁶⁴ the aim of which is to achieve efficiency and to reinforce the value of accountability and transparency towards the improvement of its economic and social performance. The lack of corporate governance in the Philippines’ GOCCs is particularly notable in the following issues: 1) Political interference into the decision making of GOCC’s Board of Directors as a result of the appointment of Cabinet Secretaries as *ex-officio* members or *ex-officio* Chairpersons to the Boards; 2) lack of transparency and uniform rules in the selection of GOCCs’ Board members and 3) lack of integrity and transparency in the monitoring mechanisms of the performance of GOCCs.

⁶¹ *Id.*

⁶² Maria Vagliasindi, *Governance Arrangements for State Owned Enterprises*, (The World Bank Sustainable Dev. Network, Policy Research Working Paper No. 4542, March 2008, available at <http://elibrary.worldbank.org/docserver/download/4542.pdf?expires=1333777626&id=id&accname=guest&checksum=D521F1040473F8A77A6E9425A21CF218>).

⁶³ Luis Alberto Andres, Jose uis Guasch & Sebastian Lopez Azumendi, *Governance in State-Owned Enterprises Revisited: The Case of Water and Electricity in Latin America and the Carribean*, (The World Bank Latin Am. And the Caribbean Region Sustainable Dev. Unit, Policy Research Working Paper No. 5747, August 2011), available at http://wwwds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2011/08/01/000158349_20110801150940/Rendered/PDF/WPS5747.pdf.

⁶⁴ *Id.* at 3.

1. *Political interference into the decision making of GOCC's Board of Directors as a result of the appointment of Cabinet Secretaries as ex-officio members or ex-officio Chairpersons of the Boards*

The current framework of GOCCs in the Philippines is characterized by a formal system of centralized supervision and control.⁶⁵ The centralized system is explained by the Ministry concept, which means that SOEs performing similar functions are attached to ministries (now called departments), and are placed under the supervision and control of a minister (now called cabinet secretary).⁶⁶ Table 1 shows the list of GOCCs attached to departments.⁶⁷

⁶⁵ Briones, *supra* note 25, at 3.

⁶⁶ *Id.*

⁶⁷ SEPO Profile of GOCCs , *supra* note 41, at 27.

GOCCs	Department/s to which the GOCCs are attached
National Power Corporation	Department of Energy
National Electrification Administration	Department of Energy
Phil. National Oil Company	Department of Energy
National Food Authority	Department of Agriculture
National Irrigation Administration	Department of Agriculture
National Development Company	Department of Trade and Industry
Phil. Economic Zone Authority	Department of Trade and Industry
Philippine National Railways	Department of Transportation and Communication
Light Rail Transit Authority	Department of Transportation and Communications
Philippine Ports Authority	Department of Transportation and Communications
National Housing Authority	Housing & Urban Development Coordinating Council
Home Guaranty Corporation	Jointly by Housing & Urban Development Coordinating Council and Department of Finance

Further, the task of monitoring and supervision of the financial performance of GOCCs is given to the Department of Finance Corporate Affairs Group. This task is limited, however, to evaluating the impact of the financial performance of GOCCs to the national fiscal situation of the National Government.⁶⁸

⁶⁸ *Id.*

The potential of political intrusion into the GOCCs' business operations stems from the fact that in the charters of these GOCCs, the cabinet secretaries of the departments to which these GOCCs are attached are deemed *ex officio* chairpersons of their Board of Directors. Table 2 shows a list of cabinet secretaries sitting as members of the Board of Directors in some GOCCs.⁶⁹

GOCCs	No. cabinet secretaries in the Board	Total no. of board members
National Power Corporation	8	9
National Development Company	5	10
Light Rail Transit Authority	5	9
Phil. Ports Authority	6	9
National Housing Authority	6	8

Further, because the charters of these GOCCs allow the cabinet secretaries to become *ex officio* members of the Board, this resulted to multiple Boards being occupied by a single cabinet secretary in various GOCCs. For example, the Department of Energy (DOE) secretary sits as a Chairman of the Board in five GOCCs and as member in two other GOCCs.⁷⁰ Another example is the Department of Trade and Industry secretary who sits as Chairman of the Board in two GOCCs and as member in five other GOCCs.⁷¹

This institutionalized manner of appointing cabinet secretaries to occupy important positions on the Boards of GOCCs exposes the entire Board to the danger of undue political intervention, pressure, and influence on its decision making from the National Government. These

⁶⁹ *Id.* at 29.

⁷⁰ *Id.*

⁷¹ *Id.*

cabinet secretaries exert influence and moral ascendancy on the other members of the Board. The cabinet secretaries, being presidential appointees, are expected to remain loyal to and execute the desires of their appointing authority.

Another irregularity that arises from the appointment of cabinet secretaries to GOCC Board chairmanships/memberships is the anomalous situation of having chairpersons who are both regulators, as they head the department to which the GOCC is attached, as well as industry players, as they also are also members of that Board.⁷² Aside from the resulting lack of focus arising from this multiple membership, the cabinet secretary is thus confronted with conflicting duties, which is actually a microcosm of the problematic situation of the SOE itself.

Further, as *ex-officio* members, cabinet secretaries sit on the Board as long as they hold their cabinet portfolio, which is tantamount to holding the position indefinitely. This has resulted to a lack of professionalism and commitment to the mandate of the Boards. This has also resulted to a lack of continuity in the actions or decisions of the Boards, as abrupt changes in the appointment of cabinet secretaries would then result to change in Board membership. Consequently, the actions or decisions of the former Board may no longer be properly monitored or executed due to policy changes or desires of the new Board membership.

2. *Lack of transparency and uniform rules in the selection of Board members of GOCCs*

There is no uniform and clear rule on the manner of selection of Board membership as well on the qualifications except that the same is fully within the discretion of the President of the Philippines. For example, a military graduate and a journalist, without any background on energy-related work, were appointed by former President Gloria Macapagal-Arroyo to the Board of Directors of PNOC. There are absolutely no criteria in selecting those who would serve as members of the governing body other than their political affiliation. In addition to a lack of criteria, there is no clear and transparent manner of selection. No independent body

⁷² Briones, *supra* note 25, at 4.

or group vets the persons whom are likely to be appointed to the board membership. As a result, interest groups and the public are completely unaware, and are thus deprived of the opportunity to question or inquire into the qualifications of the people who are appointed to the board membership. This partly explains the lack of a sense of accountability of these appointees to the entire Board itself as well as to the public in general. The lack of transparency likewise results in corrupt activities committed by the board members once they assume the positions. Reports of misuse of funds of GOCCs committed by these board members or excessive allowances and monetary benefits given to these appointees are typical. In one audit report issued by the Commission on Audit (COA), it was found out that board members and senior officials of six (6) GOCCs violated the rules prescribed by the General Appropriations Act (GAA) on the allocation and utilization of funds intended for extraordinary and miscellaneous expenses of selected GOCCs, that is, for setting expense rates in excess of those prescribed by the GAA.⁷³

3. *Lack of integrity and transparency in the monitoring mechanisms of the financial conditions of GOCCs*

Accurate reports on the financial conditions of GOCCs depend on the efficiency and honesty in the monitoring of its financial conditions. Accurate reporting of a GOCCs financial performance is necessary to know whether there are violations of any pertinent laws or regulations, especially related to the use of funds. It is also critically important as these records serve as official data for the use of policymakers to come up with informed policies.

In the Philippines, the Commission on Audit (COA) has the authority and duty to examine, audit, and settle all accounts pertaining to the revenue and receipts of, and expenditures or uses of funds and property, owned or held in trust by or pertaining to the government

⁷³ *What Government-Owned and Controlled Corporations Have Been Found Breaking the Law on Expenses*, Pera Natin 'to: Philippine Public Transparency Reporting Project, http://www.transparencyreporting.net/index.php?option=com_content&view=article&id=57:what-government-owned-and-controlled-corporations-have-been-found-breaking-the-law-on-expenses-&catid=35:editorial&Itemid=87 (last visited May 30, 2012).

corporations and their subsidiaries.⁷⁴ However, as the supreme state audit body, it is not insulated from graft and corrupt practices committed by some of its officials. Various reports on the corruption committed by the state audit body, such as bribery or collusion with GOCC officials to conceal corrupt activities, are typical.⁷⁵

Moreover, because of insufficient manpower and resources, COA suffers from heavy backlog in auditing GOCCs. It takes COA at least a year to finish its auditing,⁷⁶ from the time of submission by the concerned GOCC. This results to the inability of any interested party to promptly and accurately review the performance of GOCCs and weaker oversight of the other branches of the government over GOCCs.⁷⁷

GOCC Governance Act of 2011

In 2010, President Benigno S. Aquino III disclosed in his State of the Nation Address the irregularities and anomalies being perpetuated by board members and senior officials of the Metropolitan Waterworks and Sewerage System (MWSS), a GOCC mandated to operate and maintain water and sewerage services in Metropolitan Manila.⁷⁸ President Aquino cited the excessive and unauthorized salaries, allowances, and other monetary benefits being received by the governing boards and other senior officials and employees of MWSS while being in arrears in the payment of pension of its retired employees and even the unauthorized cutting of trees in a certain watershed to build homes for the top officials of the said GOCC.⁷⁹ Responding to the call for reform, the Congress of the

⁷⁴ Exec. Ord. No. 292, Book V, Sub-title B, chap. 4, sec.11(1) (Phil.), available at <http://www.gov.ph/1987/07/25/executive-order-no-292-book-v-title-isubtitle-bchapter-4-jurisdiction-powers-and-functions-of-the-commission/>.

⁷⁵ David Dizon, *Chiz: COA at the root of gov't corruption*, ABS-CBN News.com (Feb. 15, 2011, 1:46 PM), <http://www.abs-cbnnews.com/nation/02/15/11/chiz-coa-root-govt-corruption>.

⁷⁶ SEPO Profile of GOCCs, *supra* note 41, at 32.

⁷⁷ *Ibid.*

⁷⁸ *Id.* at 61.

⁷⁹ *State of the Nation Address of President Benigno S. Aquino III (transcript)*, ABS-CBNnews.com (July 25, 2011, 5:01 PM), <http://www.abs->

Philippines passed R.A. 10149, otherwise known as GOCC Governance Act of 2011.⁸⁰

The GOCC Governance Act of 2011 contains the following salient features:

1. Exercise by the National Government of certain rights consistent with its right as owner of GOCCs, including “(a) the power to enter into and sever, within a period not longer than one (1) year agency relationships with the directors and executive officers of GOCCs; (b) unequivocal policy that such directors and officers are trustees of the State, with no appropriating power over GOCC assets; (c) unrestricted access to GOCC books of account and the right to exact strict compliance with accounting and financial disclosure standards; (d) the power to privatize, abolish or otherwise restructure GOCCs without need of legislative action; and (d) the power to set standards of performance, compensation, and other matters incidental to the conduct of GOCC affairs.”⁸¹
2. Creation of a centralized advisory, monitoring, and oversight body called the GOCC Commission on Governance (GCG). Among its authorized powers, the GCG may: (a) formulate, implement and coordinate policies, which shall be presided by a Chairman with the rank of a cabinet secretary; (b) promulgate an ownership and operations manual and corporate standards for GOCCs; (c) establish a performance evaluation system and conduct periodic assessment of GOCCs’ performance; (d) evaluate the conflicting mandates of a GOCC as to whether it is a regulatory body or engaged in the activity which it regulates and made recommendations to the President of the Philippines appropriate action to address such conflict;⁸²

cbnnews.com/nation/07/26/10/state-nation-address-pres-benigno-s-aquino-iii-english-translation.

⁸⁰ Available at <http://www.gov.ph/2011/06/06/republic-act-no-10149/>.

⁸¹ Drilon, *supra* note 4.

⁸² *Id.*

3. Require strict disclosure by GOCCs to the public of their financial performance and audit mechanisms by the Commission on Audit;
4. Provides for one year terms of the members of the Board of Directors of all GOCCs subject to reappointment when such board member obtained an above average performance according to a criteria set by the GCG;
5. Requires appointment to board membership by the President from candidates shortlisted by the GCG according to the Fit and Proper test to be set by the latter;
6. Lists a provision of standards and limitations on the compensation, allowances, per diems and incentives of the board members which shall be fixed by the GCG; and
7. Expresses provision on the fiduciary duty of the Board members and officers towards GOCCs and the adverse consequences in case of breach of this duty.

The governance reforms being sought by RA 10149 to improve the performance of GOCCs are commendable. However, they still fall short of certain measures that would help insulate the GOCCs from political intrusions and abuse, or those that would exact discipline and professionalism from the governing body. In other words, the law still lacks stringent corporate governance structures and mechanisms that are sensitive to the unique political and social environment within which these GOCCs operate.

Critique of the Current SOE Governance Reforms and Their Proposed Improvements

Public discourse on implementing governance reforms on SOEs could be interpreted as coming from two different perspectives. The first perspective emphasizes improved governance practices of SOEs as a necessary step prior to privatization,⁸³ or the sale of SOEs to private

⁸³ This policy was influenced by the New Public Management, a concept based on which a myriad of reforms were introduced in many countries that have an impact on the public sector. See Jonathan Boston, *Basic NPM Ideas and their Development*, in *The Ashgate Research Companion to New Public Management*, 17-32 (Tom Christensen ed., 2011).

investors.⁸⁴ The objective is to improve governance to be assured of higher valuations and revenue from privatization.⁸⁵ This is also in line with the belief that the government's role in the market is a regulator and not a player. The second perspective considers SOE governance reforms as an end in itself and not merely as a pre-privatization strategy.⁸⁶

The second perspective of adopting SOE governance reforms creates a stronger impact to the over-all growth of the public sector institutions. In developing economies, privatization is not always an available option, as the private sector's role and participation in the economy may not be as pronounced as that of the government. Thus, SOE governance reforms are doubly critical in developing countries like the Philippines. The adoption of reforms in SOE governance policies and practices according to international standards would undoubtedly lead to significant economic gains, improvement in the delivery of public goods and services, and a decrease in public sector deficit and public debt.

In 2005, the OECD developed the *Guidelines on the Corporate Governance of State-Owned Enterprises* ("OECD Guidelines")⁸⁷ to address corporate governance issues in SOEs. These Guidelines have become the international standards in the area of SOE corporate governance policies and practices, and have been used as the benchmark in the formulation of such reforms in both member and non-member economies.⁸⁸ While the Philippines is a non-member economy of OECD, these guidelines could be adopted in the formulation of governance reforms in addition to those provided in R.A. 10149 or the GOCC Governance Act of 2011. In the alternative, they can serve as pointers to re-evaluate some of the policies provided in the current law that fall short of the requirements of the OECD Guidelines.

⁸⁴ Andres, Guasch & Szumendi, *supra* note 67, at 3.

⁸⁵ David Robinett, *Held by the Visible Hand: The Challenge of SOE Corporate Governance for Emerging Markets*, 4 (2006).

⁸⁶ Andres, Guasch & Azumendi, *supra* note 67, at 3.

⁸⁷ Network on Corporate Governance of State-Owned Enterprises in Asia, OECD, *Policy Brief on Corporate Governance of State-Owned Enterprises in Asia: Recommendations for Reform*, (2010), <http://www.oecd.org/dataoecd/58/8/45639683.pdf> [hereinafter *Brief on Corporate Governance*].

⁸⁸ *Id.*

2005 OECD Guidelines and their Applicability to the Philippines

Below is an analysis of specific guidelines set forth in the OECD principles, and how they may have a positive effect on governance and accountability in the management of SOEs.

1. “The legal and regulatory framework for SOEs should ensure a level-playing field in markets where SOEs and private sector companies compete in order to avoid market distortions.”⁸⁹

Under this general and broad guideline, the OECD Guidelines provide for the following two (2) sub-guidelines which could be applied in the case of Philippines’ GOCCs. The first of these sub-guidelines states: “There should be a clear separation between the state’s ownership function and other state functions that may influence the conditions for state-owned enterprises, particularly with regard to market regulation.”⁹⁰ The second sub-guideline states: “SOEs should face competitive conditions regarding access to finance. Their relations with state-owned banks, state-owned financial institutions and other state-owned companies should be based on purely commercial grounds.”⁹¹ The framework provided by this portion of the OECD Guidelines would allow for a level playing field between the private sector and SOEs in the Philippines.

a. Clear separation between the state’s ownership functions from its other functions

In order to achieve a clear delineation of the state’s ownership functions of the GOCCs and its other state functions such as promotional or regulatory functions, there are two proposed reforms that should be considered: (1) GOCCs should be completely severed from the departments to which they are attached which likewise entails abolishing the present rule of making the cabinet secretary as *ex officio* chairperson or member of the GOCCs under their departments and (2) create a

⁸⁹ OECD, OECD Guidelines on Corporate Governance of State-Owned Enterprises (2005), 12. Available at <http://www.oecd.org/corporate/ca/corporategovernanceofstate-ownedenterprises/34803211.pdf>.

⁹⁰ *Id.*

⁹¹ *Id.*

centralized body that would have the sole authority to exercise states ownership rights and functions over GOCCs.

Severance of GOCCs from the line agencies / departments to which they are attached

A clear separation between the ownership functions and regulation is a pre-requisite for ensuring a level playing field with the private sector. This cannot be achieved without severing GOCCs from the departments to which they are attached. This problem is not addressed in the Governance Reform Act of 2011, and still reinforces the present set-up of GOCCs being under the concerned line departments. There are three types of models or organizations by which a state could exercise its ownership rights over GOCCs, namely: the decentralized or sector model, the dual model, and the centralized model.⁹²

The decentralized or sector model characterizes the present setup of GOCCs in the Philippines. In this model, the ownership function is dispersed among different ministries or departments.⁹³ The notable advantage is that the concerned sector could lend its expertise to the SOE for more focus and better performance.⁹⁴ On the other hand, since the department or ministry performs the regulatory function of the state, there is a great danger for the SOE to act in an anti-competitive way in the market and there is a risk of governmental interference in the day-to-day operations of the SOE.⁹⁵

In the dual model, there is a sector ministry/department and another ministry/department which acts like a centralized body exercising oversight functions over all SOEs.⁹⁶ Both ministries/departments may have the right to exercise ownership rights in behalf of the government such as nominating representatives for the board of directors or approval

⁹² Vagliasindi, *supra* note 66, at 27.

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.* at 11.

⁹⁶ *Id.*

of certain corporate transactions or contracts.⁹⁷ A notable advantage of this model is that it facilitates technical (sector ministry/department) and fiscal oversight (the other ministry/department).⁹⁸ The main disadvantage is that it may be a source of political conflict between the two departments/ministries as to the delineation of functions.

In the centralized model, there is only one ministry/department which has the authority to exercise ownership rights over the SOEs.⁹⁹ The advantages of this model is that there is a “clear line of accountability from the SOE to the government; the ability of the government to exert close fiscal supervision and to form a coherent SOE policy, and the fact it allows the best use of the typically limited human resources available within the civil service to undertake the specialized job of exercising the government’s ownership function.”¹⁰⁰ The main disadvantage is that there is a possibility that the expertise that could be offered by a sector model may not be available or may be exercised to a lesser degree than that of a decentralized or sector model.¹⁰¹

Creation of a centralized body that would have the sole authority to exercise state’s ownership rights and functions over GOCCs

OECD recommends the centralized model and further suggests that the ministry/department which would have the sole authority to exercise ownership functions should be an independent one and not merely another line ministry/department.¹⁰² This is what should be adopted in the Philippines in order to separate the ownership functions from the regulatory or promotional functions of the state in GOCCs. The decentralized or sector model is used as a tool by the line agencies / departments to act in an anti-competitive manner in the market, such as lowering the price of the goods or services of the GOCC. In the long run, this anti-competitive practices burdens the National Government as the

⁹⁷ Vagliasindi, *supra* note 66, at 11.

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.*

¹⁰² Vagliasindi, *supra* note 66, at 11.

GOCC would eventually rely on subsidies from the National Government to recover its losses as well as domestic or foreign borrowing to the detriment of the public treasury as the National Government acts as the principal obligor to these loans.

The move towards the centralized model entails abolishing the present law on making the cabinet secretaries as *ex officio* members or chairpersons of the board of GOCCs. This would not only help insulate the GOCC from political interference on its operations or from inappropriate influence by the cabinet secretary, but would help achieve efficiency because of the unified ownership structure.

The centralized model was adopted by Vietnam in 2005, when the government established the State Capital Investment Corporation (SCIC) to represent the state shareholdings in the SOEs.¹⁰³ The creation of SCIC integrated the ownership functions to one entity and separated them from regulatory and policy functions carried out by line ministries.¹⁰⁴ It is organized as a financial holding company,¹⁰⁵ and is the sole authority in exercising state's rights and functions as owner in the SOEs. This governance reform measure clearly conforms to the OECD guideline which, states that, "*The exercise of ownership rights should be clearly identified with the state administration. This may be facilitated by setting up a co-ordinating entity or more appropriately, by the centralisation of the ownership function.*"¹⁰⁶

b. SOEs should face competitive conditions regarding access to finance

In the Philippines, government financial institutions (GFIs) and other private banks would often issue rules putting GOCCs as one of their priority sectors. This means easy access to credits or loans coupled with favorable terms or rates to these credits. This does not come as a surprise, as these GOCCs have the National Government guaranteeing or even

¹⁰³ Brief on Corporate Governance, *supra* note 91, at 18.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*

¹⁰⁶ OECD, *supra* note 101, at 13.

acting as their primary obligor to these loans contracted by them. An example would be PNOC, which is authorized to contract foreign and domestic loans.¹⁰⁷ Some GOCCs, such as the Philippine National Railways, do not even have ceilings on the amount of domestic or foreign loans they could secure.¹⁰⁸ This issue is likewise not addressed in the GOCC Governance Act of 2011.

This undue advantage is captured by the soft budget constraint of an SOE, which leads to excessive indebtedness, wasted resources, market distortions, and a culture of complacency on the part of the governing body of SOEs.

OECD recommends that state-owned banks and financial institutions grant credit to SOEs on commercial grounds; that is, on the same terms and conditions as with the private sector.¹⁰⁹ Moreover, the state should not give automatic guarantee in respect of SOE liabilities.¹¹⁰ In this regard, the National Government should set out conditions and certain pre-requisites before a guarantee could be extended to a loan obtained by the SOE, which should be in a case by case basis.

This particular governance reform has already been implemented in some OECD member countries. In Chile and Israel, commercially operating SOEs raise capital on market terms. In Estonia, the Ministry of Finance has provided loans to SOEs in a few cases, but on market terms. In Slovenia, SOEs could still secure loans from state-owned banks but generally not on concessionary terms.¹¹¹

2. *“The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of SOEs is carried out in a transparent and accountable*

¹⁰⁷ SEPO Profile of GOCCs , *supra* note 41, at 162.

¹⁰⁸ *Id.* at 186.

¹⁰⁹ Brief on Corporate Governance, *supra* note 91, at 12.

¹¹⁰ OECD Guidelines *supra* note 101 at 22 .

¹¹¹ OECD, State-Owned Enterprise Governance Reform: An Inventory of Recent Change (2011), *available at* http://www.oecd.org/document/38/0,3746,en_2649_34847_48455206_1_1_1_1,00.html.

*manner, with the necessary degree of professionalism and effectiveness.”*¹¹²

OECD Guidelines direct the state to let SOE boards exercise their responsibilities and respect their independence.¹¹³ In 2010, just a few months before the expiration of the term of President Gloria Macapagal-Arroyo’s government, directives to sell the 60% stake of PNOC-Exploration Corporation¹¹⁴ in the Malampaya gas project were issued to the boards of PNOC and PNOC-EC from Department of Finance. The planned privatization was heavily criticized in the media. Moreover, senior members of the boards of PNOC and PNOC-EC “quietly” resisted such plan because of the unfavorable market conditions and the political situation at that time.¹¹⁵ The attempt to influence the decision-making of the boards of the said GOCCs undermined the independence and autonomy of the board members.

It is lamentable, however, that the GOCC Governance Act of 2011 does not contain any provision that would directly address this fundamental problem in the governance of GOCCs. The focus of this provision is on the decision-making process taken on by the board members—

a function not only of the individual character and circumstances of the person selected as member, but also of the characteristics of the environment where such board member is expected to act and decide. This means that it is important that in nominating a person to board membership, his/her commitment to think and decide independently should be taken into account. It is also equally necessary that mechanisms and structure be put in

¹¹² OECD, *supra* note 101 at 13.

¹¹³ *Id.*

¹¹⁴ PNOC-Exploration Corporation is the oil and gas development arm of the state-owned Philippine National Oil Company and wholly-owned subsidiary of PNOC.

¹¹⁵ Donnabelle L. Gatdula, *Arroyo administration eases up on plan to sell PNOC-EC stake in Malampaya*, Philstar.com (June 14, 2010, 12:00 AM) http://www.philstar.com/microsite/noynoy_aquino_inauguration_2010/article.aspx?articleId=584076&publicationSubCategoryId=66.

place that would insulate such members from any direct or indirect political and/or bureaucratic interference.

OECD Guidelines provide that independence “requires that all board members carry out their duties in an even-handed manner with respect to all shareholders,” without taking into account any political concerns.¹¹⁶ Therefore, any factor that would potentially influence or exert pressure on the decision-making process of the board member should be eliminated, such as having a cabinet secretary as *ex officio* chairperson/chairman of the board of directors, or making the president of the country the sole authority to remove such member from the board.

In GOCC Governance Act of 2011, the power to remove board members is still vested on the President of the Philippines. This exerts a political pressure or influence on the part of the board member to act in accordance with the wishes of the president, which directly runs counter to what the OECD Guidelines seek to prevent. In this case, removal of any board member should be put in the hands of the other members of the board, by election—a procedure akin to private corporations.

India has adopted a policy of granting greater autonomy to selected SOEs, giving them the status of “Navratnas” or “Miniratnas.”¹¹⁷ These categories of SOEs are then obliged to restructure their boards by selecting at least four independent directors with demonstrated experience and professional standing.¹¹⁸ This principle behind the independent director system in SOEs in India may be adopted in GOCCs in the Philippines, at least as far as nominating and selecting persons to board membership is concerned. In other words, selecting a board without being tainted by any political factor, and thus, assuring autonomy in decision-making.

Thailand is another good example of incorporating a governance reform that focuses on the independence and non-political affiliation of a board member. For example, in 2008 the government introduced a Directors’ Pool in SOEs from which one-third of the board members of an

¹¹⁶ OECD, *supra* note 111, at 24.

¹¹⁷ Brief on Corporate Governance, *supra* note 91, at 20.

¹¹⁸ *Id.*

SOE should come.¹¹⁹ Those selected to be in the pool are known to be non-political, independent-minded, and with a track record of credibility.¹²⁰

3. “SOEs should observe high standards of transparency in accordance with the OECD Principles of Corporate Governance.”¹²¹

OECD Guidelines on the section of Transparency and Disclosure state that “SOEs, especially large ones, should be subject to an annual independent external audit based on international standards.”¹²² This is another corporate governance practice that is not incorporated in the GOCC Governance Act of 2011. There is presently no law or rule which requires GOCCs to be audited by an independent external audit unlike that of private corporations.

According to OECD Guidelines, audit of SOEs by state supreme audit entities is not sufficient, as this audit is designed merely to monitor the use of public funds and budget resources rather than for the purpose of monitoring SOEs financial performance.¹²³ This is true in the Philippines, as its supreme state audit body or Commission on Audit (COA) merely looks into the GOCCs compliance with the accounting standards and laws in their financial reports.¹²⁴

This requirement of an independent external audit is necessary in the Philippines as its supreme state audit body is likewise besieged with allegations of corruption. The integrity of the audit result would always be questioned as the integrity of the body conducting the audit is itself calloused with negative public perception. Thus, to build public trust on

¹¹⁹ *Id.* at 21.

¹²⁰ *Id.*

¹²¹ OECD, *supra* note 101 at 16.

¹²² *Id.*

¹²³ OECD, *supra* note 101, at 43.

¹²⁴ *Checks and Balances: Audit and Accountability in Philippine Public Finances*, Pera Natin ‘to: Philippine Public Transparency Reporting Project, http://www.transparencyreporting.net/index.php?option=com_content&view=article&id=87:-checks-and-balances-audit-and-accountability-in-philippine-public-finances-&catid=55:background-papers&Itemid=94 (last visited May 30, 2012).

the information provided by the GOCCs as well as to be able to formulate accurate policies and decisions on the part of the policymakers, the NG should institutionalize an external independent audit system.

In Poland, for example, Supervisory Boards of SOEs conduct competitive bidding to select external auditors based on their relevant experience, price, and more importantly, independence.¹²⁵

4. “The boards of SOEs should have the necessary authority, competencies and objectivity to carry out their function of strategic guidance and monitoring of management. They should act with integrity and be held accountable for their actions.”¹²⁶

The GOCC Governance Act of 2011 expressly provides that members of the board of directors of GOCCs are fiduciaries of the state and have the legal obligation to always act in the best interest of the GOCCs of which they are members.

Fiduciary duties in corporate governance impose “prohibitions on any dealings or transactions that would create interests or obligations that conflict with the duty of the officer to act in the best interests of the corporation.”¹²⁷ In the case of SOEs, ‘best interests of the corporation’ should not be equated with the interests of the National Government or any government body. The state as an owner of SOEs should not be construed to mean the National Government. In a democratic country, the state is the people or the citizens of a country.¹²⁸ President Benigno S. Aquino even raised the idea of changing the name of GOCCs to “consumer-owned and controlled corporations” or to people-owned

¹²⁵ OECD, *Corporate Governance of State-Owned Enterprises: A Survey of OECD Countries* (2005), available at https://bvc.cgu.gov.br/bitstream/123456789/3489/1/transparency_and_disclosure.pdf.

¹²⁶ OECD, *supra* note 101 at 17.

¹²⁷ Michael J. Whincop, *Corporate Governance in Government Corporations* 72 (2005).

¹²⁸ David Robinett, *Held by the Visible Hand: The Challenge of SOE Corporate Governance for Emerging Markets*, The World Bank Corp. Governance (May 2006), available at <http://rru.worldbank.org/Documents/Other/CorpGovSOEs.pdf>.

companies.¹²⁹ Thus, the GOCC Governance Reform Act should clarify who the real owners of these SOEs are, and to whom the board of directors owes their fiduciary duties. The entire structure of governance reforms in SOEs will collapse if the shareholder of an SOE would mean the government and not the body of people it represents. This policy should be explicit in the preamble of the GOCC Governance Reform Act to show its pivotal importance in defining to whom the board of directors owes their fiduciary duties.

A good example of this good corporate governance can be found in Singapore. Temasek Holdings is the centralized holding company of Singapore's government-linked companies (GLCs), Singapore's SOEs.¹³⁰ The overarching principle of its governance is its accountability to the President of Singapore himself, who is the principal representative or agent of the people. Based on this principle, therefore, every corporate decision it would make should redound to the benefit of the people.¹³¹ The president or the government is merely a link to the people who are the real shareholders and not merely stakeholders. Thus, fiduciary duty is owed to the citizens and not to Singapore government which is merely a conduit for the people.

In the Philippines, however, accountability of GOCCs is to the Cabinet Secretary of the department to which such GOCC is attached. The Cabinet Secretary is in turn accountable to the President of the country. There are two scenarios that could arise from this situation, both of which demonstrate the weakness of this governance structure.

The first scenario arises from the fact that since cabinet secretaries are un-elected members of the National Government, the line of accountability to the people is unclear, or even non-existent. The effect of

¹²⁹ *Aquino's call: Turn GOCCs to people-owned firms*, INQUIRER NEWS (Oct. 24, 2011, 7:45 AM), <http://newsinfo.inquirer.net/82075/aquino%E2%80%99s-call-turn-goccs-into-people-owned-firms>.

¹³⁰ Agung Wicaksono, *Corporate Governance of State-Owned Enterprises: Investment Holdings Structure of Government-Linked Companies in Singapore and Malaysia and Applicability for Indonesian State-Owned Enterprises* (2008) (Ph.D. dissertation, University of St. Gallen), available at [http://www1.unisg.ch/www/edis.nsf/SysLkpByIdentifier/3488/\\$FILE/dis3488.pdf](http://www1.unisg.ch/www/edis.nsf/SysLkpByIdentifier/3488/$FILE/dis3488.pdf).

¹³¹ *Id.*

this political reality is to trivialize the duty of the board of directors to prioritize the interests of the citizens. Accountability and fiduciary duty may not inspire as much significance as when they are directly owed to the citizens themselves.

The second scenario arises from the fact that cabinet secretaries, as agents of the President, may just be executing the latter's wishes even without or even against the will of the people. This is reinforced especially in situations where board members want to get some favors from the president or simply just want to have some "connection." In either case, the citizens are left to the periphery of the governance structure rather than the center of it.

In corporate governance of SOEs, the proposition that the people from different sectors and interest groups such as the creditors, employees, customers/clients, local communities, and managers are of paramount importance. This is the principle upheld in countries such as Japan and Germany, and should guide the formulation of concrete reforms in the Philippines.¹³² This is not to say that the board of directors should see the GOCC as a charitable institution; rather, this perspective has to be incorporated into the governance structure of the GOCCs to mitigate the extent of the political influence that the government exerts on the board members and senior management.

If it is the citizens to whom the members of the board of directors owe their fiduciary duties, the people should be given opportunity to participate in the nomination and selection of the board's members. The GOCC Governance Act of 2011, however, is silent on the role of the citizens in the matter of shortlisting and recommending prospective board members to the President. In this regard, a mechanism should be put in place to give opportunity to any interest or sectoral group by inviting them to a public hearing similar to nominating candidates to judicial positions, for the purpose of evaluating each candidate's qualifications to the job.

¹³² Whincop, *supra* note 124, at 162.

Challenges to GOCCs Governance Reforms

The greatest challenge to governance reforms in GOCCs in the Philippines could be traced to the central characteristic of the country's political economy, that is, its patrimonial characteristic.¹³³ Max Weber described a patrimonial state as follows:

In general the notion of an *objectively defined* official duty is unknown to the office that is based purely upon personal relations of subordination...Instead of bureaucratic impartiality and of the ideal – based on the abstract validity of one's objective law for all – of administering without respect of persons, the opposite principle prevails. Practically everything depends explicitly upon the personal considerations: upon the attitude toward the concrete applicant and his concrete request and upon purely personal connections, favors, promises and privileges.¹³⁴

In patrimonial state, public officials are interested in promoting their own interests or their associates rather than national development.¹³⁵ The promotion of industries or businesses to promote largely depends on connections rather than considerations of efficiency or productivity.¹³⁶

According to Paul Hutchcroft, patrimonialism in the Philippines runs deeper and characterizes not merely former President Marcos' regime, but the whole state itself.¹³⁷ Not long ago the Philippines was described as a “weak state preyed upon by a powerful oligarchy that has an economic base largely independent of the state but depends upon

¹³³ Paul D. Hutchcroft, *Oligarchs and Cronies in the Philippine State: The Politics of Patrimonial Plunder*, 43 *WORLD POLITICS: A Q. J. OF INT'L REL.*, n. 3, 414-50 (1991), available at <http://www.jstor.org/stable/pdfplus/2010401.pdf>.

¹³⁴ *Id.*

¹³⁵ Eric N. Budd, *Patrimonial Barriers to Political and Economic Development*, 11 *KASARINLAN: Philippine J. of Third World Stud.*, N. 1, 177 (1995), available at <http://journals.upd.edu.ph/index.php/kasarinlan/article/view/1629/1557>.

¹³⁶ *Id.*

¹³⁷ Nathan Gilbert Quimpo, *Oligarchic Patrimonialism, Bossism, Electoral Clientelism, and Contested Democracy in the Philippines*, 37 *Comparative Politics* 2, 229-250 (2005), available at <http://www.jstor.org/stable/pdfplus/20072884.pdf?acceptTC=true>.

access to state machinery as the major means to accumulate wealth.”¹³⁸ The “favored elite class” of politicians and families could easily get their way in any state apparatus as they have the right “connections.”

The concepts of patrimonial oligarchy, political influence, largesse, and a system of political spoils are completely antithetical to the values being promoted by the proposed governance reforms in GOCCs such as transparency, accountability, fiduciary duty, and professionalism. Moreover, reforms to put SOEs in equal footing with the private sector would be rendered inutile if the private sector would only mean the favored private elite class.

If these governance reforms in the GOCCs are to be enforced, the first step would be for the president himself to sever personal ties that surround public’s suspicions of his appointments to the board membership and senior officers of GOCCs. However, it would be illusory to think that patrimonial oligarchy and the spoils system that are deeply rooted in the institutions and rules of political economy of the country would be completely eradicated by this action alone. What is achievable at this point, however, is to have a leader whose actions shall be perceived to be true to the spirit of reforms. In the matter of SOEs, what would serve as an impetus to the successful implementation of governance reforms is for the president to take the first step, and break the chain of patrimonial and spoils system in the appointment of persons who will lead the Governance Commission on GOCCs (GCG). To do this, he should judiciously appoint individuals of demonstrated professionalism, integrity, and independent-thinking from among those short-listed by the GCG; call on people to participate in the deliberation of the qualifications of these candidates; and respect and honor the autonomy and independence of the people appointed by him to the boards of GOCCs. These are just initial steps to achieve the results envisioned in the proposed governance reforms. But these steps would matter a lot to initiate and sustain good governance in the institution of public enterprises.

¹³⁸ *Id.*

Conclusion

This article proposes the application of the principles contained in the OECD Guidelines on Corporate Governance of SOEs on the Philippines GOCCs in light of the governance reforms introduced by the GOCC Governance Reform Act of 2011. Non-member economies such as Vietnam, India, Thailand and Singapore have governance measures on their SOEs which apply the same principles as those of the OECD Guidelines. Countries which have recently joined the OECD such as Chile, Israel, Estonia and Slovenia have started implementing some of these governance reforms provided in the OECD Guidelines.

What emerges as the overarching principle that should govern corporate reforms of SOEs, particularly those which are engaged for purely profit maximization or for mixed commercial and social pursuits, is that board members owe their fiduciary duties not to the appointing authority or the popularly elected members of the government but to the people themselves. This is articulated by the principal-agent problem of an SOE which means that since an SOE is run by people who are not its owners, it could never be managed as efficiently as that of a private enterprise. This is the significance of a governance structure and procedures that would protect and safeguard the interests of the people as real owners of these SOEs.