U N C L A S S I F I E D

PD-AAW-564

AGENCY FOR INTERNATIONAL DEVELOPMENT ISN-52716

Washington, D. C. 20523

PROJECT PAPER

PHILIPPINES: Financial Resources Mobilization
(492-0377)

September 11, 1987

U N C L A S S I F I E D

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete)
Amendment Number:

DOCUMENT CODE: 3

2. COUNTRY/ENTITY: Philippines

3. PROJECT NUMBER: 492-0377

4. BUREAU/OFFICE: ANE 04

5. PROJECT TITLE (maximum 40 characters): Financial Resources Mobilization

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 09 DD 30 YY 92

7. ESTIMATED DATE OF OBLIGATION (Under "B:" below, enter 1, 2, 3, or 4)
A. Initial FY 87 B. Quarter 4 C. Final FY 90

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY B. FX	FIRST FY C. L/C	FIRST FY D. Total	LIFE OF PROJECT E. FX	LIFE OF PROJECT F. L/C	LIFE OF PROJECT G. Total
AID Appropriated Total	700	300	1,000	6,184	2,316	8,500
(Grant)	(700)	(300)	(1,000)	(6,184)	(2,136)	(8,500)
(Loan)	( )	( )	( )	( )	( )	( )
Other U.S. 1.						
Other U.S. 2.						
Host Country /Private Sector					5,057	5,057
Other Donor(s)						
TOTALS				6,184	7,373	13,557

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. PRIMARY TECH. CODE 2. Loan	D. OBLIGATIONS TO DATE 1. Grant	D. OBLIGATIONS TO DATE 2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	E. AMOUNT APPROVED THIS ACTION 2. Loan	F. LIFE OF PROJECT 1. Grant	F. LIFE OF PROJECT 2. Loan
(1) SDA	700	910				3,500	-	3,500	-
(2) ARDN	200	190				5,000	-	5,000	-
(3)									
(4)									
TOTALS						8,500	-	8,500	-

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each)

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)
A. Code
B. Amount

13. PROJECT PURPOSE (maximum 480 characters)

The project purpose is twofold: To enhance the environment to mobilize private term financial resources for investment in productive private enterprises and to reduce the burden of the acquired assets and public corporations on the national budget.

14. SCHEDULED EVALUATIONS
Interim MM YY: ; MM 03 YY 90 — Final MM 09 YY 92

15. SOURCE/ORIGIN OF GOODS AND SERVICES
☒ 000 ☐ 941 ☐ Local ☐ Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

17. APPROVED BY

Signature: Frederick W. Schieck
Frederick W. Schieck

Title: Director, USAID/Philippines

Date Signed: MM 08 DD 22 YY 87

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION
MM DD YY

AID 1330-4 (8-79)

FINANCIAL RESOURCES MOBILIZATION
432-0377

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ANNEXES

ACRONYMS

AA	-	Advice of Allotment
ADB	-	Asian Development Bank
ADU	-	Asset Disposal Unit
AID	-	Agency for International Development
AIIF	-	Agro-Industrial Investment Fund
APT	-	Asset Privatization Trust
ARDN	-	Agriculture, Rural Development and Nutrition
CB	-	Central Bank of the Philippines
CDSS	-	Country Development Strategy Statement
CMDWG	-	Capital Markets Development Working Group
COP	-	Committee on Privatization
DBM	-	Department of Budget and Management
DBP	-	Development Bank of the Philippines
DOA	-	Department of Agriculture
DOF	-	Department of Finance
DOT	-	Department of Tourism
DOTC	-	Department of Transportation and Communications
DTI	-	Department of Trade and Industry
DTI-NDC	-	Department of Trade and Industry-National Development Company
FSN	-	Foreign Service National
GDP	-	Gross Domestic Product
GFI	-	Government Financial Institution
GNP	-	Gross National Product
GOCC	-	Government-Owned and -Controlled Corporation
GOP	-	Government of the Philippines
GSIS	-	Government Service and Insurance System
ICOR	-	Incremental Capital-Output Ratio
IESC	-	International Executive Service Corporation
IFC	-	International Finance Corporation
IP	-	Implementation Plan
IPG	-	Investor's Promotion Group
IQC	-	Indefinite Quantity Contract
NEDA	-	National Economic and Development Authority
OCD	-	Office of Capital Development
PAIDCOR	-	Private Agricultural Investment and Development Corporation
PAIICO	-	Philippine Agribusiness Industrial and Investment Company
PASC	-	Philippine Accounting Standards Council
PICPA	-	Philippine Institute of Certified Public Accountants
PIDS	-	Philippine Institute for Development Studies
PIN	-	Philippine Investment Notes Program
PIO/T	-	Project Implementation Order for Technical Services
PMS	-	Presidential Management Staff
PNB	-	Philippine National Bank
PNOC	-	Philippine National Oil Company
PRE	-	A.I.D. Private Enterprise Bureau
SDA	-	Selected Development Assistance
SEC	-	Securities and Exchange Commission
SSS	-	Social Security System
TA	-	Technical Assistance
TCOP	-	Technical Committee on Privatization
USAID	-	United States Agency for International Development
WB	-	World Bank

EXECUTIVE SUMMARY

The five-year Financial Resources Mobilization Project will assist the Government of the Philippines (GOP) to strengthen the role of the private sector in the economy, thereby supporting the economic recovery goal of increased employment and incomes. Project funding will total an estimated $13.577 million. AID will provide $8.5 million of bilateral Development Assistance (DA) funding. The GOP will contribute an estimated $4.851 million and private Philippine investors an estimated $0.206 million.

The purpose of the project is twofold: (a) To enhance the environment for mobilizing private term financial resources for investment in productive private enterprises, and (b) to reduce the burden of the public corporations and acquired assets on the national budget.

The project includes two major components, a privatization component and a capital markets development component. Under privatization, AID will assist the GOP with implementation of its program to privatize selected state-owned corporations and acquired assets through the recently established Asset Privatization Trust and existing asset disposal units (ADUs), and ADUs to be established. AID-financed inputs will include short- and long-term technical assistance in investment banking, legal, accounting and engineering areas ($3.770 million); policy studies ($0.535 million); and limited quantities of equipment ($0.250 million).

The capital market development component will assist appropriate government and private sector entities to strengthen the capacity of capital markets to mobilize private term capital and encourage an increase in the supply of securities. Expected outputs include proposals for revised legislation and regulations submitted to Congress and an improved Securities and Exchange Commission serving in a developmental as well as a regulatory capacity. A.I.D. project funds will finance technical assistance ($1.530 million); training ($0.125 million); computer equipment acquisition ($0.8 million); and a capital development market conference ($0.025 million). For both components, an additional $1.465 million is budgeted for evaluation, audit, inflation and contingency.

The principal GOP implementing agency for the privatization component will be the Department of Finance. The Capital Market Development Working Group -- with the Secretariat in the Department of Trade and Industry -- will serve as the primary implementing entity for the legal/regulatory and institutional development activities of the capital market development component. An Investors' Promotion Group to be formed under the project will coordinate directly with A.I.D. to implement activities for the development of a private investment company.

The project will procure technical assistance for the project through a combination of host country and AID-direct contracts.

PROJECT AUTHORIZATION

Name of Country: Philippines

Name of Project: Financial Resources Mobilization

Number of Project: 492-0377

1. Pursuant to the Sections 103 and 106 of the Foreign Assistance Act of 1961, as amended (the "FAA"), I hereby authorize the Financial Resources Mobilization Project (the "Project") for the Republic of the Philippines (the "Cooperating Country") involving planned obligations of not to exceed $8,500,000 in grant funds over a four year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process, to help in financing foreign exchange and local currency costs for the Project. Of the authorized amount, $5,000,000 is authorized pursuant to Section 103 of the FAA and $3,500,000 is authorized pursuant to Section 106 of the FAA. The planned life of the project is five years.

2. The two-fold purpose of the Project is (a) to enhance the environment necessary to mobilize private term financial resources for investment in productive private enterprises, and (b) to reduce the national budgetary burden of the public corporations and acquired assets.

3. The Project Agreement, which may be negotiated and executed by the officer(s) to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following essential terms and major conditions, together with such other terms and conditions that A.I.D. may deem appropriate:

   a. The Cooperating Country shall agree in substance to give due consideration to and consult with A.I.D. regarding the findings and recommendations proposed by technical assistance contractors financed under the Project on measures to further the Cooperating Country's program for privatizing acquired assets and government corporations and on measures to enhance the capacity of capital markets to mobilize term capital resources.

   b. Commodities financed by A.I.D. under the Project shall have their source and origin in the Cooperating Country or in the United States, except as A.I.D. may otherwise agree in writing. Except for ocean shipping, the suppliers of commodities or services shall have the Cooperating Country or the United States as their place of nationality, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Project shall, except as A.I.D. may otherwise agree in writing, be financed only on flag vessels of the United States.

Signature: ______________________
Julia Chang Bloch
Assistant Administrator
Asia and Near East Bureau

Date: 7/11/87

Clearances:

ANE/PD:RVenezia	[handwritten initials]
ANE/PD:BJOdell	[illegible]
ANE/PD/EA:JNussbaum	(draft)
ANE/EA:WNance	[handwritten initials]
ANE/DP:PBenedict	[handwritten initials]
ANE/TR:BTurner	BT
GC/ANE:HMorris	(draft)

I. The Problem Context

A. Overview

The two-fold purpose of the Financial Resources Mobilization (FRM) Project is to (a) reduce the national budgetary burden of acquired assets and Government-owned and controlled corporations (GOCCs); and (b) enhance the environment necessary to mobilize private term financial resources for investment in productive private enterprises. Project activities addressing these purposes support two major Government of the Philippines (GOP) thrusts: (a) to increase capital efficiency through the divestiture of nonperforming assets and inefficient state-owned corporations; and (b) to shift from subsidized credit policies encouraging debt-financing of capital-intensive industrial development and promote alternative means of capitalization. The GOP views these efforts as important to mobilize increased savings necessary to achieve the Medium-Term Development Plan projected average growth rate of 6.9 percent for the 1987-1992 period. The following sections provide background on the investment efficiency and financing problems, the recent macroeconomic outlook and the GOP strategy.

1. Investment Efficiency and Financing

Past GOP policies and investment practices have left the country with major investment and debt challenges, including:

- Net debt servicing averaging 40 percent of GOP expenditures, 27 percent of all foreign exchange earnings and 5 percent of Gross National Product (GNP) during 1987-1992;
- Reduced GOP capability to provide basic services;
- Reduced private sector capability to contract debt; and
- Large numbers of public and private sector nonperforming assets/ailing businesses.

These challenges evolved from the cumulative effects of unsuccessful development strategies that reached crisis proportions in 1983. The 1983-1986 economic crisis ended a long period of debt-financed economic growth in the Philippines beginning in the early 1970s. This growth effectively hid worsening structural imbalances in the economy due to: (a) an import substitution strategy promoting inefficient, import-dependent and overly capital-intensive, urban-based industrial sector development; and (b) government intervention in the goods and financial assets markets that created monopolistic structures and rent-seeking activities, largely benefitting the cronies of former President and Mrs. Marcos.

By 1980 the country began to experience a financial crisis that reflected the nonviability of major investments of the 1970s. Private and government financial institutions acquired private companies through foreclosure. Government corporations incurred increasing liabilities and deficits that in turn increased significantly the GOP's liabilities and deficit. The 1983 economic crisis exacerbated these problems. Many corporations went bankrupt. The GOP assumed a number of crony companies under GOP debt guarantees, thus increasing the GOP's liabilities. The peso's significant depreciation further increased the peso burden of GOP foreign exchange-denominated loan liabilities. By March 1987, the country's total external debt totaled $28.6 billion.

2. Recent Macroeconomic Trends and Forecasts

The economy appeared to be recovering by the third quarter of 1986. Latest GOP estimates for 1986 show that the real Gross National Product (GNP) increased by 1.51 percent while gross domestic product (GDP) increased by 1.08 percent. The growth momentum appears to have continued into the first quarter of 1987. Real GNP was 5.5 percent greater than GNP in the first quarter of 1986. Similarly, real GDP rose by 5.8 percent over the first quarter 1986 GDP. Significantly, investments, as measured by real gross domestic capital formation, continued to decline in 1986 but posted positive growth in the first quarter of 1987 relative to both the first and fourth quarters of 1986. On the production side, agriculture was the major growth sector in 1986; but, during the first quarter of 1987, poor weather conditions affected growth. On the other hand, the industrial and services sectors became more robust.

Available projections for Philippine economic growth vary, but all indicate the vulnerability of future growth to investment efficiency and the availability of investment financing.

The 1987-1992 Medium Term Philippine Development Plan for 1987-1992 targets real GNP and real GDP growth rates for 1987 at 6.5 percent and 6.7 percent, respectively. Average annual growth rate targets for the period 1987-1992 are 6.8 percent for GNP and 6.9 percent for GDP. These target growth rates, which correspond to an implied incremental capital-output ratio (ICOR) of 2.8, appear optimistic.

In commenting on the above targets, Montes (1986) points out that the average ICOR for the 1962-1982 period has been 4.0. Using a simple model with the savings rate approximating historical levels and various external debt servicing scenarios, Montes demonstrates that at this historical ICOR level, real GDP growth would average 4.4 percent per year during the plan period with no debt rescheduling and 5.6 percent per year with zero payments on rescheduled principal.

Unofficial forecasts prepared by Mariano and Constantino (1987) from the National Economic and Development Authority (NEDA)-Philippine Institute for Development Studies Annual Econometric Model, which is supply driven and therefore more reflective of structural adjustment processes, indicate average real growth for both GNP and GDP at 5.1 percent per year for the period 1987-1991. (ICOR is endogenously determined in this model with a forecast average of 3.5 for the same period.)

3. GOP Development Strategy

The 1987-1992 Medium-Term Development Plan emphasizes greater private sector investment to increase income and employment. The GOP expects the economy to recover and sustain respectable growth with the consistent implementation of its structural adjustment program and policy reforms. Key objectives of the structural adjustment program are: (a) to reduce the budget deficit burden and increase private sector efficiency through the privatization of public corporations and the divestiture of acquired assets; (b) to retool/ rehabilitate major private entities to utilize existing capital stock effectively; and (c) to increase the availability of domestic financial resources for long-term investment. The project will support directly these objectives by providing the GOP assistance to implement its Privatization Program and to mobilize financial resources through the capital markets.

B. Privatization

1. Public Enterprises and Acquired/Sequestered Assets

Currently, the GOP faces the task of divesting of a large number of public enterprises resulting from the proliferation of public enterprises in the 1970s and the poor financial performance of many public enterprises and private companies whose debt the GOP has financed through government financial institutions and/or guarantees. Included are more than 350 acquired assets of government financial institutions, approximately 260 sequestered companies and more than 100 GOCCs. Fifteen large chartered corporations make up about half of total public corporation assets; 76 smaller corporations and 149 wholly owned subsidiaries make up the remainder.

2. Effects on the Economy

Public corporations have generally performed poorly and have increasingly placed a heavy financial burden on the GOP. A discussion of their impact on the economy follows:

Public corporations have been involved in practically all sectors, with the services sector accounting for the largest number of shares, followed by manufacturing and finance. Their 1975-1984 contribution to domestic production (gross value added or GVA) grew at a slower 18.6 percent per annum relative to that of GNP at 20.9 percent. The government corporate sector's share in GDP increased from 1.9 percent in 1975, peaked at 3.3 percent in 1983 but dropped to 1.9 percent in 1984. Government corporate involvements in the electricity, gas and water sector and in the financial sector have been most prominent. Public enterprises accounted for 55.5 percent of the electricity, gas and water GVA and 33.3 percent of the financial sector's GVA in 1975-1984.

In general, the public corporations have contributed little to employment, less than 1.0 percent annually during 1976-1984. Their contribution to investment has been more significant. Capital expenditures of 58 corporations represented 23.5 percent of gross domestic capital formation during 1975-1984. However, most investment was financed from external sources.

Nor have public corporations used scarce resources efficiently. Labor, capital and total factor productivity have been declining over time. Total factor productivity of government corporations was only 13 percent that of the economy in 1981. Further, the average 1975-1984 rate of return on assets of audited corporations was only 4.34 percent; on equity, 2.92 percent.

The public corporations have also increased significantly the GOP deficit. During 1980-1986 the combined deficit of the 15 largest nonfinancial public corporations alone averaged 3.1 percent of GNP. Total deficits of all public corporations during the same period could have easily exceeded 5.0 percent of GNP. To finance these deficits, public corporations have relied heavily on foreign borrowings and national government support.

Lastly, the public corporations have increasingly drained GOP budget resources. Between 1975 and 1980, national government assistance to public corporations averaged 11 percent of budgetary disbursements. In 1981, the share of public corporations reached 18 percent, exceeding for the first time the budgetary share for infrastructure. By 1986, GOP assistance to public corporations amounted to pesos 29.9 billion (approximately $1.5 billion) or 28 percent of total budgetary expenditures. For 1987, however, the GOP plans to reduce support for government corporations to pesos 16.7 billion ($835 million) or 14 percent of the expenditure program, primarily by reducing lending.

3. GOP Public Corporate Sector Rationalization and Divestiture

The Aquino administration has initiated a five-year program to rationalize the public corporate sector to reduce the continued devastating effects on the economy. The program includes six alternative actions on public corporations: (a) retention, (b) consolidation or merger with other corporations, (c) regularization (as government agencies), (d) conversion to private corporations, (e) dissolution or liquidation, and (f) total or partial divestiture.

Steps taken to date to carry out the privatization program include the following:

- Financial restructuring and rehabilitation of the major Government Financial Institutions (GFIs)--namely, the Development Bank of the Philippines (DBP) and the Philippine National Bank (PNB);

- Creation of the Committee on Privatization (COP) and Asset Privatization Trust (APT). The COP is a cabinet-level committee tasked with identifying for the President those nonperforming assets to be privatized, determining which assets will be transferred to the APT, establishing guidelines for privatization, and approving the sale and disposition of assets. The APT will serve as a disposal unit, primarily for the acquired assets of PNB and DBP (365 accounts representing an aggregate loan exposure of $8 billion and with an estimated market value of $1 billion); and public corporations and/or their subsidiaries which could not undertake their own privatization efforts. The privatization of the 260 sequestered private companies will be accomplished by a separate entity.

- COP issuance of privatization guidelines (See Annex L4);

- Commencement of privatization plan preparation by privatization units of other public corporations;

- COP review of 121 public corporations for privatization;

- Presidential approval of 86 corporations for immediate privatization (see Annex L5 for the list of GOCCs approved for privatization);

- Initiation of disposal process. As of July 1987, the COP had circulated general catalogues covering 50 assets and approved asset sales totalling pesos 915.5 million. In addition, parent companies have sold some GOCCs.

On the whole, the GOP seems to be making significant progress in its efforts to rationalize the government corporate sector. The present administration's commitment to enhance private sector participation in the development effort facilitates this task. Notably, impetus for privatization has gained increased attention not only because of the pressing need to reduce the budgetary burden but also because of the GOP's plan to use the proceeds to finance the Comprehensive Agrarian Reform Program.

Despite the progress to date, various factors could constrain the completion of the privatization effort within the short five-year time frame--namely, the sheer size of the task, the range of financial and technical analysis requirements, legal encumbrances, marketing requirements, and consistency of outcomes with GOP general policy initiatives (e.g., the possible substitution of private for public monopolies).

C. Investment Financing and the Capital Markets

1. Overview. The GOP investment financing policies of selective credit allocation and of the provision of medium- and long-term credit at subsidized interest rates encouraged businesses to become highly dependent on debt financing and less inclined to undertake equity financing. The country's top 1000 corporations showed greater reliance on debt, with average debt-equity ratios changing from 4.64 in 1981 to 5.31 in 1985. Although businesses can use debt successfully to generate returns after financial charges, over reliance on debt could also lead to disproportionate capital structures and high debt to equity ratios which constrain future debt capabilities.. Reliance on debt also increases vulnerability to economic downturns. Such vulnerability is heightened when political and social considerations outweigh viability in financing decisions, as was the case for a large number of Philippine companies.

The GOP's financial policies also fostered a partially developed nonsecurities market (the banking system) but retarded growth in the securities (stocks and bonds) markets. Businesses with term financing needs not operating in GOP-selected sectors and without the appropriate political affiliations had to resort to short-term commercial debt.

Well-developed capital markets in the Philippines to mobilize domestic resources and foreign savings are important to encourage savings through offering investors a variety of investment opportunities and to assure that the flow of net savings is directed to more efficient enterprises. Investors generally demand corporate securities with consistently profitable performance and/or growth potential, creating competition among companies and forcing companies to improve their operating efficiency. In addition, well-developed capital markets usually facilitate broader ownership of assets and distribution of wealth.

Two basic types of instruments are traded in the Philippine capital markets, equity claims and debt claims. Within each of these two categories are a wide variety of instruments ranging from the nonsecurities markets--e.g., traditional loans, mortgages and trust certificates--to the securities markets--primarily, stocks and bonds. A discussion follows on the status and constraints of the Philippine bond market and stock exchange.

2. The Bond Market

The bond market is predominantly composed of government securities, with only a handful of private bonds issued by some of the country's large companies.

During the period 1980 and 1985, government security issues grew by an average rate of 23.3 percent annually. However, the annual average rate was 40.0 percent during 1984 and 1985, largely as a result of the rapid growth of Central Bank issues and short-term national government issues used as anti-inflationary policy tools. Political instability during that period also enhanced the demand for short-term issues from investors who preferred to remain liquid to hedge against uncertainties. Institutional investors likewise opted for short-term issues in anticipation of future cash requirements and in response to high short-term yields. The demand for short-term issues during this period resulted in increasingly slower growth of medium- and long-term issues. By 1985 short-term issues accounted for more than 60 percent of outstanding government securities.

As a result of the new GOP administration policy, some Central Bank issues have been phased out. Such a policy would normally have reduced the share of short-term issues to total government securities outstanding, but it has slowed growth of all issues. Saldana (1986) attributes the slow expansion of medium- and long-term government debt issues to the inactive secondary trading of these securities, the easy availability of negotiated debt financing from government financial institutions, and, beginning in 1985, the debt-ceiling targets under the GOP's stabilization program.

Corporate bonds are virtually nonexistent in the country. Traditional short-term commercial paper and promissory notes issued by private companies in the money market are by far the major forms of corporate securities. Available longer term instruments are extremely limited in volume and variety, and only a handful of private companies have issued corporate bonds in the local market.

During 1980-1985, the public nonbank institutions and the Central Bank were the biggest investors in government securities with a combined average 47 percent share, largely because of GOP moral suasion on publicly owned institutions to purchase government flotations. The banking system was the next biggest investor during the same period because of the excess liquidity and security features such as reserve eligibility, government guarantees and tax exemptions. Reduced business activities of most corporations and lack of sufficient confidence in the government resulted in low private nonbank sector participation.

Demand for government securities increased because of high yields. In general yields varied widely, from zero to as high as 40 percent in 1985. Short-term issues have been more competitive than long-term issues resulting in a reverse yield curve. Demand for corporate bonds has been and continues to be nil. The primary consideration of investors is asset risk and convertibility. Also, the economic crisis and continuing investor ambivalence do not augur well for an active market. The credit reputation of the borrower remains a primary consideration. In addition, the absence of a secondary market for corporate bonds has a dampening effect on demand.

3. The Stock Market. Secondary trading in stock issues has had a long history in the Philippines, but remains undeveloped. The Manila Stock Exchange was established in 1927 and the Makati Stock Exchange in 1963. About 138 companies now trade in the two stock exchanges, and only 48 of the top 1,000 companies in the Philippines actually have shares listed. The remaining companies are mostly mining and oil speculative "paper companies." Further, only an estimated 30 percent of the shares of listed companies are available for trading, and the majority are held by principal owners and institutions as permanent investments. Most of the new issues are not underwritten and the majority are rights issues at par value, below market prices.

The stock market's performance was progressively depressed between 1980 and 1985, with the annual volume decreasing from pesos 4.65 billion in 1980 to pesos 4.04 billion in 1985. During 1986 the value of transactions in the two exchanges increased dramatically to pesos 11.4 billion, outstripping the previous high of pesos 6.75 in 1976. The 1987 stock market activity has become more bullish, particularly after Congressional elections in May. These recent developments appear to reflect increased demand in light of changed political circumstances, substantial interest by foreign buyers and increased prices of shares. However, the supply of securities has not appreciably increased and has resulted in what both the Department of Finance and the Securities and Exchange Commission consider to be a bubble with a great potential to burst. The GOP questions whether the increased trading and share values represent authentic investment or simply a means to launder money retained in the country for political uses.

The undeveloped stock market results in trends which impede efficient investment operation.

- Low predisposition of private owners of highly profitable firms to share control over their enterprises;

- Unequal tax treatment of public and closely held corporations with the advantage going to the latter;

- GOP focus on the nonsecurities market and institutions resulting in overdependence on debt financing and inability of securities market to develop;

- Weaknesses in the regulatory and institutional framework for capital market development; and

- Lack of working knowledge among private firms of the advantages and procedures for securities issuance.

Increasingly, the GOP recognizes the need to undertake reforms to streamline trading functions. This project will assist the government to implement needed reforms.

D. Relationship to CDSS and AID Policy

1. Relationship to CDSS

The project directly supports the FY 1988 CDSS Supplement objectives to support GOP policy reforms to permit and encourage the private sector to play its primary role in development--namely, those directed to privatize acquired assets and selected public corporations and simplify/clarify investment rules.

2. Relationship to AID Policy

Privatization. This project is in full compliance with Agency policy guidance on privatization contained in the March 1985 Policy Paper on Private Enterprise Development and totally meets the AID Privatization Objectives stated in the June 1986 AID Policy Determination No. 14. Specifically, this project meets the Agency's directive to engage the Philippine Government in discussions on privatization. Also, the Mission expects to be involved in more than two privatization activities annually, primarily utilizing the complete divestiture technique. However, some activities will involve the partial divestiture technique.

In addition, the Mission is engaged in one other privatization effort and a liquidation activity, outside the scope of this project, with the Department of Agriculture. The first involves the divestiture of National Food Authority operations that are peripheral to its primary function, and the second, the liquidation of the Farm Systems Development Corporation parastatal.

The project also addresses all four of AID's pillars -- policy dialogue, institution building, private sector support, and technology transfer.

Policy Dialogue. The project directly supports the Mission's FY 1988 CDSS Supplement policy dialogue agenda with the GOP to (a) encourage and support the GOP in implementing, maintaining and managing policy actions for sustained near-term recovery and long-term development; and (b) reduce the government's role in the private sector and promote deregulation through the privatization of acquired assets and selected public corporations, and simplification/clarification of investment rules. The project will also provide more focus to our policy dialogue with the GOP on fiscal and monetary responsibility.

Institution Building. The project supports AID Institutional Development Policy directives. Institution Building will be addressed primarily by two project elements: (a) Technical assistance to the Securities and Exchange Commission to enhance its capacity to play a more developmental role in capital market development, reduce the scope of its regulatory powers and enhance its regulatory/enforcement powers where necessary to protect the public interest; and (b) technical asssistance for upgrading the stock exchanges and improving their efficiency, critical ingredients to providing an efficient secondary market for investors.

Private Sector Support. This project directly supports the development and growth of the private sector. Its efforts are directed to increasing the productivity of the private sector, increasing the flow of investment in the private sector and increasing the supply of and demand for private investment grade securities through creating an environment conducive to issuing and investing in term securities and the establishment of a private company for turning around financially distressed companies and for providing investment capital for both new and on-going private agribusiness ventures.

Transfer of Technology. The project will provide technical assistance and commodities to the stock exchanges to modernize trading practices and install a computerized trading system. This improvement in technology will allow the stock exchange to operate more efficiently. The project will also upgrade the Security Exchange Commission's information management system and allow it to pursue its oversight and regulatory function with greater efficiency and effectiveness.

E. Other Donor Involvement

The World Bank (WB), the Asian Development Bank (ADB) and the International Finance Corporation (IFC) have all been directly involved in promoting privatization and capital market development in the Philippines. The WB has been a vital force in promoting privatization. It conditioned its $310 million economic recovery loan on reforms in the government financial institutions, including the establishment of a mechanism for the privatization of acquired assets and the restructuring of the DBP and PNB. In addition, the WB may develop a Public Corporate Sector Rationalization loan to support the privatization of selected non-financial government corporations and increase the operating efficiency of remaining public corporations. Progress on this loan appears to have stalled recently, however, due to an unwillingness on the part of the GOP to incur more foreign debt.

The ADB involvement in privatization has been limited to providing grant technical assistance for privatization-related studies. The ADB funded an inter-country comparison of six Asian countries' capital markets in March 1985 which included the Philippines and is currently undertaking a Mutual Funds review to examine the feasibility of establishing a domestic mutual fund and make recommendations for its structure.

II. PROJECT DESCRIPTION

A. Project Objectives

The project will contribute to the national economic recovery goal of increasing employment and incomes.

The Government of the Philippines recognizes the essential role of the private sector in the pursuit of economic recovery. This role includes investing in productive enterprises and potentially productive government-held acquired assets and public corporations. The government has recognized as well the necessity of lessening the drain on the national budget resulting from the maintenance and operation of such assets and corporations.

Accordingly, the project purpose is:

- to reduce the national budgetary burden of the acquired assets and public corporations; and
- to enhance the environment necessary to mobilize private term financial resources for investment in productive private enterprises; and

This project's approach is to: (1) assist the government with the divestiture of acquired assets and state-owned corporations, to increase the firms' productivity and reduce related national budgetary expenditures; (2)

work with the government and the private sector to improve the capacity of capital markets to mobilize term capital, and (3) directly assist private sector efforts to establish a mechanism for channelling private investment to firms being privatized, distressed firms, and new and operating agro-industrial based ventures.

The following conditions, expected to prevail at the end of the project, will indicate that the purpose has been achieved:

- The burden on the GOP budget resulting from maintaining acquired assets and financing the operating costs of parastatals will have been reduced;

- The capital markets will serve more effectively as mobilizers of capital; and

- Conditions to encourage an increase in the supply of securities will be in place.

B. Project Components

To accomplish these purposes, the five-year project has two major components: 1) a privatization component to support the government in the implementation of its ongoing privatization program; and 2) a capital market development component to assist relevant government and private sector entities enhance the capabilities of the capital markets to serve as effective mobilizers of term capital and to encourage an increase in the supply of securities. These are described in detail below:

1. Privatization

The Philippines' Privatization Program involves more than 350 acquired assets of government financial institutions (GFIs), approximately 260 sequestered companies and more than 100 government owned and controlled corporations (GOCCs). The total book value of the GFI-acquired assets alone approximates $8 billion. In an attempt to deal with the enormous task of privatization expeditiously, the Asset Privatization Trust (APT) will concentrate its efforts on privatizing the acquired assets of the GFIs. These include the PNB, DBP and the Government Service Insurance System.

Coordinated through the Undersecretary of Finance (Chairman of the Technical Committee on Privatization), the privatization of GOCCs will be undertaken by the parent GOP Departments/Agencies to the extent they are capable and willing to do so. Only in the event of a GOCC's refusal to comply with a GOP directive to privatize will the APT be called in.

The GOP's budget resources to execute its Privatization Program are meager. The WB has estimated that the APT alone could need as much as $10 million per year to effectively privatize the acquired assets under its conservation. While the APT and some GOCCs have very capable (but limited) staffs, they are also underfunded. Other GOCCs have neither the staff nor the resources to acquire the services required to execute their respective privatization programs.

The sweeping objectives of the GOP's Privatization Program, sophistication of the market and structural layout of the sectors to be privatized require the application of diverse and specialized disciplines. Given the financial and human resource constraints of the APT and GOCCs, technical assistance in the preparation of information, appraisal of assets, design of sectoral strategic studies and execution of privatization/ divestiture programs is required. Suppliers of these services should include auditors, specialized engineering firms, management consultants, investment banks and legal advisors.

Key GOP officials, including the Chief Executive Trustee of the APT and the Undersecretary of Finance, have recognized this need and have a desire to obtain AID assistance. Therefore, this project component will provide technical assistance and commodities to the Asset Privatization Trust and other Asset Disposal Units (ADUs), as described below:

a. Asset Privatization Trust

(1) Technical Assistance

A.I.D. will finance short- and long-term expatriate and local specialized services and advisory consultancies in the following areas:

(a) Information and Data Management

The APT has inherited voluminous files on more than 300 companies, including the type of physical assets/technical specifications, company financial and operating records, employment data, and legal documents. A sound filing and retrieval system is needed for the APT to function effectively. Technical assistance will be provided to the APT to catalogue, audit and store files and data. This will include training APT personnel on the use of computer hardware and relevant software applications and supplying short-term manpower for the one time catalogue, and audit/turn over exercise.

(b) Legal Services

Valuation and legal services are the two most critical functions of the APT. Prior to the sale of an enterprise, legal assistance is needed to solve issues such as labor contracts, contingent and hidden liabilities, and to execute on behalf of the seller the actual disposal of assets to a new owner. External counsel is needed to move decisively on accounts and clear the bottlenecks in the marketing effort. AID will provide short-term services from local institutional sources or with a local firm as a subcontractor to an expatriate advisor as discussed below.

(c) Valuation and Marketing Services

Advisory assistance will be provided to the APT for valuation and marketing services, primarily for those entities requiring some level of foreign investment because of the large financial value of the assets involved, technology requirements, foreign interest, etc. Smaller enterprises may also be included, as needed. The assistance to be provided will include:

- Valuation;

- Prospectus preparation;

- Identification of prospective investors;

- Information dissemination;

- Offering of securities or public share placement;

- Investment proposal evaluation;

- Bid development or negotiations with prospective investors;

- Fairness statement or opinion; and

- Closing, including legal services.

This assistance will be provided through an expatriate investment banking firm with expatriate and/or local subcontractors, as appropriate, for a grouping of firms (i.e. agribusiness, services, industrial). Project assistance will utilize institutional rather than personal services to provide greater accountability.

(d) Policy/Operations Studies

A.I.D. will also finance expatriate and/or local consulting services for studies to guide the APT in decisions ranging from rehabilitation versus liquidation and spin-offs/mergers to best use studies and corporate strategy development.

(2) Commodities

A.I.D. assistance will be provided for the procurement of computer hardware to support the information and data management effort described above for the APT.

b. Asset Disposal Units for Government-Owned and -Controlled Corporations (GOCCs)

(1) Technical Assistance

A.I.D. will assist the parent Departments/Agencies of GOCCs by providing short- and long-term expatriate and local specialized services and advisory consultancies for GOCC Asset Disposal Units (ADUs) and for the parent entity's execution of the Privatization Program. It is envisaged that the following GOP entities will be assisted:

- Philippine National Oil Company (PNOC);

- Department of Trade and Industry - National Development Company (DTI-NDC);

- Presidential Management Staff (PMS);
- Department of Agriculture (DOA);
- Department of Tourism (DOT);
- Department of Finance (DOF); and
- Department of Transportation and Communications (DOTC).

(Please note that while NEDA is the GOP entity under which a number of the GOCCs fall, the entities actually responsible for disposition include the Development Bank of the Philippines [DPB], Philippine National Bank (PNB), Government Service Insurance System [GSIS], Social Security System (SSS) and the Asset Privatization Trust [APT]).

Services provided will be similar to those listed above for APT and will include management planning, investment banking, legal, accounting/auditing, and specialized engineering services. In addition, where new ADUs are to be formed, AID will assist the parent Department/Agency establish the ADU. Activities financed under this element will include, but not necessarily be limited to:

- Establishment of ADUs, including development of guidelines for their operation and administration, scope of activities, relationship to the COP, APT and DOF;
- Refinement of privatization objectives;
- Identification of impediments to privatization and development of privatization strategies, including project specific studies as necessary (e.g., rehabilitation versus liquidation);
- Assistance with the turnover of accounting information files by the GOCC to the ADU, including legal documents, financial and physical assets, employment data, and third-party creditor information;
- Recommendation of appropriate information and data management systems, including both hardware and software;
- The assessment of the demand for investment;
- The conduct of financial analysis and/or capital restructuring;
- Valuation;

- Marketing assistance, including prospectus development, information dissemination, identification of prospective investors, offering of securities, investment proposal evaluation, bid development or negotiations or placement of public share offerings;

- Presentation of a formal opinion on the "fairness' of the terms of the sale; and

- Closing services.

In those instances where ADUs exist and involve the privatization of sizeable assets or where technology transfer issues are involved and possibly require foreign investment (i.e., PNOC and NDC), an expatriate investment banking firm, with expatriate and/or local subcontractors as appropriate (i.e., legal services, specialized engineering) will be procured to handle an appropriate grouping of the involved firms (e.g., agribusiness, shipping, services,). For less complex transactions, and as conditions warrant, either an expatriate or local firm or some mix of the two will be procured to provide the necessary services.

For the establishment of ADUs, it is anticipated that a mix of expatriate and local consulting services will be required. Each ADU will be composed of a staff with financial analysis and sectoral specific expertise, preferably with no association with the GOCC to prevent conflict-of-interest situations. The ADU staff members will come from either the public or private sector and be managed by an individual with direct reporting responsibilities to the individual with ultimate decision making authority (i.e., Secretary or Undersecretary of a Department or an Agency Head). The major task of the ADU will be to design and implement an Action Plan and manage the overall privatization process. Each ADU will define its objectives, determine the extent to which financial restructuring measures are necessary, and develop and execute a marketing strategy.

In those instances where it does not make sense to establish an ADU, consulting services will be procured to develop and execute an appropriate privatization program.

(2) Commodities

A.I.D. assistance will be provided for the procurement of computer hardware to support the information and data management requirements identified by the technical assistance provided above for selected ADUs.

2. Capital Market Development

The initial USAID examination of the capital market in the Philippines was undertaken in 1985-86 to expand on an evaluation prepared in 1984 by the Asian Development Bank. The 1984 report focused largely on banks and bank lending. It was felt that USAID might assist by focusing on the securities markets for long-term financing, and by participating in an expected implementation of recommendations in the report. Although capital market development was not high among the GOP's priorities at the time, the

Mission attempted to gain an overview of the securities markets to see if development efforts were warranted. In 1985, discussions were held with many people in the private sector, and it became obvious that the long-term securities markets were dramatically underdeveloped.

The new government brought a change in attitude. In December 1986, the Ministry of Finance and the Ministry of Trade and Industry (Ministries are now known as Departments) initiated discussions on steps that could be taken to encourage development of the capital market, with the objective of encouraging the provision of long-term finance to industry through the securities markets.

A.I.D. will assist the GOP and private sector develop and more fully utilize the existing Philippine capital market as a means of mobilizing domestic and foreign savings for medium-to-long-term capital financing for investment in productive enterprises. This component has seven elements: Legal and Regulatory Framework; Securities and Exchange Commission; Stock Exchanges; Accounting and Auditing; the Capital Markets Conference; Public Media Campaign; and Philippine Agribusiness Industrial and Investment Company (PAIICO). A detailed description of each follows:

(a) Legal and Regulatory Framework

A number of laws and regulations, such as the Securities Act of 1936 as amended in 1982, are based on laws of other countries (in this case the United States) and it is not clear that they reflect policies appropriate to development of the Philippine capital markets and private sector. Also, *ad hoc* rules and regulations have been built one on top of another, and inadequately thought out regulations are supplemented by more regulations to fill "loopholes" in the original regulations.

The Securities Act of 1936, as amended in 1982, is a prime example. It is based almost exclusively on laws in the United States. The law is a copy of relevant parts of the U.S. Federal Securities Act of 1933 and Securities and Exchange Act of 1934, which were based on disclosure. However, significant changes were added, to blend in the approach of securities laws (so-called "blue sky" laws) of certain states (most particularly California), adopting from those states the concept that public offerings of securities may not be made unless the government body administering the law finds that the issuing company and the securities are "sound" investments.

A number of topics are not covered; certain topics are covered in a narrow way (such as required "approvals" for public issues, as compared to simply requiring adequate disclosure). The law does not address the needs of a modern, changing securities market (e.g., new techniques of finance, links between markets, over-the-counter trading). Finally, the law does not address the fundamental need of the Philippines -- to develop its capital market.

With the passage of the Investment Houses Law in February 15, 1973 through Presidential Decree No. 129, underwriting, an important activity, was virtually removed from the stockbrokerage firms and became the preserve of Investment Houses. When new equity issues were subsequently floated in the market, stockbrokers became known merely as "selling agents."

The tax code has also impeded the demand for securities. For example, dividends and interest income are taxable to the payee, but dividends are not deductible expenses of the payor. A tax on undistributed earnings also discourages business expansion.

The Corporations Code of the Philippines, adopted in 1980, replaced the 1906 Corporation Law, which was based on the then California Corporations Code. The 1980 law was intended to "establish a new concept of business corporations so that they are not merely entities established for private gain but effective partners of the National Government in spreading the benefits of capitalism for the social and economic development of the Nation." Impediments to the supply of securities inherent in the 1980 Corporations Code include the following:

- The pre-emptive rights requirement restricts a wider distribution of shares from new public offerings;

- The requirement that new public issues be sold at par instead of market value. This severely restricts the capacity of a company to raise new equity and acts as a disincentive to public issues;

- The SEC has the power to approve/disapprove increases in capital, a decision which should be left entirely to the company; and

- Closed corporations (less than 20 shareholders, shares prohibited from transfer) are not permitted to have public offerings, are subject to no restrictions on the size of assets, and are not subject to public disclosure requirements. These factors encourage businesses to operate as closed rather than public companies that raise term capital through the securities market.

In sum, there are many legal and regulatory impediments to development of the capital market. The environment needs to be examined and evaluated from this perspective.

(1) <u>Technical Assistance</u>

A.I.D. will assist the Capital Markets Development Working Group (CMDWG) conduct a comprehensive review of laws, regulations and procedures pertinent to the regulation, development and growth of the capital markets in the Philippines. (Please see Section IV for a description of CMDWG.) This review will focus on the changes/revisions in current legislation/regulations/rules required to provide a clear legal framework to develop and regulate the capital markets more effectively.

The review will identify revisions/changes needed to foster: (1) an improved business climate; (2) an increase in the supply and demand of securities; (3) the growth of full service securities firms (i.e. merchant/investment banks); and (4) the protection of investors, including minority shareholders. Furthermore, the review will take into consideration the impact of the new Constitution and the role of Congress as a legislative body in its recommendations for legislative change.

The Act/Codes/Regulations/ Rules to be reviewed include:

- The Securities Act of 1936, As Amended;
- The Investment Company Act of 1960;
- The Investment Houses Law of 1973;
- The 1980 Corporation Code of the Philippines;
- The Omnibus Investment Code of 1987;
- The Internal Revenue Code;
- Board of Investment Regulations; and
- Securities and Exchange Commission Regulations.

In addition, legal audits will be performed in the following areas:

- Banking and Universal Banking Law;
- Insurance Law and law governing insurance company investment;
- Laws affecting venture capital and leasing;
- Laws concerning foreign investment;
- Price control and stabilization laws; and
- Judicial laws and procedures.

A comprehensive report will be issued providing recommendations on legislation required and revisions needed in rules/regulations/procedures of the responsible GOP Departments/Agencies. This report will also include draft legislation/regulations/procedures/rules as well as an Action Plan that will fully delineate the responsibilities of the parties involved in implementing the recommendations made, and a timetable for executing the Action Plan.. The report will be accompanied by a succinct presentation on capital market legislative issues, suitable for use by GOP departments and agencies in presentations before the newly formed Congress.

(b) <u>Securities and Exchange Commission</u>

The Securities and Exchange Commission (SEC) is a quasi-judicial body created by the Securities Act of 1936. The SEC is charged with administering the Securities Act of 1936, as revised in 1982, the Investment Company Act of 1960, the Corporation Code of 1980 and other related laws. The SEC acts as a securities market regulatory body, and also as the registrar of companies to enforce the Companies Law and keep public records of all company filings.

These two functions are in many ways contradictory and the SEC performs neither well. SEC responsibilities related to company registration and approval of company articles of incorporation carry more weight than supervision of the securities market, which has led to loose enforcement of the regulatory rules in the securities market.

The SEC has not regulated the markets effectively; does not understand the securities markets in terms of their economic development significance; has antiquated regulations and rules; has issued rules that were too sweeping and impractical; lacks adequate staff and qualified personnel; has not adequately protected the public interest; and has not developed guiding principles to govern securities markets. In addition, SEC regulatory practices have not been evenly applied, giving rise to accusations of favoritism. These factors have resulted in confusion and even chaos in the capital markets, with the public interest not being adequately protected.

Restoration of public confidence in the market is a major prerequisite of attracting investors' funds. The SEC needs to strengthen its policy-making and selected regulatory functions. It also needs to divest itself of other regulatory functions. Policy-making functions of the SEC should focus on long-term capital market development planning. In particular, the SEC should define the role of the equity market in mobilizing private sector savings. Regulatory functions should involve stricter registration and listing requirements, closer monitoring of broker conduct and better policing of the market against manipulation and fraud. To better protect investors, regular reporting requirements and the full disclosure of information should be observed by the listed companies and strictly enforced by the SEC.

(1) Technical Assistance

The 1986 A.I.D.-financed study on capital markets recommended the establishment of a cabinet-level institution for securities market development. In addition, it recommended a review of the SEC's regulatory functions and organization. The DOF and DTI prefer to investigate the possibility of upgrading the capital market development capabilities of an existing organization, in this case the SEC, rather than establish a new cabinet-level organization. If not feasible, they will then recommend that a cabinet-level Capital Market Commission be established. The DOF, DTI and SEC have all indicated to AID that as a result of the findings in the AID and ADB studies, the SEC must adjust its objectives to play a more developmental and promotional role vis-a-vis the capital markets. They have requested AID assistance toward this objective.

In response to this request, AID will finance an organizational review of the SEC to develop recommendations for its reorganization. The purpose will be to enhance its professional capabilities, make it more developmental, and strengthen those enforcement responsibilities critical to effective capital market operations. The review will include an Action Plan for implementation by the SEC, and will cover, but not be limited to, the following areas:

- Developing the framework for an institution to promote capital market development. That framework will include delineating its objectives, functions, organization, staffing requirements, and relationship to other GOP Departments/Agencies and the private sector;

- Determining whether a capital market development function can effectively be incorporated by the SEC. If not, recommending where this function should be placed and whether a new institution is required;

- Reviewing current SEC responsibilities, rules, regulations, and procedures, and recommending ways to make it more responsive to the current needs of the securities industry. This aspect of the review will focus on: (1) How best to blend the company registrar with the broader security industry regulatory function, if possible and how to prevent the narrower subjects from limiting the broader focus; (2) how to bring the SEC more actively into the GOP's securities policy formulation framework; (3) the appropriateness of its enforcement and adjudicative activities and whether they should be retained, changed or removed; (4) implementing regulations that need to be adopted (e.g., disclosure, broker conduct duties of stock exchanges, etc.); (5) developing public comment/review procedures to ensure public comment on all proposed SEC rules, regulations and initiatives;

- Reviewing the current SEC organizational structure and staffing, developing recommendations for a more effective organization, and identifying staff requirements and training needs; and

- Reviewing the current SEC information base and its utilization by the SEC and developing recommendations on information requirements and information system needs--including commodities and staff requirements--to enhance the SEC's information collection, retrieval, evaluation, and record keeping capabilities as well as the practicality of keeping company disclosure reports in a computer base available for broad public access.

(2) Training/Seminars

A.I.D. will finance training for the SEC and selected GOP officials (e.g., from the CB, DOF, DTI) directly involved in capital market regulatory and development activities The SEC/GOP training program will be based on the recommendations of the SEC organizational assessment. It is expected that this training will focus on economics, finance, regulation theory and practice and policy formulation.

(3) Commodities

AID assistance will be provided for the procurement of computer hardware to upgrade the SEC's information collection, retrieval, evaluation and record-keeping capabilities.

(4) Observation Tours

Observation tours to countries that have recently taken a developmental approach to their capital markets will also be financed. Several such tours involving SEC and other GOP officials together with the securities and stock exchange professionals will visit countries such as Korea, Taiwan, and possibly Jordan and Brazil to become acquainted with: (a) development strategies being pursued and the resultant growth of those markets; and (b) current trends toward a wider range of financial services.

(c) Stock Exchanges

If actions are taken by the GOP and private sector to improve the supply of and demand for securities, the stock exchange --as perceived by the public, currently organized, and managed/operated -- will not be in a position to provide investors the secondary market liquidity and savers the mechanism required to invest funds. A professionally managed stock exchange with a wide range of high quality listed stocks is critical to the development of the capital markets and imperative for the efficient allocation of term investable funds to productive end uses.

The two active stock exchanges in the Philippines, the Manila and Makati Stock Exchanges, are perceived as gambling dens with speculation and manipulation. Reasons for this perception include:

- Approximately 150 companies are traded in the stock exchanges. Of the top 1000 companies in the Philippines, only about 50 have shares listed. The remaining companies are in oil and mining and a number of them are paper companies with no business activities. While the stock exchanges have taken steps recently to "clear the boards" of more than 80 nonperforming or dormant stocks, very weak listing requirements, and poor monitoring, analysis and general research performance portend continuing problems in this area;

- There are no clear rules governing when brokers can trade on the exchanges for their own account vis-a-vis giving priority and precedence to customer orders. This is particularly important in light of the fact that brokers on the floor of the exchanges have privileged access to market information and trends and can therefore trade for their own accounts to the disadvantage of public customers.

- Future and delayed transactions are allowed whereby the customer delays completing a transaction for several days or weeks. This leads to market speculation and sudden drops in the market.

The stock exchanges are not professionally managed. They are run by brokers/dealers who cannot devote full time to the proper management of the exchanges and the enforcement of exchange rules and policies. As a result, the stock exchanges cannot react to changing conditions in the financial markets and lack forward planning capacity.

In terms of technology and efficiency, stock trading in the Philippines lags far behind that in other Asian countries. While Hongkong, Japan and Singapore have modern trading practices and computerized trading systems, the Philippine stock exchanges, in their current bull-run environment, cannot cope. The SEC recently mandated the closing of the Exchanges on Fridays, as a one-day respite from trading, to cope with the heavy volume of paper work. The trading practices of the exchanges are out-moded. Instead of an open process in which all interested brokers can compete, the present system provides for brokers to stand in line and buy and sell on a "first come, first served" basis, with orders physically posted on blackboards. This system does not allow for an efficient, fair, open and free market for investors.

Contributing to the inefficiency in the stock market is the existence of two exchanges trading the same shares. The trading volume simply does not justify two exchanges. Neither exchange is able to expeditiously disseminate information on transactions to the public and it is not possible for brokers to get the best price available in all markets. Some brokers are opposed to the unification of the two stock exchanges. However, a "Unification Committee" made up of representatives from the SEC, DTI, and the two exchanges has been formed to thrash out the issues centering on where to house a unified exchange and which of the two exchanges should survive.

The stock market is booming and some analysts predict one or two years of growth in stock values. However, this optimistic outlook is premised not only on a greater supply of and continued demand for securities but also on the ability of the exchanges to professionalize their management. This will mean improved self-regulatory capacity, revised trading procedures, modernized facilities, better provision of information to investors on a more timely basis, and better coordination between the exchanges, hopefully culminating in their merger.

(1) <u>Technical Assistance</u>

A.I.D. assistance will be provided to improve the organization, operations and governance of the Philippine stock exchanges. Advisory assistance will be provided to evaluate and make recommendations for implementation by the stock exchanges in, but not limited to, the following areas:

Organization

- Closer exchange relationships, and the advisability of a merger between the Manila and Makati Stock Exchanges; and

- Criteria for membership in the stock exchanges.

Operations

- The current trading procedure, to develop a more open and efficient process;

- Methods for information about exchange transactions to be collected and disseminated to the public more expeditiously;

- The capacity of the exchanges to detect and eliminate improper trading activities;

- The capacity of the exchanges to act as self regulatory organizations and to enforce compliance by members with rules of the exchanges and the SEC;

- Listing and delisting policies for establishing stricter minimum capital, performance and disclosure requirements;

- The role of broker trading for personal account and the dealer's role in making a market for listed securities on the floor of the exchanges; and

- The equipment base of the exchanges to determine the equipment/commodity needs of the exchange for the efficient posting and handling of daily transactions on the exchanges and for more closely monitoring the financial conditions of the listed companies.

Governance

- The need and desire to professionalize the management of the exchanges and include public representation on the Boards of Directors.

(2) Training/Seminars

A.I.D. will finance seminars for securities professionals and stock exchange officials on enhancing professionalism, technical capacity, and efficiency in their respective operations. Seminars will be based on the evaluations of their respective operations and identified needs. It is expected that these seminars will be held in areas such as new business development, legal and regulatory requirements, fiduciary responsibilities to customers (e.g. disclosure, conflict of interest), self-regulatory obligations, etc.

(3) Equipment/Commodities

Computer hardware and commodities will be procured to upgrade the capacity of the exchanges to post their daily transactions and to more closely monitor the financial conditions of listed companies.

(d) Accounting and Auditing

The financial statements of Philippine companies are not reliable. Often, their financial statements do not disclose information according to uniform standards and accounting principles are not applied consistently. Some companies simply refuse to provide adequate disclosure of financial information and to file required statements with the SEC.

Although some would assert that financial statements in the Philippines are adequate, those who use and rely on such financial statements (lenders, investors) do not agree. Steps must be taken to evaluate these concerns more deeply and to establish accounting principles, auditing standards (including independence of auditors from the companies they audit) and reporting requirements appropriate to needs in the Philippines. There must be uniform financial reporting requirements, agreed-upon and fair generally accepted accounting principles (referred to as "GAAP") and generally accepted auditing standards (referred to as "GAAS"), and independent accountants.

A.I.D. will provide assistance to the Philippine Accounting Standards Council (PASC) to establish generally accepted accounting principles (GAAP) and to the Philippine Institute of Certified Public Accountants (PICPA) to establish an Accounting Standard Board and generally accepted auditing standards (GAAS). Once established, these can generate reliable and uniform financial information that can be utilized by investors to make informed investment decisions based on the actual operational results of the companies involved instead of rumor and inside information. Improvements in this area will also enhance the SEC's ability to enforce disclosure of information requirements.

(e) Capital Market Conference

The project will also support the staging of a Capital Market Conference to be sponsored by the Department of Finance, Department of Trade and Industry, the Securities and Exchange Commission and the private financial community. The purpose of this Conference will be:

(1) To issue a policy statement by the Secretaries of Finance and Trade and Industry or the President of the Philippines (subject to her availability), as was done with the GOP's

"Privatization Program," making the development of the Philippine Capital Market a high priority; and

(2) To provide a forum for both private and public sector interest groups to discuss the promotion and effective regulation of the capital markets.

The project will finance a local conference organization consultant, selected cost elements for staging the Conference (i.e., venue, publicity) and limited international resource participation.

(f) Public Media Campaign

A.I.D. will provide funds for an intensive promotion and information public media campaign to educate privately held closed corporations and the public on the importance of the capital markets, how securities markets operate, advantages of securities (including bonds and stocks) as alternative forms of investment and raising capital, how to make a public offering or invest, and investor rights and protection. This campaign will be conducted with the assistance of a contractor and coordinated by the CMDWG.

(g) Philippine Agribusiness Industrial and Investment Company (PAIICO)

The legacy of the previous government for individual companies has been devastating:

- Companies' assets were systematically diverted offshore to private bank accounts or squandered on personal consumption;

- Companies' capital goods were overvalued or overly expensive for the size and scale of operations;

- Debt zoomed because private companies' lenders passed on foreign exchange risks to them, and the decline of the peso could not be compensated for by increased prices;

- Inexperienced and inefficient managers drove companies into the ground with mismanagement;

- Market rigging schemes drove companies to the wall because they were not favored customers or lost markets and/or raw materials.

Many private companies had to be bailed out of bankruptcy by the GOP; others were unable to meet their payments on bank debt and are now nonperforming assets on the books of the Philippine banks -- both government and private. Everywhere in the Philippines, new private investment depended on "cronyism" and not upon carefully analyzed, market-oriented investment opportunities. As a result, significant numbers of private businesses now require large increases in investment due to severe undercapitalization, mismanagement, overreliance on debt, and misallocation of funds.

The only way that existing troubled businesses can be improved, dormant assets developed and nonperforming and government-owned businesses resuscitated is to recapitalize them and bring in effective managers. Much of the existing plant and equipment investment in distressed companies has not been carefully reviewed by experienced managers to ascertain its real value. The values of plant, equipment, facilities and the business as a going concern have not been audited by experts in the field. Rather, many reviews of existing businesses have been simply "desk audits" without practical evaluations or "financial audits" without managerial reviews.

Since the GOP's national economic policy emphasizes agribusiness development as its highest priority, restructuring is particularly critical in agribusiness. The restructuring of agribusiness investment, its expansion to meet domestic and traditional export needs, and the refurbishing of agricultural processing and distribution systems are all essential to the economic expansion the Philippines requires over the next few years.

However, an appropriate combination of financial, engineering and managerial analytical capabilities is lacking among Philippine financial institutions. Capabilities to restructure existing ailing companies are extremely limited. A number of different types of services must be combined to analyze investment proposals and place them with qualified investors, including:

- Financial engineering capabilities;
- Managerial know-how;
- Equity placement power;
- Domestic and international market knowledge; and
- Business and equipment valuation expertise.

No existing company provides a full line of these needed services in the Philippines on a sufficient scale to have meaningful impact on the market:

- The five universal banks are not sufficiently integrated and do not have enough expert personnel;

- No investment house has the necessary broad financial capabilities, sufficient capital or the managerial/technical expertise;

- Government agencies do not provide merchant banking/technical skills to private buyers/investors and have conflicts because of many problem loans and investments; and

- Foreign investment bankers do not have the necessary managerial and technical expertise that is available directly in the Philippines.

The project will provide technical assistance to establish a new private company, named the Philippine Agribusiness Industrial and Investment Company (PAIICO). The objective of PAIICO will be to mobilize private term capital for investment in: 1) firms slated for privatization; 2) financially distressed privately-held firms; and 3) new and existing agro-industrial enterprises. With these objectives, PAIICO will have two basic functions. The first will be to act as an intermediary/ broker in obtaining investors/buyers who will provide new capital and managerial expertise which will "turn around" existing distressed businesses. The second will be to invest in and manage an agro-industrial fund that would provide investment capital for investment in agricultural projects of high return potential.

The project will fund the technical assistance (TA) required to organize an "Investor's Promotion Group" to establish and start-up PAIICO. A management consulting firm will be contracted on an AID-Direct basis to organize an Investor's Promotion Group (IPG). The PAIICO promotion strategy calls for the selection of certain key institutions and/or individuals to constitute an initial core of investors and promoters of PAIICO. These institutions/individuals would be selected for their standing in the business and financial communities in the Philippines and abroad. It is important that the promotion of PAIICO be the responsibility of potential investors and not the Government, lest PAIICO be perceived as a government corporation. The IPG organized for the proposed Private Agricultural Investment and Development Corporation (PAIDCOR) will be used as the starting point for the contractor.

Upon formation of the IPG, consulting advisory services will be provided to the IPG for:

- Preparation of the PAIICO business plan.
- Design and development of the documentation required by the IPG to solicit expressions of interest, and review of the proposals submitted by potential securities underwriters/placers to place PAIICO securities.
- Assistance to the IPG in the negotiation of a best efforts underwriting contract with the selected securities underwriting/placement firm.

The Mission and the PRE Bureau expect to work closely on the development and implementation of the PAIICO concept and, as currently envisioned, the PRE Bureau will implement PAIICO. However, if PAIICO is not established, this will not jeopardize the attainment of the Financial Resources Mobilization project objectives.

III. FINANCIAL PLAN

A. Cost Estimate and Financial Plan

The total cost of the project is estimated at $13.557 million. Project funds will be provided by USAID/Manila, the involved GOP Departments/Agencies, and benefitting private sector entities (e.g. Stock exchanges, brokers, investment houses, etc.)

The estimated life of project costs by source of funds are summarized in Table III-A, Summary Cost Estimates and Financial Plan (All Years). A summary table of Expenditure Projections by Fiscal Year and a summary table of Expenditure Projections for AID Project Funds by Element and Fiscal Year are provided as Tables III-B and III-C, respectively. Item C of Table III-A includes $50,000 as provision for non-federal auditing services. The detailed cost assumptions for Table III-A are provided in Annex F.

1. USAID/Manila

USAID/Manila will provide $8.5 million in Development Assistance Grant funds from the 103-Agriculture, Rural Development and Nutrition and 106-Selected Development Assistance Accounts. The table below shows planned obligations.

PLANNED YEARLY OBLIGATIONS
($000)

Functional Acct:	FY 87	FY 88	FY 89	FY 90	TOTAL
SDA	$1,000	$2,000	$500	-	$3,500
ARDN	-	4,000	-	1,000	$5,000
	$1,000	$6,000	$500	$1,000	$8,500

2. GOP

The GOP's contribution to the Project will primarily be in the form of the administrative costs to support the Committee on Privatization, Asset Privatization Trust, GOCC asset disposal units, CMDWG Secretariat by DTI; administrative and logistical support to expatriate and local contractors; and travel support costs for seminars and training activities. The GOP contribution to the Project is estimated at $4.851 million.

3. Philippine Private Sector

Philippine private sector participants in the technical assistance and institutional development elements of the Capital Markets component of the Project will be expected to contribute at least 25 percent of the cost of the activities in which they are involved. The Philippine private sector's contribution for the project development is estimated at $206,000.

TABLE III-A

SUMMARY COST ESTIMATES AND FINANCIAL PLAN (ALL YEARS)
(US $000)

ELEMENT	A.I.D. GRANT FX	A.I.D. GRANT LC	GOP FX	GOP LC	PHIL. PRIVATE INVESTORS FX	PHIL. PRIVATE INVESTORS LC	TOTAL
A. Privatization							
1. Technical Assistance							
a. Local Short Term TA	0	400	0	0	0	0	400
b. Local Long Term TA	0	540	0	0	0	0	540
c. Expatriate Short Term TA	723	0	0	0	0	0	723
d. Expatriate Long Term TA	1,942	165	0	0	0	0	2,107
2. Privatization Unit Staff, Equipment and Facilities	200	50	0	4,000	0	0	4,250
3. Policy/Operational Studies	270	265	0	0	0	0	535
	3,135	1,420	0	4,000	0	0	8,555
B. Capital Markets							
1. General Contractor/CMDWG	1,100	330	0	50	0	0	1,480
2. Training/Seminars Observation Tours	100	25	0	50	0	50	225
3. Capital Market Conference	9	16	0	10	0	13	48
4. Equipment/Commodities							
a. SEC	300	50	0	90	0	0	440
b. Stock Exchanges	400	50	0	0	0	115	565
5. PAIICO Technical Assistance	100	0	0	0	0	0	100
	2,009	471	0	200	0	178	2,858
C. Evaluation and Audit	200	50	0	0	0	0	250
Sub-Totals	5,344	1,941	0	4,200	0	178	11,663
Inflation	540	190	0	420	0	18	1,168
Contingency	300	185	0	231	0	10	726
TOTALS	6,184	2,316	0	4,851	0	206	13,557

TABLE III-B

PROJECTIONS OF EXPENDITURES BY FISCAL YEAR
(US $000)

FISCAL YEAR	A.I.D. GRANT	GOP	PHIL. PRIVATE INVESTORS	TOTAL
88	2,040	950	35	3,025
89	2,981	950	35	3,966
90	1,214	950	35	2,199
91	614	900	35	1,549
92	436	450	38	924
Inflation	730	420	18	1,168
Contingencies	485	231	10	726
TOTALS	8,500	4,851	206	13,557

TABLE III-C

PROJECTION OF EXPENDITURES OF AID GRANT FUNDS
BY FISCAL YEAR AND BY PROJECT ELEMENT
(US $000)

ELEMENT	FISCAL YEARS 88	89	90	91	92	TOTAL
A. Privatization						
1. Technical Assistance						
a. Local Short Term TA	100	100	90	60	50	400
b. Local Long Term TA	100	240	100	50	50	540
c. Expatriate Short Term TA	208	200	130	115	70	723
d. Expatriate Long Term TA	531	650	528	308	90	2,107
2. Privatization Unit Staff, Equipment and Facilities	100	100	50	0	0	250
3. Policy/Operational Studies	200	150	130	55	0	535
B. Capital Markets						
1. General Contractor/CMDWG	676	676	26	26	26	1,430
2. Training/Seminars Observation Tours	0	65	60	0	0	125
3. Capital Market Conference	25	0	0	0	0	25
4. Equipment/Commodities						
a. SEC	0	350	0	0	0	350
b. Stock Exchanges	0	450	0	0	0	450
5. PAIICO Technical Assistance	100	0	0	0	0	100
C. Evaluation and Audit	0	0	100	0	150	250
Sub-Totals	2,040	2,981	1,214	614	436	7,285
Inflation						730
Contingency						485
TOTAL						8,500

B. Methods of Financing

The methods of financing to be followed by the contributors involved may be classified as follows:

1. Direct Payments - USAID may make direct payments to suppliers or contractors.

2. Reimbursement - Under the reimbursement method of financing, the GOP implementing agency or contractor disburses its own funds and is then reimbursed by USAID upon submission of appropriate documentation.

3. Advance/Liquidation - The advance/liquidation method of financing will be used when appropriate. Liquidation will be based on actual costs. This method will be designed to ensure that the entity receiving the advance will have adequate cash flow to carry out activities.

The maximum cash advance that USAID can give is for a 90 day cash requirement and will be subject to the Controller's approval. The request must show the monthly breakdown by line item as approved in the Implementation Plan or PIL.

The liquidation report must be treated as a separate report from the Request for Cash Advance. Liquidation of a previous cash advance is not necessary before USAID can grant an advance for the following quarter. However, USAID will not provide a third advance before the next-to-last cash advance has been liquidated.

Methods of Implementation and Financing

Inputs	Methods of Implementation	Methods of Financing	Amount
1) Technical assistance	AID direct contract	Direct Payment	$5,325
	Host country contract	Direct payment/ reimbursement	
2) Policy studies	AID direct contract	Direct Payment	535
	Host country contract	Direct payment/ reimbursement	
	Host country contract	Advance/ liquidation	
3) Training/Seminars	AID direct contract	Direct payment	125
	Host country contract	Direct payment/ reimbursement	
	Host country contract	ADvance/ liquidation	
4) Commodities	AID direct procurement	Direct payment	1,050
	Host country procurement	Direct payment/ reimbursement	
	Host country procurement	Advance/ liquidation	

Inputs	Methods of Implementation	Methods of Financing	Amount
5) Evaluation/Audit	AID Direct Contract	Direct Payment	250
6) Inflation			730
7) Contingency			485

C. Flow of Funds

a. GOP Implementing Agencies

Prior to the project's inclusion in the GOP's General Appropriation's Act, the project will utilize the advance/liquidation method of financing.

Accordingly, the reimbursable payment method is not possible until the agencies' Work and Financial Plan is reviewed and approved by the Department of Budget and Management (DBM). Once approved, DBM will issue Advices of Allotment (AAs). The GOP agencies will submit copies of said AAs and annual implementation plans (IP) to USAID. Upon USAID's approval of the IP, the GOP may submit to USAID requests for cash advances or finance an activity included in the IP out of GOP funds and subsequently request for reimbursement from USAID.

b. USAID

Once funds are obligated for the project, earmarking, commitment and disbursement will follow depending on the project's pace of activity. Flow of USAID funds will be subject to standard rules and regulations.

IV. Implementation Arrangements

A. Implementing Entities

AID and the National Economic and Development Authority (NEDA) will execute the Project Grant Agreement.

1. Privatization

Primary oversight for the privatization component of the project will be the responsibility of the Department of Finance (DOF). The Secretary of Finance is the Chairman of the Committee on Privatization (COP), and an Undersecretary of Finance is Chairman of the COP's Technical Committee. Thus, the Office of the Undersecretary of Finance will coordinate USAID assistance to the APT and asset disposal units (ADUs) of the GOCCs.

2. Capital Market Development

a. Capital Market Development Working Group

The primary implementing entity for the technical assistance element of the capital market development component will be the recently created Capital Market Development Working Group (CMDWG). The CMDWG is a mixed public and private sector body established under the sponsorship of the Secretary of Trade and Industry. The office of an Undersecretary of Trade and Industry serves as secretariat to CMDWG, and will be USAID's point of contact for project implementation.

The CMDWG will oversee the general contractor implementing the following: 1) activities to enhance the legal and regulatory framework; 2) the public media campaign; and 3) the capital markets conference. The CMDWG will also provide oversight for the training and observation tours mentioned in Sections II.B.2.b and II.B.2.c. above. AID may provide a limited amount of funding to the CMDWG for costs it incurs in its oversight role. Technical assistance and commodities for the SEC and stock exchanges will be provided directly to each of them. Technical assistance for accounting and auditing improvements will be provided directly to the Philippine Accounting Standards Council (PASC) and the Philippine Institute of Certified Public Accountants (PICPA.) Memoranda of Agreement delineating implementation responsibilities and procedures will be signed with the CMDWG, the stock exchanges, PASC and PICPA.

b. PAIICO

PAIICO operations will be outside the purview of the CMDWG. AID will contract directly to provide the technical assistance for the establishment of PAIICO.

B. Contracting Arrangements

Contracting will be either AID direct or host country, the latter in accordance with procedures set forth in AID Handbook 11. The eligible source/origin countries for services procured with project funds are the U.S. or the Philippines.

1. Privatization

a. Short-Term Local Technical Services

Indefinite Quantity Contracts (IQCs) will be established by the Technical Committee on Privatization (TCOP) for recurring short-term (no more than four months) local service needs by both the APT and the GOCC ADUs. At least two (2) local firms will be qualified as IQCs for short-term, as-needed services in each of the following categories:

- Information and Data Management;
- Legal Services; and
- Policy/Sector Specific/Operations Studies

The types of local firms to be qualified will include data management, legal, management consulting and architectural and engineering firms. AID Handbook 11 Host Country Contracting procedures will be utilized to procure the necessary services. USAID/Manila will approve the terms-of-reference, evaluation criteria, evaluation, selection of and contracts with each IQC for each category of services. The TCOP will issue basic ordering agreements against the IQCs based on the submission by the APT or GOCC of a detailed scope-of-work and budget for services. USAID will also approve each scope-of-work/budget for services requested and the basic ordering agreement, including IQC proposal, level-of-effort and cost, before its execution.

b. Long-Term Local Technical Services

Indefinite Quantity Contracts (IQCs) will be established by the Technical Committee on Privatization (TCOP) for long-term (extended period of more than four months) local services needs by both the APT and GOCC ADUs. These services will be restricted to privatization transactions for those relatively small assets of like character without foreign investment and technology transfer requirements. At least four (4) local firms will be qualified as IQCs to provide the full range of privatization services presented in Section II.B of this Project Paper. AID Handbook 11 Host Country Contracting procedures will be utilized to procure the necessary services. All of the USAID approval rights relative to the IQC itself and the subsequent basic ordering agreements to be issued against the IQCs will be followed.

c. Short-Term Expatriate Services

Short-term expatriate services will be procured on an AID-Direct basis. Based on the nature of the services required, USAID/Manila will buy-in to one of the several PRE-Bureau centrally funded contracts, such as:

- Privatization;
- Financial Markets; and
- Private Enterprise Development Support;

or buy-into an appropriate AID/W Indefinite Quantity Contract and/or Science and Technology Bureau centrally funded contract to procure the required services.

USAID will also utilize the International Executive Service Corp. (IESC) for specialized management or engineering services on both a prime or subcontract basis (See Annex L6.)

d. Long-Term Expatriate Services

Expatriate services will be procured on an AID-Direct contract institutional basis for long-term expatriate service needs by both the APT and GOCC ADUs. Such services will be utilized for those privatization transactions involving a sectoral grouping of primarily large assets requiring solicitations of foreign investment and/or technology transfer requirements. These services will also be available for the smaller, less complex sectoral groupings of assets, if desired by the APT and GOCC ADUs. These services will be procured through a buy-in to the PRE-Bureau financed Center for Privatization Contract. If the choice of firms that can be made available by the Center for Privatization is not satisfactory to the APT or relevant GOCC ADU, the AID Handbook 11 Host Country Contracting procedures will be utilized to procure the requisite services. Wherever possible, IESC will be utilized on a prime or subcontractor basis to provide needed services.

The services provided will be for the full range of privatization requirements from the initial legal services, valuation, prospectus preparation to issuance of the fairness statement or opinion to the closing services. An investment banking firm will be the lead firm with other specialized firms on both an expatriate and local basis participating as subcontractors.

2. Capital Markets Component

a. Institutional Development Element

An umbrella AID-Direct "general contract" will most likely be the mechanism for procurement of technical services in this area. Due to the interrelated aspects of this element, services must be properly timed and coordinated. The Mission envisions a lead contractor and a consortium of subcontractors with specialized expertise in investment banking, securities law, securities financing, organizational behavior, stock exchange operations, accounting/auditing standards and advertising. The sources of these services may include the U.S. Securities and Exchange Commission, New York Stock Exchange, American Institute of Certified Public Accountants and the National Association of Accountants. The Mission anticipates buying into the PRE-Bureau's Capital Markets Development or Financial Markets Contracts to acquire these services.

b. PAIICO Element

An 8(A) or Minority Business Contractor will be procured on an AID-Direct contract basis to organize the PAIICO Investor's Promotion Group (IPG) and provide the IPG advisory services in the establishment and organization of PAIICO.

C. Training/Seminars/Observation Tours

1. Privatization

The information and data management training services identified in Section II.B of this Project Paper will be conducted by the IQC selected in accordance with AID Handbook 11 Host Country Contracting procedures, as an element of the short-term technical services discussed in Section II.B.

2. Capital Markets

The development of a training plan that will involve formal course training, seminars and third country observation tours, will be the responsibility of the Capital Markets Development General Contractor in coordination with the CMDWG. Training, seminar, and observation tours will be arranged by the General Contractor.

D. Commodity Procurement

The project will fund the acquisition of computer hardware equipment and associated installation services, training, spare parts, etc. for the APT, selected GOCCs, the SEC and stock exchanges, and other commodities for the stock exchanges. Eligible source/origin countries for project-funded goods are the U.S. and the Philippines. A procurement services agent will be utilized to procure commodities from the U.S. However, consideration will be given to procuring U.S. manufactured computer equipment from local firms, to ensure the availability of maintenance, spare parts and warranty service.

E. Monitoring

Monitoring progress in the area of privatization will be the responsibility of the Office of the Undersecretary of Finance. That office will submit quarterly reports to USAID.

The secretariat of the CMDWG in the office of the concerned Undersecretary of Trade and Industry will be responsible for monitoring progress in activities related to the development of the capital markets (excluding PAIICO) and will submit quarterly reports to USAID.

F. USAID Project Management

Project management will be the responsibility of the Office of Capital Development (OCD). The OCD project officer will spend approximately 30% of his/her time on the project. A foreign services national (FSN) project assistant with financial markets expertise will be recruited and will spend approximately 75% of his/her time on the project. The OCD Project Officer will draw upon assistance from other members of the project committee as needed, including the Office of the Program Economist, Controller, and Legal Counsel.

Regular reviews of progress involving senior Mission management will be held quarterly. If problems surface relative to achieving the project's purpose, these reviews will be followed by meetings involving senior Mission and implementing agency management, as necessary.

G. Implementation Plan

Following is a schedule of project implementation milestones:

1. General

Action	Month/Year	Responsible Entity
FY 1987		
- Authorization of project	Sept. 1987	USAID
- Obligation of FY 87 funds	Sept. 1987	USAID/NEDA
FY 1988		
- Satisfaction of Initial CPs	Dec. 1987	NEDA, DOF, DTI, SEC
FY 1990		
- Project Mid-Term Evaluation	March 1990	USAID/Consultants
FY 1992		
- Final Evaluation	Sept. 1992	USAID/Consultants
FY 1993		
- PACD	Dec. 1992	

2. Privatization Component

FY 1988

- Submit complete list of GOCCs approved for Privatization, identifying those to participate in the project	Oct. 1987	DOF
- Submit one year APT Work Plan	Nov. 1987	DOF, APT
- Submit one year Work Plans for GOCCs	Jan. 1988	DOF, GOCCs
- Local TA IQCs Executed	Feb. 1988	USAID/DOF
- Expatriate TA PIO/Ts Executed	Throughout FY 1988	DOF, USAID
- APT/GOCC Work Plans Executed thru Basic Ordering Agreements and AID-Direct Contracts	Throughout FY 1988	DOF, APT, GOCCs, USAID
- Equipment Procurement plans submitted for APT and selected GOCCs	March 1988	DOF, APT
- Equipment Procured by Procurement Services Agent (PSA)	April 1988	USAID
- Equipment Delivered, Installed and Training Conducted at APT	June 1988	APT, USAID

FY 1989

- Equipment Procurement Plans Submitted for Selected GOCCs	March 1989	DOF, GOCCs
- Equipment Procured by PSAs	March 1989	USAID
- Equipment Delivered, Installed and Training Conducted at GOCCs	Jun-Aug. 1989	GOCCs, USAID
- One year Work Plans submitted by APT and GOCCs for 1989	Dec. 1988	DOF, APT, GOCCs
- APT/GOCC Work Plans Executed thru Basic Ordering Agreements and AID-Direct Contracts	Throughout FY 1989	GOCCs, USAID DOF, APT

FY 1990

- One year Work Plans submitted by APT and GOCCs	Dec. 1989	DOF, APT, GOCCs

- APT/GOCC Work Plans executed thru Basic Ordering Agreements AID-Direct Contracts	Throughout FY 1990	DOF, APT, GOCCs USAID
FY 1991		
- One year Work Plans submitted by APT and GOCCs	Dec. 1990	DOF, APT, GOCCs
- APT/GOCC Work Plans executed thru Basic Ordering Agreements and AID-Direct Contracts	Throughout FY 1991	DOF, APT GOCCs, USAID

3. Capital Market Component

FY 1988		
- Evidence submitted formally establishing the CMDWG	Oct. 1987	DTI, DOF
- Memorandum of Understanding between CMDWG and DTI, stock exchanges and DTI, and PASC/PICPA and DTI	Nov. 1987	DTI, CMDWG, Stock Exchanges, PASC/PICPA
- Capital Market Conference. Held	Nov. 1987	CMDWG
- General Contractor PIO/T Executed	Jan. 1988	DTI, DOF, SEC USAID, CMDWG
- General Contractor Contract Executed	April 1988	DTI, DOF, SEC, CMDWG, USAID
- Public Media Campaign Plan Submitted	Aug. 1988	General Contractor, CMDWG
FY 1989		
- Public Media Campaign Launched	Oct. 1988	General Contractor, CMDWG
- Legal Reviews/Audits Completed	Oct. 1988	General Contractor, SEC, CMDWG
- SEC Organizational Assessment Completed	Oct. 1988	General Contractor SEC
- Stock Market Review Completed	Oct. 1988	General Contractor, SEC, CMDWG
- Equipment/Commodities Procurement Plans Submitted for the SEC and Stock Exchange	Nov. 1988	General Contractor, CMDWG

- One Year Training Plans Submitted for GOP and Securities Industry Training	Nov. 1988	General Contractor, CMDWG
- Draft Policies/Procedures/ Regulations Completed, Approved by SEC/Stock Exchanges/PASC/PICPA	Jan. 1989	General Contractor, CMDWG, SEC, Stock Exchanges, PASC, PICPA
- Draft Legislation Completed, Approved by Executive Branch Submitted to Congress	Jan. 1989	General Contractor, CMDWG
- Training Plans Executed	Jan. 1989	General Contractor, CMDWG, USAID
- SEC and Stock Exchange equipment/commodities procured by Procurement Services Agent	Jan. 1989	General Contractor, SEC, Stock Exchanges, USAID
- Equipment/commodities installed, training conducted at the SEC and stock exchanges	June 1989	SEC, Stock Exchanges, USAID

FY 1990

- One Year Training Plans Submitted for GOP and Securities industry training	Jan. 1989	CMDWG, USAID

4. PAIICO

FY 1988

- TA contract for identification and organization of Investor's Promotion Group (IPG) executed	Nov. 1987	USAID
- IPG identified and organized	Jan. 1988	TA Contractor
- PAIICO Business Plan Completed	Jan. 1988	TA Contractor

V. Evaluation Plan and Audit

The proposed project consists of two relatively discrete but interrelated components: privatization, and development of capital markets. Each component has its own underlying objectives and implementation scheme.

As a response to this approach, the evaluation scheme, which is designed both to help management identify constraints to implementation and determine impact, will need two assessments scheduled through the project life. Of these, one is a process evaluation and the other an impact evaluation.

A. Process Evaluation

The process evaluation is scheduled in March 1990. It will focus on performance of and constraints to implementation of the privatization efforts and the development of capital markets. Since both components are designed to lay the foundation and structure for privatization activities and growth of capital markets, the evaluation should investigate whether the services and institutions are in place and performing as expected. It will look at the interactions between and among all institutions involved in implementation and assess the adequacy or inadequacy of support provided. The evaluation should also include an assessment of the effects of reported reluctance to lose family control of firms on the growth of capital markets. As a process evaluation it must be designed to identify constraints to progress as a tool for improved project management. USAID staff and external consultants, including GOP personnel and private sector representatives, will conduct the evaluation.

B. Impact Evaluation

The final evaluation will include an assessment of all components. It will determine if each component has had effects on its respective beneficiaries, direct and indirect. It should focus not only on the need to determine effects of the project but also provide management guidance to agencies and institutions which will have responsibility for the project after PACD. Thus, the impact evaluation should have a process component to determine constraints to implementation. External consultants as well as USAID staff should participate in the evaluation.

C. Audit

Primary responsibility for audits of AID-funded projects lies with the Regional Inspector General's Office. In the event, however, that the RIG is unable to carry out the audit activities, an external auditing firm will be contracted for the purpose. The amount budgeted for nonfederal audit services is $50,000.

VI. Summaries of Project Analyses

A. Economic Analysis

The economic analysis discusses the economic viability of the project's two components, demonstrating their economic merits through cost effectiveness and alternative economic rate of return analysis. The project's approach is found to be cost effective because of factors including the GOP's schedule for privatization and the nature of capital markets development issues. The required minimum levels of benefits in relation to possible improvements in corporate income, speeding-up effect on the privatization program, savings mobilization, and increased long-term capital financing are found to be easily achievable.

B. Financial Analysis

The financial analysis assesses the financial worthwhileness of the privatization component. It is demonstrated that the GOP should be able to realize easily financial proceeds at least equal to the financial cost of privatization plus the capitalized value of future net earnings that might be received minus liabilities.

C. Social Soundness

The social soundness analysis examines the constraint to project success posed by the strong tradition of the family firm in the Philippines. It describes the nature of family firm, the concerns and attitudes of owners, and the family firm's goals and objectives as they affect the growth and development of capital markets. The social soundness statement concludes that while the project will not be able to cause radical change in behavior and attitudes, it will provide the foundation for an enhanced decision-making environment. In the end, the profit motive will have to provide the impetus for change.

D. Administrative Analysis

The administrative analysis assesses the capability of the principal implementing agencies to implement the project. Within the privatization component, the Department of Finance (DOF) and the asset disposal units will be the primary agents. The choice of DOF is examined and upheld, and the involvement of the asset disposal units is justified both on the basis of institution-building, and because of the critical role they play in the privatization process. The principal actors involved in the capital markets component will be the CMDWG, the Capital Markets Development Commission (if formed), the Securities and Exchange Commission and various private sector entities, including the stock exchanges, stockbrokers, investment houses, universal banks. It is recommended that the CMDWG serve as the lead implementing entity.

E. Technical Analysis

The technical analysis presents the technical rationale for selecting the project's components and determing its approach. The GOP has stated its goal of reducing the burden of acquired assets and public corporations on the national budget and demonstrated its political will to execute its privatization program to achieve this goal. In deliberating how AID could be of assistance to the GOP in this area, a number of alternative were considered, including providing:

- working capital credit to the private sector purchasers of the GOCCs and acquired assets;
- term credit facilities for the private sector purchase of GOCCs and acquired assets;
- technical assistance to the GOP in the execution of its Public Sector Corporate Rationalization Program; and
- technical assistance to the GOP in the execution of its "Privatization Program."

The latter was chosen as the most appropriate option. The elements of the project's privatization component are based on the objectives of the privatization program, the degree of sophistication of the Philippine market and the structural layout of the sectors to be privatized.

The Mission adopted an operational approach to providing assistance to the GOP and private sector for capital market development. Legal reviews/audits will be conducted to formulate recommendations for change; the SEC will be examined and recommendations/action plan developed; the stock exchanges will be professionalized and reorganized; TA to the accounting/auditing profession will provide for uniform accounting and auditing principles and standards; and a public media campaign will be undertaken to educate the corporate sector and the public on capital market development. The project will also partially finance a conference to highlight capital market development as a top priority of the GOP. Finally, training, seminars, and observation tours will be provided to enhance the professional capabilities of the securities industry.

VII. CONDITIONS PRECEDENT AND COVENANTS

The following are the conditions precedent and covenants A.I.D. intends to negotiate in the Project Agreement. Their substance is not expected to change during agreement negotiations.

A. Condition Precedent to Initial Disbursement

Prior to first disbursement of A.I.D. project assistance, or the issuance by A.I.D. of documentation pursuant to which the first disbursement will be made, the GOP shall furnish A.I.D., except as A.I.D. may otherwise agree in writing, in form and substance satisfactory to A.I.D.:

1. An opinion of counsel acceptable to A.I.D. that the Project Agreement has been duly authorized and/or ratified by and executed on behalf of the GOP and that it constitutes a valid and legally binding obligation of the GOP in accordance with all of its terms;

2. A statement of the names of the persons authorized to represent the GOP for implementation of the Project and of any additional representatives together with a specimen signature of each person;

B. Condition Precedent to Disbursement for Privatization Technical Assistance to the Asset Privatization Trust

Prior to disbursement of A.I.D. project assistance, or to the issuance by A.I.D. of documentation pursuant to which such disbursements will be made for, respectively, (1) Local Long-Term Technical Assistance; (2) Expatriate Short-Term Technical Assistance; and (3) Expatriate Long-Term Technical Assistance, the GOP shall, except as AID may otherwise agree in writing, furnish to AID in form and substance satisfactory to AID:

(i) A one-year work plan, developed by the APT, specifying the type and magnitude of assistance required to execute its privatization responsibilities; and

(ii) A signed and executed Indefinite Quantity Contract with respect to item (1) above, and approval in writing by the duly authorized representative of the Department of Finance for the Project of an AID Project Implementation Order for Technical Services ("PIO/T") with respect to items (2) and

(3) above authorizing A.I.D. to procure under an A.I.D. direct contract financed under the Grant a contractor to provide for such activity.

C. Condition Precedent to Disbursement for Privatization Technical Assistance to the Government Owned and Controlled Corporations (GOCCs)

Prior to disbursement of AID project assistance or to the issuance by AID of documentation pursuant to which such disbursements will be made for, respectively, (1) Local Long-Term Technical Assistance; (2) Expatriate Short-Term Technical Assistance; and (3) Expatriate Long-Term Technical Assistance, the GOP shall, except as AID may otherwise agree in writing, furnish to AID in form and substance satisfactory to AID:

(i) A one-year work plan, developed by each GOCC for which technical assistance will be provided, specifying the type and magnitude of assistance required to execute its respective privatization responsibilities; and

(ii) Signed and executed by the Department of Finance an Indefinite Quantity Contract with respect to item (1) above and, approval in writing by the duly authorized representative of the Department of Finance for the Project of an AID "PIO/T" with respect to items (2) and (3) above authorizing AID to procure under an AID Direct contract financed under the Grant a contractor to provide for such services.

D. Condition Precedent to Disbursement for Equipment Under the Privatization Component

Prior to disbursement of AID Project Assistance or to the issuance by AID of documentation pursuant to which such disbursements will be made for the procurement of equipment for the APT and selected ADUs, the GOP shall furnish to AID, except as AID may otherwise agree in writing, in form and substance satisfactory to AID:

(1) An equipment procurement plan specifying, in detail, the need for the equipment, equipment specifications, and a reasonable cost estimate for the equipment; and

(2) Approval in writing by the duly authorized representative of the DOF for the Project of an AID PIO/T authorizing A.I.D. to procure under an AID direct contract financed under the grant a Procurement Services Agent to procure the equipment for purposes of the Project.

E. Condition Precedent to Disbursement for the Institutional Development and Technical Assistance Elements of the Capital Markets Development Component

Prior to the disbursement of AID project assistance or the issuance by AID of documentation pursuant to which such disbursement will be made for the institional development and technical assistance elements, the GOP shall furnish to AID except as AID may otherwise agree in writing, in form and substance satisfactory to AID:

(1) Evidence of the formal establishment and designation of the staff of the Capital Markets Development Working Group (CMDWG), including designation of its head;

(2) A Memorandum of Understanding between the CMDWG and Department of Trade and Industry (DTI) detailing the responsibilities of CMDWG in the implementation of the Capital Markets Component and assistance to be provided CMDWG under this Project.

F. Condition Precedent to Disbursement for Training/Seminars/ Observation Tours for the Capital Markets Component

Prior to the disbursement of AID project assistance or the issuance by AID of documentation pursuant to which such disbursement will be made for training, seminars and observation tours, the GOP shall furnish to AID except as AID may otherwise agree in writing, in form and substance satisfactory to AID:

(1) An annual training plan encompassing the training needs for the involved GOP agencies based on the recommendations of the long-term Institutional Development Contractor; and

(2) In coordination with the CMDWG, an annual training plan encompassing the training needs for the involved private sector entities based on the recommendations of the long-term Institutional Development Contractor.

G. Condition Precedent to Disbursement for Equipment under the Capital Markets Component

Prior to disbursement of AID Project Assistance or to the issuance by AID of documentation pursuant to which such disbursements will be made for the procurement of equipment, the GOP shall furnish to AID, except as AID may otherwise agree in writing, in form and substance satisfactory to AID:

(1) An equipment procurement plan based on the recommendations of the long-term Institutional Development Contractor specifying, in detail, the need for the equipment, equipment specifications, and a reasonable cost estimate for the equipment; and

(2) Approval in writing by the duly authorized representative of the DTI for the Project of an AID PIO/T authorizing AID to procure under an AID direct contract financed under the grant a Procurement Services Agent to procure the equipment for purposes of the Project.

H. Condition Precedent to Disbursement for Equipment for the Stock Exchange under the Capital Markets Component

Prior to disbursement of AID Project Assistance or to the issuance by AID of documentation pursuant to which disbursements will be made for the procurement of equipment for a stock exchange, the GOP will furnish to AID, except as AID may otherwise agree in writing, in form and substance satisfactory to AID:

(1) A signed agreement effectuating the merger of the Makati and Manila Stock Exchanges; and

(2) The establishment of facilities to operate the Manila and Makati stock exchanges as a merged entity and commencement of operations as a merged entity pursuant to the agreement.

I. Covenants

The General Covenants in the Project Grant Standard Provisions Annex as prescribed by A.I.D. Handbook 3 will be included in the Project Grant Agreement. In addition, the following covenants shall be included:

1. Project Evaluation. A.I.D. and the GOP agree to establish an evaluation program as an integral part of the Project. Except as the parties may otherwise agree in writing, the program will include, during the implementation of the Project and at one or more points thereafter;

   a. evaluation of progress toward attainment of the objectives of the Project;

   b. identification and evaluation of problem areas or constraints which may inhibit such attainment;

   c. assessment of how such information may be used to help overcome such problems; and

   d. evaluation, to the degree feasible, of the overall development impact of the Project.

2. The GOP agrees to give due consideration to and to consult with AID in connection with actions proposed by the technical assistance/General Contractors/Study Consultants relating to the findings and recommendations of:

   a. the comprehensive report to be issued providing the findings, conclusions, and recommendations on legislation required and revisions/changes needed in rules/regulations/procedures of the responsible GOP Departments/Agencies; draft legislation/regulations/procedures/rules; and the Action Plan for implementing the recommendations made;

   b. the Action Plan for the reorganization and reorientation of the SEC;

   c. the Action Plan for the reorganization and reorientation of the stock exchanges.

ANNEX A1

[Following is the text of a letter from the National Economic and Development Authority (NEDA), Government of the Philippines, to USAID/Manila. Text was received in AID/Washington by cable (Manila 28514) on September 9, 1987.]

3 September 1987

Mr. Frederick W. Schieck
Director
USAID Mission
Ramon Magsaysay Center
Roxas Blvd., Manila

Dear Fred:

Following several discussions on the design of the Financial Resources Mobilization Project, we wish to request USAID to provide the necessary assistance to the Government to implement said Project.

The Project is envisioned to assist the Government in its ongoing privatization program, improve the capability of the capital markets to mobilize equity investment and establish a turnaround company, the Philippine Agribusiness Industrial and Investment Company (PAIICO). In general, these objectives are consistent with existing national policies although the mechanics of setting up PAIICO as well as other project subcomponents will have to be more thoroughly discussed with concerned Government agencies as well as the private sector.

We hope that with this request we can proceed to finalize the Project details and to resolve the remaining issues before concluding the Project Agreement.

Sincerely,

Solita Collas-Monsod
Secretary of Economic Planning
NEDA Director-General

ANNEX A2

REPUBLIC OF THE PHILIPPINES
MINISTRY OF FINANCE
Securities and Exchange Commission
SEC BLDG., EDSA, GREENHILLS
MANDALUYONG, METRO MANILA

August 20, 1987

MR. KEITH E. BROWN
Chief Office of Capital Development
US Agency for International Dev.
18th Floor, R. Magsaysay Center
Roxas Blvd., Manila

Dear Mr. Brown:

I have gone over the draft copy of the paper on your financial resources mobilization project, more particularly the component on capital market development. I would like to express at the outset our sincerest appreciation for the concern of USAID in the development of the Philippine capital market.

As I mentioned to you during our conversation last August 18, there is an urgent need to review not only the structure and functions of SEC but more importantly the legislations and regulations which the SEC implements.

We are particularly concerned with the development of equity securities, a subject matter your draft paper focused on with emphasis on strengthening the stock market.

Your proposed technical assistance in the training of the staff of the SEC as well as the procurement of computer hardware will be most helpful in carrying out our functions.

We are specifically interested in a developmental thrust for the SEC, a departure from its present regulatory posture.

We look forward to hearing from you again.

Very truly yours,

MONICO V. JACOB
Associate Commissioner

ANNEX A3

REPUBLIKA NG PILIPINAS
MINISTRI NG PANANALAPI
MAYNILA

August 20, 1987

Mr. Keith Brown
Agency for International Development
Magsaysay Building
Roxas Boulevard, Manila

Dear Mr. Brown:

In accordance with our recent telephone conversation, I wish to confirm that the Department of Finance supports the project concept of your Financial Resources Mobilization project.

The Department of Finance shall be prepared to carry out the coordinating role for the privatization component.

Very truly yours,

EDGARDO M. DEL FONSO
Undersecretary

REPUBLIKA NG PILIPINAS
MINISTRI NG PANANALAPI
MAYNILA

October 28, 1986

Mr. Frederick W. Schieck
Director, Agency for
International Development
Manila

Re: Capital Market Development Project

Dear Sir:

On behalf of Minister Ongpin, I am writing to acknowledge receipt of the draft report on Capital Market Development in the Philippines and to request that an action program be developed to implement a capital market development project.

We have found the draft report to be broad and comprehensive, covering a wide range of significant issues and problems. We understand that the report was written during the time when circumstances were changing and the interest of the government in capital market development had not been clearly expressed to you. Accordingly, we suggest that a revised report consider the views of the present Administration on the issues described in the report as a first step in the capital market development project. The revised report should reflect recent developments and policy thrusts which deal with some of the issues raised in the report, such as privatization initiatives and reform of government financial institutions.

Initially, we believe that a period of four to six weeks of work with Mr. Reilly and ourselves will be needed for the completion of the revised report which would be the basis of a suggested action program. During this period, discussions will be held with other relevant government agencies and other interested parties to gain a consensus on the priorities and specific areas of action.

Following completion and acceptance of the revised report, we would expect to address promptly the implementation of the suggested action program.

In conclusion, I confirm on behalf of Minister Ongpin that the government does wish to undertake a capital market development program with US AID assistance covering the full range of problems raised in the draft report and others as appropriate. Therefore, I request that you initiate the appropriate procedures within US AID to develop and finance a capital market development project for the Philippines.

Very truly yours,

Edgardo M. Del Fonso
Deputy Minister

MANILA STOCK EXCHANGE
MANILA, PHILIPPINES

RECEIVED
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March 12, 1986

US Agency for International Development
Ramon Magsaysay Center
Roxas Bldg., Manila

Attention: Mr. Frederick W. Scnieck
Director

Gentlemen:

This is to request for a meeting with your good office to initially explore the possibility of how our stock exchanges can avail of the assistance of your agency in connection with the initiated effort to revitalize the Philippine capital market.

For your information, I had the opportunity to briefly discuss with the members of your staff on this matter during the ADB sponsored symposium on Capital Market Development in the Asia-Pacific Region held last January 14 to 16, 1986. But due to the then impending presidential elections scheduled last February 7th, formal effort was deferred to pursue the matter. Shortly, thereafter, events further prevented us to pursue the same.

Last Friday, March 7, 1986, however, we had our elections at the Manila Stock Exchange wherein I was re-elected as president affording me another term of office to pursue this important project. Moreover, I feel very confident that our new government will be supportive to this effort.

I will greatly appreciate the advise of your office by giving us a call soonest.

Very truly yours,

ROBERT COYIUTO, JR.
President

/cmr

ACTION TAKEN

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USAID

26 August 1986

Mr. Frederick W. Schieck
Director
U. S. Agency for International Development
Ramon Magsaysay Center
1680 Roxas Boulevard
M a n i l a

Dear Fred,

ACTION
DATE
6-26

Thank you for the Memorandum on Privatization prepared by First Boston Corporation. By way of reaction, I would like to give you the following comments:.

1. In general, what I found new and especially interesting was that the Memorandum dealt extensively with work programs, i.e. the actual operating stages involved in privatization. In contrast, most of our other discussions on privatization have concentrated on organization rather than operations. First Boston's suggestions are obviously based on working experience and will certainly be considered when we implement our privatization program.

2. The Memorandum expresses some concern about the treatment of foreign investment. With respect to privatization, we do not intend to impose restrictions on foreigners over and above what is already provided by existing laws, nor will we extend foreigners incentives which are not available to Filipinos. Incidentally, contrary to the Memorandum's supposition, we have received foreign inquiries on simple portfolio investment rather than majority ownership.

3. I would like to suggest a follow-on to this Memorandum, which would be very helpful in speeding our privatization effort. A privatization operation of the sort described in the Memorandum would be warranted only for corporations which could be sold as going concerns requiring restructuring only with respect to debt and organization, i.e. not rehabilitation; I also have the impression that this would apply only to a relatively small number of corporations. However, there has not been a systematic examination of the total set of privatizable corporations to identify this group and give impartial valuations. Such an identification and valuation would obviously be very helpful

ACTION TAKEN
Date
No.
Initials 1512

ISANG BANSA, ISANG DIWA, ISANG WIKA

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in indicating potential markets and in designing the privatization organization. If you think a grant for this purpose would be feasible, I would be happy to discuss the matter at your convenience.

With best personal regards,

Yours sincerely,

JAIME V. ONGPIN
Minister

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USAID/C&R

ACTION COPY

Action Taken:
No action necessary:
7/6/87 Inits: K Brown

AIDAC

E.O. 12356: N/A
TAGS: N/A
SUBJECT: FINANCIAL RESOURCES MOBILIZATION PROJECT
(492-0377)

1. THE PROJECT COMMITTEE REVIEWED THE SUBJECT PID 28 MAY. BASED ON THE PC'S RECOMMENDATIONS, THE AA/ANE APPROVED THE PID AND AUTHORIZED THE MISSION TO DEVELOP A PROJECT PAPER SUBJECT TO THE GUIDANCE OUTLINED BELOW.

2. SCARCITY OF 106 FUNDS: MISSION PLANS TO USE 106 MONEY FOR ALL OR MOST PROJECT FUNDING COULD RUN INTO SERIOUS DIFFICULTY GIVEN THE INCREASING SCARCITY OF THESE FUNDS IN THE BUREAU. (SECTION 106 FUNDS HAVE DECLINED FROM DOLS 40 MILLION IN FY 85 TO DOLS 15 MILLION IN FY 87.) BECAUSE THIS SITUATION IS UNLIKELY TO IMPROVE AND MAY DEGENERATE, THE MISSION IS ENCOURAGED TO DEVELOP STRATEGIES FOR USING OTHER FUNDS. FOR EXAMPLE, THE MISSION MIGHT IDENTIFY RURAL AND AGRIBUSINESS ELEMENTS OF THE PROJECT TO PERMIT THE MAXIMUM USE OF 103 FUNDS. SIMILARLY, EDUCATION RELATED ACTIVITY (E.G. TRAINING, SEMINARS, EQUIPMENT, ETC.) MIGHT BE FINANCED WITH 105 FUNDS. FURTHER, EVERY EFFORT SHOULD BE MADE TO USE PL-480 OR PRE FUNDS FOR THE CAPITALIZATION. IN THIS REGARD, MISSION SHOULD PURSUE DISCUSSIONS WITH PRE ON POSSIBLE TRANSFER OF SECTION 103 (OR OTHER) FUNDS INTO SECTION 108 REVOLVING FUND AS ONE MEANS TO HELP FINANCE THIS PROJECT.

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3. LINKING THE TURN-AROUND COMPANY (TAC) AND PRIVATIZATION: THE PID INDICATES THAT THE TAC WILL INCLUDE FIRMS ACQUIRED FROM THE GOVERNMENT AND PRIVATELY OWNED FINANCIALLY DISTRESSED COMPANIES. HOWEVER, THERE IS NO INDICATION THAT THE TAC WOULD BE FORMALLY COMMITTED TO PRIVATIZING PUBLICLY OWNED COMPANIES AS A CONDITION TO RECEIVING AID SUPPORT. IT IS POSSIBLE THAT WITHOUT SOME FORMAL COMMITMENT, NO GOVERNMENT OWNED COMPANIES WOULD BE INCLUDED. THEREFORE, SHOULD AID SUPPORT BE TIED TO A FORMAL COMMITMENT? THE PP DESIGN TEAM SHOULD ASSESS THE NEED FOR AND PROBABLE RESULTS OF CONDITIONING AID SUPPORT TO A COMMITMENT BY THE TAC TO INCLUDE FIRMS ACQUIRED FROM THE GOVERNMENT IN ITS

PORTFOLIO AS A MEANS TO HELP FACILITATE PRIVATIZATION.

4. SPONSORS FOR TAC: IT IS UNCLEAR WHETHER MISSION HAS YET IDENTIFIED SPECIFIC INVESTOR INTEREST IN THE TAC. SINCE ITS VERY EXISTENCE HINGES ON THE WILLINGNESS OF CREDIBLE AND QUALIFIED PRIVATE ENTREPRENEURS TO INVEST IN IT, THE PP DESIGN TEAM NEEDS TO DETERMINE BEFORE THE PROJECT IS AUTHORIZED (A) WHAT IS AN APPROPRIATE RATIO OF AID-TO-PRIVATE FUNDS FOR THE CAPITALIZATION OF THE TAC; AND (B) WHETHER THERE IS A CRITICAL MASS OF PRIVATE SPONSORS WILLING TO CAPITALIZE THE COMPANY AT THAT LEVEL.

5. AVAILABILITY OF MANAGEMENT TALENT: THE ULTIMATE DETERMINATION OF THE PROPOSED TAC'S VIABILITY WILL BE ITS SUCCESS IN IMPROVING THE MANAGEMENT AND PRODUCTIVITY OF FINANCIALLY SALVAGEABLE DISTRESSED FIRMS IN ITS PORTFOLIO. THE PID DOES NOT ADDRESS THE QUESTION OF WHETHER THERE IS SUFFICIENT TRAINED/EXPERIENCED MANPOWER AVAILABLE (E.G. PERSONNEL, OPERATIONS AND FINANCIAL MANAGERS, ACCOUNTANTS, MARKETING SPECIALISTS, ETC.) WHICH THE TURN-AROUND COMPANY COULD ACCESS TO ANALYZE AND TO CORRECT THE PROBLEMS OF AILING COMPANIES. IF SUCH A CADRE DOES NOT EXIST, COULD IT BE DEVELOPED BY OUTSIDE EXPERTS WITHIN THE PROJECT LIFE? THE PP SHOULD IDENTIFY THE TYPE OF SKILLS AND OTHER QUALIFICATIONS NEEDED AND THE TIMEFRAME WITHIN WHICH THEY WILL BE REQUIRED, ASSESS THE AVAILABILITY OF QUALIFIED PEOPLE WITH THOSE SKILLS, AND TO THE EXTENT THAT GAPS ARE IDENTIFIED, HOW THOSE GAPS WILL BE FILLED.

6. EXPANDING THE ROLE OF THE SEC: THE PID INDICATES THAT IN ADDITION TO IMPROVING THE SEC'S CAPACITY TO CARRY OUT ITS EXISTING REGULATORY FUNCTIONS, THE PROJECT WILL DEVELOP ITS CAPACITY TO PROMOTE DEVELOPMENT, I.E. TO TAKE AN ACTIVE ROLE IN EVALUATING THE IMPEDIMENTS TO CAPITAL MARKET DEVELOPMENT AND TAKE ACTIONS NEEDED TO STIMULATE THAT DEVELOPMENT. THE PP SHOULD DISCUSS MORE FULLY WHAT THE DEVELOPMENT FUNCTION INVOLVES AND ITS COMPATIBILITY WITH THE SEC'S REGULATORY FUNCTION AND INSTITUTIONAL HISTORY AND EXPERIENCE OF THE SEC, AS WELL AS ASPECTS OF THE POLITICAL ENVIRONMENT, WHICH MIGHT BE RELEVANT IN PREDICTING THE SUCCESS OF PROJECT EFFORTS FOR SEC CHANGE.

7. GOP SENSITIVITIES TO AID INVOLVEMENT IN PRIVATIZATION: THE PID SUGGESTS A KEY ROLE FOR AID IN THE PRIVATIZATION PROCESS, INCLUDING FINANCING U.S. AND FILIPINO TECHNICAL ADVISORS TO THE DISPOSAL UNITS. GIVEN THE POLITICALLY SENSITIVE NATURE OF PRIVATIZATION, WILL THE GOP FEEL FREE TO USE U.S. OR FILIPINO CONSULTANTS FINANCED BY THE PROJECT? ALTHOUGH AN UNEQUIVOCAL ANSWER TO THIS QUESTION BY

PP SHOULD PROVIDE EVIDENCE THAT SUFFICIENT GOP ACCEPTANCE EXISTS FOR AID-FUNDED TECHNICAL ASSISTANCE IN SUPPORT OF THE PRIVATIZATION PROCESS.

8. MISSION MANAGEMENT CAPACITY: BOTH THE PRIVATIZATION AND CAPITAL MARKET DEVELOPMENT COMPONENTS OF THE PROJECT INVOLVE MAJOR UNDERTAKINGS WITH VERY COMPLEX POLICY, INSTITUTIONAL, TECHNICAL AND, PARTICULARLY IN THE CASE OF PRIVATIZATION, POLITICAL ISSUES. THE PID CALLS FOR, AMONG OTHER THINGS, THE PROVISION OF A LARGE NUMBER AND WIDE RANGE OF LONG- AND SHORT-TERM SPECIALISTS AND THE ESTABLISHMENT OF NUMEROUS WORKING GROUPS INVOLVING BOTH PUBLIC AND PRIVATE SECTOR PARTICIPATION. CONTRACTING FOR AND MONITORING THESE SERVICES, AND PROVIDING POLICY, ADMINISTRATIVE AND TECHNICAL SUPPORT AS REQUIRED WILL BE LABOR-INTENSIVE AND WILL CALL FOR SKILLS WHICH THE MISSION MAY NOT INCLUDE ON ITS PRESENT STAFF GIVEN THE PRESSURES OF THE EXISTING WORKLOAD AND THE ADDITIONAL PRESSURES THAT WILL DEVELOP AS THE RURAL INFRASTRUCTURE PROJECT WITH ITS 4 MAJOR SUBPROJECTS COMES ON LINE, WILL THE MISSION BE ABLE TO PROVIDE THE EXPANDED SKILL REQUIREMENTS AND WORKLOAD GENERATED BY THIS PROJECT? ALTHOUGH BOTH COMPONENTS OF THIS PROJECT ARE INTER-RELATED, THEY DO NOT APPEAR TO BE INTERDEPENDENT. IF NOT, WOULD IT BE POSSIBLE AND DESIRABLE TO PHASE THE START-UP OF THE TWO ACTIVITIES, EITHER AS SEPARATE PROJECTS OR UNDER ONE UMBRELLA PROJECT? IF PHASING IS NOT FEASIBLE, IS IT POSSIBLE TO AUGMENT MISSION DIRECT

HIRE STAFF OR TO ADD ONE OR MORE PSC'S TO HELP MANAGE THE TWO COMPONENTS? THE PP SHOULD DISCUSS REQUIREMENTS RELATED TO THIS PROJECT IN DETAIL IN THE CONTEXT OF THE OTHER MISSION PROJECTS AND MISSION STAFFING PROJECTIONS, AND PROVIDE ASSURANCES THAT ADEQUATE AND APPROPRIATE MANPOWER WILL BE AVAILABLE WITHIN THE MISSION TO EFFECTIVELY MANAGE ALL COMPONENTS OF THE PROJECT.

9. THE IMPACT OF CULTURAL FACTORS: THE PID POINTS OUT THAT THE UNDERDEVELOPED AND UNDERUTILIZED CHARACTER OF PHILIPPINE FINANCIAL MARKETS IS DUE IN PART TO, QUOTE: AN EXTREMELY STRONG TRADITION OF FAMILY CONTROLLED AND FAMILY RUN COMPANIES AND A STRONG DISLIKE BY BUSINESSMEN OF DISCLOSURE AND OTHER REQUIREMENTS APPLICABLE TO PUBLICLY HELD COMPANIES. UNQUOTE. HOWEVER, THE PID DOES NOT INDICATE HOW THE PROJECT WILL ADDRESS SUCH FIRMLY ESTABLISHED TRADITIONS AND ATTITUDES. THE PP SHOULD DISCUSS IN DETAIL THE NATURE OF THIS TRADITIONAL SYSTEM, THE FACTORS UNDERLYING ITS EXISTENCE, HOW THE PROJECT WILL ADDRESS THOSE FACTORS, AND WHY THE PROJECT DESIGNERS BELIEVE THE PROJECT WILL CHANGE IT.

10. PREVIOUS EXPERIENCE: THE PID SHOULD DISCUSS PAST AID AND OTHER INTERNATIONAL AGENCY ASSISTANCE EFFORTS WITH REGARD TO VENTURE AND CAPITAL MARKET DEVELOPMENT AND REGULATORY REFORM IN THE PHILIPPINES AND, TO THE EXTENT RELEVANT, OTHER COUNTRIES, INCLUDING LESSONS

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LEARNED".

11. PP AUTHORIZATION: BECAUSE OF THE INNOVATIVE NATURE OF THIS PROJECT AND INTRODUCTION OF SOME IMPORTANT ISSUES THAT ARE RELEVANT TO A NUMBER OF PLANNED INITIATIVES IN THE BUREAU, AID/W WOULD LIKE THE OPPORTUNITY TO REVIEW PP AND AUTHORIZE PROJECT. THIS DECISION IS NOT BASED ON PRESUMPTION THAT WE HAVE ANY MORE WISDOM THAN THE MISSION IN DEALING WITH THESE ISSUES, BUT WE DO FEEL THAT SUCH ISSUES SHOULD BE FULLY VETTED TO HELP CLARIFY APPROACHES FOR RESOLVING THEM AND ESTABLISHING APPROPRIATE PRECEDENTS FOR THE FUTURE.

12. THE CONGRESSIONAL NOTIFICATION FOR FINANCIAL RESOURCES MOBILIZATION IS IN PREPARATION. WILL NOTIFY MISSION WHEN FIFTEEN DAY WAITING PERIOD BEGINS. ARMACOST
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RESPONSES TO ANE BUREAU REVIEW CABLE (STATE 197453)

1. Paragraph 2 - Scarcity of 106 Funds. The Mission plans to use a combination of deobligated or N.O.A. 103 Account D.A. funds, using 106 Account D.A. funds only for non-agricultural/rural development purposes. Since most companies to be privatized are anticipated to be agriculture related businesses, the use of mostly 103 Account funds is appropriate.

2. Paragraphs 3, 4, and 5 no longer apply, since the Mission is providing only a limited amount of technical assistance to the turnaround company under this project. However, in response:

   a. Paragraph 3 - Linking Turn-Around Company (TAC) and Privatization. The Mission believes that it should not formally restrict the TAC to the privatization of a specified number of government-owned or controlled-companies (GOCCs). The purpose of PAIICO is linked to capital market development, not the privatization objective. More specifically, PAIICO would make a direct contribution to mobilizing and channeling term resources to productive enterprises that will, over the medium-to long-term provide investors with investment grade securities in which to invest. The "Turnaround Window" of PAIICO should have as large of an universe as it can for turnaround opportunities. The operating assumptions for PAIICO shows that not every opportunity will pan out, but it must, at the same time generate a higher "hits" to "misses" ratio to generate successful turnaround opportunities and the income to earn the returns needed to make such a company attractive to investors. It should be understood, however, that the bulk of the turnaround opportunities are with the GOCCs and acquired assets that comprise the GOP's Privatization Program.

   Restricting PAIICO's operations to the GOP's Privatization Program is an undue restriction and not in-keeping with its objective of assisting, in a direct manner, the mobilization of both domestic and foreign investment and the supply of investment grade securities in the Philippines.

   b. Paragraph 4 - Sponsors for TAC. The PAIICO feasibility study provides several scenarios which, in-turn, present suggested ratios of AID-to-private funds for PAIICO's capitalization. These ratios are based primarily on the following factors:

   - During PAIICO's start-up period, there will be a somewhat slower payback for investors than equity investors normally expect in developing countries, particularly as it relates to agriculturally based activities. Therefore, AID's suggested contribution will support

PAIICO's need to pay for the investigation process for a long enough period of time to enable PAIICO to establish itself on a self-sustaining basis; and

- The Constitution of the Philippines restricts foreign investment to 40% of equity. In addition, it is AID policy not to make an equity investment in Private Sector enterprises. Accordingly, international private investment is slated for 40% of voting common stock. Philippine Business groups will contribute equity capital equating to 60% of the voting common shares. AID and other possible donor capital contributions will be on a subordinated debt or quasi-equity basis.

c. Paragraph 5 - Availability of Management Talent. Please see Annex M6 for a discussion of PAIICO staffing.

3. Paragraph 6 - Expanding the Role of the Security Exchange Commission (SEC). The Reilly Report recommended that a separate organization be established for capital market development functions. However, the government prefers expanding SEC's role. The project will undertake a detailed assessment of SEC functions to determine if the expanded development role is appropriate. Government agreement to procure services of a general contractor, including an agreed-upon scope of work (SOW) and budget, will be included as a Condition Precedent to disbursement of funds for this component. Undertaking an initial assessment of the SEC and developing recommendations for SEC functions will be included in the SOW.

4. Paragraph 7 - GOP Sensitivities to AID Involvement in Privatization. The GOP has already requested AID-funded U.S. technical assistance (TA) for privatization efforts. Based on this precedent and recent discussions with GOP officials, the Mission believes that the Filipinos prefer using expatriate TA for large, international marketing activities and Filipino TA for smaller, domestic operations.

5. Paragraph 8 - Mission Management Capacity. Please refer to Section IV.G of the PP for discussion of management arrangements.

6. Paragraph 9 - Impact of Cultural Factors. Please see Annex I of the PP for the social soundness analysis.

7. Paragraph 10 - Previous Experience. Sections I.E and II.B of the PP discuss AID and other donor experience in venture and capital markets development.

PROJECT DESIGN SUMMARY
LOGICAL FRAMEWORK

Project Title & Number: FINANCIAL RESOURCES MOBILIZATION (492-0377)

Life of Project:
From FY 87 to FY 92
Total U.S. Funding $8.5 Million
Date Prepared: August 7, 1987

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
Program or Sector Goal: The broader objective to which this project contributes: (A-1) To increase employment and income.	**Measures of Goal Achievement: (A-2)** Increased employment, higher income.	**(A-3)** GOP economic data.	**Assumptions for achieving goal targets: (A-4)** - Enterprises will grow after privatization. - The availability of term capital through the capital ... will result in investment in employment-generating ...
Project Purpose: (B-1) 1. To enhance the environment necessary to mobilize private term financial resources for investment into productive private enterprises; and 2. To reduce the national budgetary burden of the acquired assets and public corporations.	**Conditions that will indicate purpose has been achieved: End of Project status. (B-2)** 1. The privatization of selected, state-owned enterprises and acquired assets will have been accomplished. 2. The burden on the GOP budget resulting from servicing the debts of the acquired assets and financing the operating costs of parastatals will have been reduced. 3. The capital markets will be organized to more effectively serve as mobilizers of capital. 4. Conditions to encourage an increase in the demand for and supply of securities will be in place.	**(B-3)** - Interim and final evaluations. - GOP records, consultants' reports.	**Assumptions for achieving purpose: (B-4)** - Political will to privatize. - Proposed legislation and practices will be approved; improved efficiency will (a) increase investor confi... (b) succeed in getting more firms to go public.
Project Outputs: (C-1) 1. Privatization a. Selected state-owned corporations and acquired assets privatized with assistance provided under the project. b. Effectively functioning disposal units privatizing government-acquired assets and state-owned corporations with personnel with the capacity to perform the essential tasks of valuation and financial packaging which are involved in privatization actions. 2. Capital Market Development a. Proposals for revised legislation and regulations submitted to Congress. b. An improved Securities and Exchange Commission serving in a developmental as well as a regulatory capacity.	**Magnitude of outputs: (C-2)** 1. Privatization a. Approximately 30 corporations/assets. b. 5 to 10 disposal units functioning. 2. Capital Market Development Revisions for legislation submitted: Securities Act, Corporations Code, tax legislation.	**(C-3)** - GOP records. - Consultants' periodic reports.	**Assumptions for achieving outputs: (C-4)** - Disposal units are established and GOP is willing to ... technical assistance for them. - The Securities and Exchange Commission is willing to ... with the private sector in regular dialogue on key capi... market development issues.
Project Inputs: (D-1) 1. Privatization a. Technical assistance in investment banking, legal, accounting, specialized engineering areas. b. Privatization unit equipment. 2. Capital Market Development a. Technical assistance to establish term-owned company. b. Technical assistance. c. Training and seminars. d. Computer equipment.	**Implementation Target (Type and Quantity) (D-2)** See table below.	**(D-3)** - AID/GOP Project Agreement - T.A. Contracts - Commodity Procurement Contracts	**Assumptions for providing inputs: (D-4)** - GOP counterpart funding is made available at levels ... - Availability of D.A. funds from A.I.D.

Implementation Target (Type and Quantity) (D-2)
($000)

	AID Grant	GOP	Private/Other	Total
1. Privatization	4,535	4,000	0	8,535
2. Capital Markets	2,400	300	176	2,876
3. Evaluation & Audit	250	0	0	250
4. Inflation and Contingencies	1,315	631	30	1,976
Total	8,500	4,931	206	13,637

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5C(2) - PROJECT CHECKLIST

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A includes criteria applicable to all projects. Part B applies to projects funded from specific sources only: B(1) applies to all projects funded with Development Assistance; B(2) applies to projects funded from Development Assistance loans; and B(3) applies to projects funded from ESF.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?

A. GENERAL CRITERIA FOR PROJECT

1. FY 1987 Continuing Resolution Sec. 523; FAA Sec. 634A. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project.

   Congressional Notification was sent July 15, 1987, and expired without objection July 30, 1987 for SDA Grant $1 Million as per STATE 235391 dated July 30, 1987.

2. FAA Sec. 611(a)(1). Prior to obligation in excess of $500,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance, and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

   (a) Yes. Financial plans are contained within the Project Paper

   (b) Yes.

3. FAA Sec. 611(a)(2). If legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?

   N/A

4. FAA Sec. 611(b); FY 1987 Continuing Resolution Sec. 501. If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines.)

   N/A

5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.

Elements of the project which are susceptible to regional execution ar being coordinated with the PRE Burea the project will be coordinated with other multilateral donors.

7. FAA Sec. 601(a). Information and conclusions on whether projects will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.

By enhancing the environment necessa to mobilize private term financial resources for investment in producti private enterprises, the project wil directly encourage efforts of the country to (a) increase the flow of international trade; (b) foster private initiative and competition; (d) discourage monopolistic practice and (e) improve technical efficiency of industry, agriculture and commerc (c) and (f) will be only indirectly affected.

8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Both components of the project will serve to encourage U.S. private trac & investment abroad. Private U.S. participation will be encouraged through the U.S. sourcing of technic assistance.

9. FAA Secs. 612(b), 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.

Of the total project cost of $13.557 GOP and private local currency contributions are expected to amount to $5.051 M.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release?

No.

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11. FY 1987 Continuing Resolution Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity?

N/A.

12. FY 1987 Continuing Resolution Sec. 558 (as interpreted by conference report). If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities (a) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (b) in support of research that is intended primarily to benefit U.S. producers?

(a) No.
(b) No.

13. FY 1987 Continuing Resolution Sec. 559. Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?

No assistance will be provided that will be subject to the provisions of this Section.

14. FAA Sec. 118(c). Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16? Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (a) stress the importance of conserving and sustainably managing forest resources; (b) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (c) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (d) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (e) help conserve forests which have not yet been degraded, by helping to increase production on lands already cleared or degraded; (f) conserve forested watersheds and rehabilitate those which have been deforested; (g) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (h) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (i) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (j) seek to increase the awareness of

Yes.

N/A

U.S. government agencies and other donors of the immediate and long-term value of tropical forests; and (k) utilize the resources and abilities of all relevant U.S. government agencies?

15. FAA Sec. 119(g)(4)-(6). Will the assistance (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas? — N/A

16. FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate sysem for accounting for and controlling receipt and expenditure of project funds (either dollars or local currency generated therefrom)? — N/A

17. FY 1987 Continuing Resolution Sec. 532. Is disbursement of the assistance conditioned solely on the basis of the policies of any multilateral institution? — No.

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FAA Secs. 102(b), 111, 113, 281(a). Describe extent to which activity will (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and

(a) The AIVC will promote the disperston of investment to more rural areas.

(b) N/A.

(c) N/A.

(d) N/A.

(e) N/A.

insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) ut lize and encourage regional cooperation by developing countries.

b. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Does the project fit the criteria for the source of funds (functional account) being used?

Yes. $5 M of Section 103, corresponding to the rural and agricultural nature of many of the Philippine enterprises to be covered under this project. $3.5 M of Section 105 for selected development activities.

c. FAA Sec. 107. Is emphasis placed on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)?

Not directly.

d. FAA Secs. 110, 124(d). Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to whch the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)?

Counterpart contributions will account for approx. 37% of total project costs.

e. FAA Sec. 128(b). If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority?

The poor will be the ultimate beneficiaries of a better-functioning private enterprise system characterized by more effective financial resource mobilization.

f. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.	The project is directly responsive to the needs, desires and capacities of the Philippine people, and will utilize the country's intellectual resources.
g. FY 1987 Continuing Resolution Sec. 540. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?	No.
Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations?	No.
Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?	No.
h. FY 1987 Continuing Resolution. Is the assistance being made available to any organization or program which has been determined to support or participate in the management of a program of coercive abortion or involuntary sterilization?	No.
If assistance is from the population functional account, are any of the funds to be made available to voluntary family planning projects which do not offer, either directly or through referral to or information about access to, a broad range of family planning methods and services?	N/A.
i. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?	Yes.

j. FY 1987 Continuing Resolution. How much of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?

Should technical assistance be required from the U.S., every effor will be made to identify a qualifie economically and socially disadvantaged firm to provide the services.

k. FAA Sec. 118(c)(13). If the assistance will support a program or project significantly affecting tropical forests (including projects involving the planting of exotic plant species), will the program or project (a) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land, and (b) take full account of the environmental impacts of the proposed activities on biological diversity?

N/A.

l. FAA Sec. 118(c)(14). Will assistance be used for (a) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; or (b) actions which significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas?

No.

m. FAA Sec. 118(c)(15). Will assistance be used for (a) activities which would result in the conversion of forest lands to the rearing of livestock; (b) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undegraded forest lands; (c) the colonization of forest lands; or (d) the construction of dams or other water

No.

control structures which flood relatively undegraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development?

2. Development Assistance Project Criteria (Loans Only)

a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan at a reasonable rate of interest.

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20 percent of the enterprise's annual production during the life of the loan, or has the requirement to enter into such an agreement been waived by the President because of a national security interest?

c. FY 1987 Continuing Resolution. If for a loan to a private sector institution from funds made available to carry out the provisions of FAA Sections 103 through 106, will loan be provided, to the maximum extent practicable, at or near the prevailing interest rate paid on Treasury obligations of similar maturity at the time of obligating such funds?

d. FAA Sec. 122(b). Does the activity give reasonable promise of assisting long-range plans and programs designed to develop economic resources and increase productive capacities?

3. Economic Support Fund Project Criteria

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?

b. FAA Sec. 531(e). Will this assistance be used for military or paramilitary purposes?

c. ISDCA of 1985 Sec. 207. Will ESF funds be used to finance the construction, operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such country is a party to the Treaty on the Non-Proliferation of Nuclear Weapons or the Treaty for the Prohibition of Nuclear Weapons in Latin America (the "Treaty of Tlatelolco"), cooperates fully with the IAEA, and pursues nonproliferation policies consistent with those of the United States?

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

ANNEX E

CERTIFICATION PURSUANT TO UTILIZATION OF GRAY AMENDMENT ORGANIZATION

I, FREDERICK W. SCHIECK, Director of the Agency for International Development in the Philippines, having taken into account the potential involvement of small and/or economically and socially disadvantaged enterprises, do hereby certify that should technical assistance be required from the U.S., every effort will be made to identify a small or disadvantaged firm to provide the assistance. It is planned that this will include a portion of the accounting and auditing services to be procured for both the privatization and capital markets components of the project. Furthermore, for the scheduled external evaluations, joint efforts involving both local expertise and Gray Amendment-satisfying organizations are anticipated. My judgment is based on the recommendations of the Project and Mission Review Committees.

Frederick W. Schieck

FREDERICK W. SCHIECK
Director, USAID/Philippines

August 22, 1987

Date

ANNEX F

COST ASSUMPTIONS

The following tables provide the cost assumptions used in the budget. Tables F-1 and F-2 provide information for local short- and long-term technical assistance. Tables F-3, F-4 and F-4a give figures for short- and long-term expatriate (and expatriate combined with local) technical assistance. Table F-5 presents cost figures for policy/operational studies, Table F-6 the costs associated with the capital markets general contractor, and Table F-7 costs for the capital markets conference. Support for the Capital Markets Development Working Group, and technical assistance to establish PAIICO are costed in Tables F-8 and F-9, respectively.

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TABLE F-1

LOCAL SHORT TERM TECHNICAL ASSISTANCE

Category of Services	Burdened Fixed Daily Rate (@)	Days in Person Months	Per Month Cost (@)	Estimated Person-Month Level of Effort	Estimated Total Cost (@)	U.S. Equivalent (at @20:$1)
Management Consulting, Accounting/ Auditing	4,000	22	88,000	50	4,400,000	220,000
Specialized Engineering	1,800	22	40,000	20	800,000	40,000
Legal	13,000	22	286,000	10	2,860,000	143,000
TOTAL				80	@8,060,000	$403,000
					say	say
					@8,000,000	$400,000

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TABLE F-2

LOCAL LONG TERM TECHNICAL ASSISTANCE

Category of Services	Burdened Fixed Daily Rate (@)	Days in Person Months	Person Month Cost (@)	Estimated Person-Month Level of Effort	Estimated Total Cost (@)	U.S. Equivalent (at @20:$1)
Investment, Banking, Management, Consultancy, Accounting/ Auditing	4,000	22	88,000	44	3,872,000	$193,600
Specialized Engineering	1,800	22	40,000	23	920,000	46,000
Legal	13,000	22	286,000	21	6,006,000	300,300
					10,798,000	539,900
					say	say
					@10,800,000	$540,000

TABLE F-3

SHORT-TERM EXPATRIATE TECHNICAL ASSISTANCE

	U.S. ($)
Assume Average Burdened Fixed Monthly Rate $25,000 x 24 PM	600,000
Travel	
International	
Assume 20 RT at $2,000/RT	40,000
U.S.	
Assume 20 RT at $300/RT	6,000
Local	
Assume Public Transport at $300/MO x 18 PM	5,400
	51,400
Per Diem	
Assume 20 1 day Int'l. Stopovers at $150/Stopover	3,000
Assume 75% of time in the Philippines (75% x 24 PM) x 30 days at $80/day	43,200
Assume 1 Day U.S. Trips at $75/Day x 20 Days	1,500
	47,700
Miscellaneous Costs	
Cable/Telex/Telephone/Postage at $1,000/MO x 24 months, split between U.S. and Philippines	24,000
	$723,100
	say
	$723,000

TABLE F-4

LONG-TERM EXPATRIATE/LOCAL TECHNICAL ASSISTANCE

	U.S. ($)	and	Local (@)
Assume Average Burdened Fixed Monthly Rate $50,000 x 36 PM	1,800,000		-
Travel			
International			
Assume 25 RT at $2,000/RT	50,000		-
U.S.			
Assume 10 RT at $300/RT	3,000		-
Local			
Assume Public Transport at $300/MO x 18 PM	5,400		-
	58,400		-
Per Diem			
Assume 25 1 day Int'l. Stopovers at $150/Stopover	3,750		
Assume 50% of time in the Philippines (50% x 36 PM) x 30 days at $80/day x @20	43,200		-
Assume 1 day U.S. trips at $75/day x 10	750		-
	47,700		-
Miscellaneous Costs			
Cable/Telex/Telephone/Postage at $1,000/Mo x 36 months, split between U.S. and Philippines	36,000		-
Local Services	-		3,300,000
Grand Total	$1,942,100		@3,300,000* ($ 163,200)
Say	say		say
	$1,942,000		($ 165,000)

*See Table F-4(a)

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TABLE F-4(a)

LOCAL TECHNICAL ASSISTANCE

Category of Services	Burdened Fixed Daily Rate (@)	Days in Person Months	Per Month Cost (@)	Estimated Person-Month Level of Effort	Estimated Total Cost (@)	U.S. Equivalent (at @20:$1)
Investment Banking, Management Consulting, Accounting/Auditing	4,000	22	@88,000	12	1,056,000	$52,800
Specialized Engineering	1,800	22	40,000	12	480,000	24,000
Legal	13,000	22	286,000	6	1,716,000	85,800
TOTAL					@3,252,000	$162,600
					say	say
					@3,300,000	$165,000

TABLE F-5

POLICY/OPERATIONAL STUDIES

	U.S. ($)	and	Local (₡)
Assume four (4) policy/operational studies will be conducted by expatriate consulting firms with local consulting firms participating			
Assume Average Burdened Fixed Monthly Rate at $18,000 x 12 PM	216,000		-
Assume Average Burdened Fixed Mo. Rate at ₡88,000 x 24 PM	-		2,112,000
<u>Travel</u>			
<u>International</u>			
Assume 6 RT at $2,000 RT	12,000		-
<u>Domestic</u>			
Assume 4 RT at $300 RT	1,200		-
<u>Per Diem</u>			
Assume 6 1 day Int'l. stopovers at $150/stopover	900		-
Assume 12 PM x 30 days at $80/day	28,800		-
Assume 1 day U.S. Trips at $75/day x 4 days	300		-
<u>Miscellaneous Costs</u>			
Cable/Telex/Telephone/Postage at $1,000/Mo. x 12 months	12,000		-
Assume four (4) policy/operational studies will be performed by local consulting firms			
Assume Average Burdened Fixed Mo. Rate at ₡88,000 x 36 PM	-		3,168,000
	271,200		5,280,000 ($264,000)
	say		say
	270,000		($265,000)

TABLE F-6

CAPITAL MARKETS GENERAL CONTRACTOR

	U.S. ($)	Local (₱)
Resident Team Leader		
Assume Average Burdened Fixed Monthly Rate $18,000 x 24 PM	432,000	-
Short Term Consultants Expatriate		
Assume Average Burdened Fixed Mo. Rate $18,000 x 27 PM	486,000	-
Local		
Assume Average Burdened Fixed Mo. Rate at ₱88,000 x 45 PM	-	3,960,000
Travel		
International		
Assume 13 RT at $2,000 RT	26,000	-
Per Diem		
Assume 75% of Short Term Expatriate Consultant time in the Philippines (75% of 27 PM) x 30 Days at $80/Day	48,600	-
Assume 13 1 day Int'l. Stopovers at $150/Stopover	1,950	-
Resident Team Leader Adm Costs		
Temporary Living Allowance		
Assume 1 x 30 days at $ 80/day	2,400	-
Assume 3 x 30 days at $ 40/day	3,600	-
Housing		
Assumes furnished housing and utilities 24 PM at $1,300/Month	31,200	-
Mobilization/Demobilization Allowance	10,000	-
Insurance		
DBA at 2.75% of Salary	11,880	-
Secretary/Messenger		
Assume 24 PM at average cost of ₱7,000/PM	8,400	-
Miscellaneous Costs		
Cable/Telex/Telephone/Postage at $1,000/Month x 24 Months	24,000	-
	$1,086,030	₱3,960,000
		($198,000)
	say	say
	$1,100,000	($200,000)

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TABLE F-7

CAPITAL MARKET CONFERENCE

	AID ($)	AID (@)	GOP (@)
Venue -	-	40,000	-
Supplies	-	11,000	-
Communications	-	-	7,000
Printing/Publicity	800	200,000	-
Support Personnel	-	-	-
Local Transport	-	-	15,000
International Reserve Participants			
- Per Diem	1,600	-	-
- Travel			
International	6,000	-	-
Local	100	-	-
Meals (Lunch/Dinner)	-	-	150,000
Conference Organization Fee	-	70,000	-
TOTAL	$8,500	@321,000 ($16,050)	@174,000 ($8,700)
	say	say	say
	$9,000	($16,000)	($10,000)

TABLE F-8

CAPITAL MARKETS DEVELOPING WORKING GROUP

	Pescs
Staff	
Professional	
Assume avg. burdened mo. rate (1) @20,000 x 60 pm	1,200,000
(2) @10,000 x 60 pm	600,000
Clerical	
Assume avg. burdened mo. rate @5,000 x 60 pm	300,000
Office Expenses	200,000
Local Travel	100,000
Misc.	200,000
TOTAL	2,600,000
	($130,000)

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TABLE F-9

TECHNICAL ASSISTANCE TO ESTABLISH PAIICO

	U.S. ($)
Assume Burdened Fixed Monthly Rate at $18,000 x 4 PM	72,000
Travel	
International	
Assume 6 RT at $2,000	12,000
U.S.	
Assume 5 RT at $300/RT	1,500
Local	
Assume public transport at $300/Mo. x 2 PM	600
Per Diem	
Assume 4 1 Day Int'l. Stopovers at $150/Stopover	600
Assume 1 Day U.S.Trips at $75/Day x 5 Days	375
Assume 80% of time in Philippines (80% x 4 PM) x 30 Days at $80/Day	7,680
Miscellaneous Costs	
Cable/Telex/Telephone/Postage at $1,000 Mo. x 4 PM	4,000
	$98,755
	say
	$100,000

ANNEX G

ECONOMIC ANALYSIS

I. Privatization Component

The objective of this component is to assist the GOP in the implementation of its privatization program. This assistance is expected to a) speed up the privatization process and b) improve the efficiency of presently public corporations and/or non-performing assets as private sector concerns. The financial proceeds of the divestiture process do not constitute direct economic benefits to society. However, proceeds of firm sales will enable the GOP to a) recoup part of government funds previously invested in the public corporations, and b) reduce the fiscal burden of financial support to public corporations. The first expected outcome, in accordance with GOP intentions, will enable the GOP to finance the planned Comprehensive Agrarian Reform Program (CARP) and possibly other GOP expenditures. The second outcome will allow the GOP to increase expenditures on basic services and other traditional government functions. (See also Financial Analysis Section.)

This economic analysis will demonstrate the economic merits of the privatization component through: a) cost effectiveness, b) alternative economic rate of return analysis, and c) speeding up the privatization process.

A. Cost Effectiveness of Selected Approach

The approach proposed for the privatization component is the provision of necessary financial and other technical advisory and other services as well as equipment. The approach taken is deemed appropriate for supporting privatization activities because of: a) the GOP's self-imposed schedule and the need to complete the task within the shortest time possible; b) the enormity and complexity of the process; c) the degree of sophistication of the corporate investment market and structural diversity of the sectors involved; and d) the general sufficiency and adaptability of the GOP personnel tasked with the effort for all but the more advanced and sophisticated financial, legal and other analytical necessities of the exercise.

Training either locally or abroad, and certainly long term training, is inappropriate because of the lack of time. Full utilization of expatriate services is equally inappropriate because of high costs, availability of highly skilled local personnel for many of the tasks, and the need to be intimately familiar with local laws and institutions in carrying out many of the duties. Contracting out most of the effort to domestic sources of financial services also would be inappropriate because of the need to have knowledge of international markets, buyers and financial sources and arrangements. Also GOP personnel politically need to be in a position to decide at various steps of divestiture and preclude possible conflicts of interests that could arise if third parties are given freer play in crucial decisions.

Clearly, there are added explicit and implicit costs in other possible alternatives in assisting the privatization effort. The approach taken is basically to let the GOP personnel accomplish their mandate and identify and request assistance where necessary and appropriate. While the proportion of expatriate services to local services is planned to be high, this seems justified by a) the need to tap foreign resources for investment, and b) the need to complement domestic expertise with foreign advisory and technical services that are not locally available.

B. Alternative Economic Rate of Return Analysis: Improvement in Corporate Incomes

While it is not possible to conduct a standard economic rate of return analysis on the project because of the lack of knowledge on the expected outcome, the economic viability of the privatization component can be justified in terms of expected improvement in corporate incomes of divested firms.

The economic cost of the component could exclude the GOP contribution since the GOP is already implementing its privatization program. However, in terms of economic worthwhileness of the activity (in contrast to obvious financial gains) for the GOP, the GOP contribution is included in the economic cost. The economic cost of the privatization component is computed as follows:

	($000)
Financial FX Cost of Grant	3,135
FX Shadow Price Adjustment (20%)	627
Financial LC Cost of Grant	1,420
GOP LC Contribution	4,000
Pro rated share in Evaluation and Audit (75.0%)	
FX	150
FX Shadow Price Adjustment (20 %)	30
Local Cost	38
Pro rated share in Contingency (75.0%)	
FX	225
FX Shadow Price Adjustment (20%)	45
Local Cost	320
Total	$9,990

Given the above economic cost of the privatization component, the social discount rate in the Philippines is used to determine the required economic impact to justify the investment in this component. In order to do this, several simplifying assumptions are used: (1) the privatization component funds are disbursed immediately upon signing of the grant agreement (this makes the analysis more conservative because using the annual project disbursements schedule would result in a lower present value of economic costs due to discounting); (2) economic return over a 20 year period will flow evenly for each dollar invested; (3) no new returns are attributed to the project component after its completion; and (4) the privatized or divested enterprises will be more efficient and productive enterprises with private sector ownership and management.

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Using the NEDA-estimated social discount rate of 15 percent (capital recovery factor for 20 years = .159761), the privatization component must achieve an annual economic return valued at $1,596,012 at 1987 prices for twenty years. This means that the divested firms/nonperforming assets should experience an increase in income equivalent to at least a value of $1.596 million or ₱33.516 million (based on an average exchange rate of ₱21.00 = $1.00 for 1987) annually for twenty years as a result of the privatization component. Otherwise, the privatization component funds should be invested in alternative activities.

The likelihood of privatization component's achieving the estimated level of required economic returns may be demonstrated in terms of the required increase (a) in contribution to gross value added, and (b) in aggregate gross revenues and net incomes of public corporations.

The analysis will concentrate on the public corporations approved for privatization. The nonperforming assets (NPAs) of the government financial institutions are excluded because of the lack of readily available information. Also there is greater probability that the NPAs may be divested as NPAs per se and not as ongoing concerns. In cases of just transfer of ownership of debt instruments without impact on operations, there will be no direct economic benefits. The sequestered companies are also excluded because of the greater likelihood of legal impediments to their divestiture.

The GOP has approved to date for privatization 86 of the 121 public corporations or government-owned and controlled corporations (GOCCs) identified for privatization. Most of these 86 corporations belong to the following sectoral categories: agriculture, fishery and forestry; manufacturing; construction; and trade. Estimated aggregate gross value added (GVA) of public corporations in these sectors amounted to ₱2,574 million in current prices in 1984, representing 25 percent of total GVA of the public corporate sector in the same year. During 1984 to 1986, GVA in current prices for all public and private establishments in the four sectors grew by 13.4 percent. For 1987, Mariano and Constantino (1987) forecast real Gross Domestic Product (GDP) growth at 5.1 percent and a GNP deflator increase at 7.0 percent. If it is assumed that GVA of public corporations increases by 13.4 percent between 1984 and 1986 and by 12.1 percent in 1987, the 1987 current price estimate of GVA of public corporations in the four sectors is ₱3,272 million. Given this estimate, the required benefits of ₱33.516 million from the privatization component imply only a little over a one percent real increase in GVA per year of privatized corporations in the four sectors to justify the economic cost of the privatization component.

The 1984 GVA estimates correspond to the contributions of 89 GOCCs. Although the public corporations vary widely in size, a casual examination of size information on firms in the four sectors appear to indicate relatively less dispersion according to size. The very large GOCCs are in the electricity, transportation and financial sectors and they are not included in the list of firms approved for privatization. Assuming that privatization results in a GVA increase of say 10 percent (the average annual real GDP growth forecast for 1987-1992 is 5.1 percent) then only about 10 firms need to be privatized.

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Alternative ways of determining likelihood of sufficient economic benefits in terms of improved GOCC productivity include comparing the level of required benefits to: (a) gross revenues and (b) net income of the 86 GOCCs approved by the GOP for privatization. The required benefits of ₱33.516 million represents 0.73 percent of estimated gross revenues of the 86 corporations in 1985, i.e. ₱4,609 million. The privatization component will be economically justifiable if aggregate gross revenues of these corporations increase by 0.73 percent. Since it appears reasonable to assume a relatively narrow range of size dispersion of the 86 corporations, a more optimistic scenario of a 10 percent increase in gross revenues or ₱460.9 million as a result of privatization requires that only about 14 of the 86 GOCCs need to be privatized. Converting the 1985 gross revenue values to 1987 levels would result in an even lower percentage, or fewer divestitures needed.

Given total 1985 assets of ₱37,278 million of the 86 corporations and an average return on assets of 4.34 percent for 1975-1984, the net income of the 86 corporations in 1985 is estimated at ₱1,618 million. The required minimum benefits represent only 2.1 percent of this net income. If the 86 corporations are privatized and realize a 10 percent return on assets, the incremental net income would be ₱2,110 million. The required economic benefits represent only about one percent of the new total net income or 1.6 percent of the increase in net income as a result of the increased return on assets. To achieve the required increase in net income, as a result of the increase in return on assets from 4.34 percent to 10 percent, only 2 corporations need to be privatized and experience such an increase.

There has been some discussion in both the public and private sectors regarding the overvaluation of the assets of the public corporations. This is probably more true for the nonperforming assets. Nevertheless, overvaluation of the public corporation assets can not be dismissed easily. How much can the GOP reduce the value of the total assets of the 86 corporations, assuming a higher rate of return on assets, and still justify the economic cost of the privatization component? Given the required minimum annual benefits, the required increase in net income of the 86 corporations is ₱33.516 million. If the new rate of return on assets is 10 percent (versus an old unchanging rate of 4.34 percent), the total assets of the 86 corporations can be revalued to ₱603 million representing a decline in total asset value of 98 percent.

C. Alternative Economic Rate of Return Analysis: Required Speeding Up Effect

According to the GOP, it needs $10 million to complete the privatization effort in five years, hence the need for the privatization component of this Project to supplement the GOP's own resources in order to achieve the privatization goal. Suppose, however, that the GOP is able to complete the divestiture process without the additional assistance, but such assistance would speed up the process. Would USAID resources of $5.99 million be justified in terms of speeding up privatization? Alternatively, in the context of the 86 corporations approved by the GOP for privatization, what would be the required speeding up effect of the USAID contributions, if the GOP would otherwise by itself complete the divestiture any way?

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As a simplifying assumption, say the GOP without assistance would divest all 86 corporations simultaneously after the end of a five year period beginning in 1987, i.e., by 1992. Assuming further that as a result of the privatization, the 86 corporations experience more than a doubling of return on assets, i.e., from 4.34 percent to 10 percent. As mentioned above, the increase in annual aggregate net income of the 86 corporations would be (.10-.0434) x ₱37,278 million = ₱2,110 million. Given the economic cost of USAID resources of $5.99 million and given the future value of this amount after five years (using a 15 percent annual compounding rate) of $12.05 million or ₱253 million, the required speeding up effect to privatize the 86 corporations would be only 1.4 months. Or, alternatively, the speeding effect would need to be only 3.4 months for 36 corporations or 7 months for 18 corporations. However, the assumed increase in return on assets and no revaluation may be too optimistic. The required speeding up effect is presented below for progressively lower increases in the return on assets, assuming no revaluation of assets.

Return on Assets (%) New	Return on Assets (%) 1975-1981 Average Rate	Increase in Annual Net Income (million pesos)	Required Speeding Up Effect (months)
9	4.34	1,737	1.7
8	4.34	1,364	2.2
7	4.34	992	3.1
6	4.34	619	4.9
5.5	4.34	432	7.0

The effects of asset revaluation to lower levels in relation to the speeding up required is shown below also assuming a new return on assets of 10 percent (or an additional 5.66 percent over the 1975-1984 average of 4.34 percent).

Assets Revalued at Various Proportions of 1985 Levels (%)	Increase in Annual Net Income (million pesos)	Required Speeding Up Effect (months)
90	1,899	1.6
80	1,688	1.8
60	1,266	2.4
40	844	3.6
20	422	7.2
12	253	12.0

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II. Capital Markets Development Component

The objective of this component is to improve the regulatory and institutional environment for capital markets to mobilize term capital effectively and to encourage an increase in the supply of securities, i.e., to foster active and efficiently functioning capital markets. This is expected to result in several favorable developments:

- o Increased mobilization of savings in the form of financial instruments because of the expected diversification of financial instruments and reduction of investment risk.
- o Reduced vulnerability of businesses, through reduction in financial leverage or risk to economic downturns.
- o Expansion of business activity and increased corporate incomes as a result of increased financial resources flowing into the business sector.

The economic analysis of this component considers: (a) the cost effectiveness of the selected approach, and (b) the likelihood of sufficient economic benefits.

A. Cost Effectiveness of Selected Approach

The proposed approach for this component consists of determining and fostering the regulatory and institutional requirements for effectively functioning capital markets through a mix of studies, advisory services, training and observation tours, and equipment. The approach appears to be appropriate in view of (a) the need to review the regulatory and institutional framework and determine the modifications necessary to attain the component's objectives; (b) the complexity and variety of tasks required; (c) the involvement of a large number of actors; (d) the adequate background and adaptability of participating institutions' personnel to advanced state of the art financial and other required technology; (e) the need to determine the necessary regulatory and institutional improvements in the context of a developing country setting. Cost effectiveness of the component's activities will be assured through competitive selection of a general contractor for the studies and collective specification and review of tasks planned to be undertaken. Further, the general thrusts of planned activities were determined collectively through a survey of expected government and private sector participants and beneficiaries. Private sector contributions to the component also provide added assurance that the subactivities selected and conducted will be cost-effective.

B. Alternative Economic Rate of Return Analysis

The economic benefits of the capital markets component activities are diffuse. Capital markets development will result in an increased proportion of long term capital financing relative to the current predominance of short-term loan-financed investment. This will also result in an expansion of

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the securities market as well as reduced financial leverage, and therefore, reduced financial risks for firms that avail of equity financing. At the same time, there will be added savings incentives and increased financing for risky and long-term investments through increased diversity of available financial instruments in the financial market. Firms as well as financial intermediaries would be better able to match their investment and financing alternatives. The end result would be increased incomes to society through higher levels of and more efficient investments.

An analysis tracing these expected results, however, does not lend easily to quantification. For purposes of demonstrating the economic desirability of the capital markets component, an alternative economic rate of return analysis is conducted. Given the economic costs of the capital markets component, it is possible to determine likelihood of the required minimum sufficient benefits in relation to a) increased savings mobilization and b) increased corporate incomes due to improved capital markets conditions.

The economic cost of the capital markets component is computed as follows:

	($000)
Financial FX Cost	2,009
FX Shadow Price Adjustment (20%)	402
Financial LC Cost	849
Pro Rated Share in Evaluation and Audit (25.0%)	
FX	50
FX Shadow Price Adjustment (20%)	10
LC Cost	12
Pro Rated Share in Contingency (25.0%)	
FX	75
FX Shadow Price Adjustment (20%)	15
LC Cost	106
TOTAL	$3,528

To determine the required minimum benefits to justify the economic cost of the capital markets component, the social discount rate is used. The following simplifying assumption are also used: (1) the funds are disbursed immediately upon grant signing; (2) economic return over a 20-year period will flow evenly for each dollar invested; (3) no new returns are attributed to the component after its completion.

Given the social discount rate of 15 percent, the capital markets component must achieve an annual benefits stream of $3.935 million. The Philippine economy will have to gain economic benefits equal to a value of at least $563,637 or ₱11.836 million annually as a result of the capital markets component.

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1) Required Increase in Savings

One of the major objectives of the capital markets component is to increase the level of savings in the economy. The capital markets component's economic viability may be demonstrated in terms of the required increase in savings levels in the economy. In current prices, gross domestic savings levels rose, if in a fluctuating manner, from ₱77,923 million in 1981 to ₱115,613 million in 1986. The share of gross domestic savings in GNP, however, dropped from 25.7 percent in 1981 to a low of 14.7 percent in 1984 before recovering to 18.8 percent in 1986. The average gross domestic savings to GNP ratio during 1981-1986 was 19.4 percent. Given this average ratio and assuming a 12.1 percent increase in GNP in current prices for 1987, the projected gross domestic savings level for 1987 is ₱133,592 million. The required annual benefits from the economic cost of the capital markets component of ₱11.836 million represents less than 0.01 percent of this amount.

The required savings level increase is expected to take the form of savings in financial assets, particularly shares of stock. In this case, the probability of achieving the required benefits may be determined in terms of expansion in the volume of stock market transactions. At a depressed volume of transactions level of ₱4.04 billion in 1984, the required annual benefits represent only a 0.3 percent increase in the volume of transactions. If the 1986 volume of stock market transactions of ₱11.4 billion is used, a smaller 0.1 percent increase is required. An even more insignificant percentage increase is required in comparison to the expected 1987 volume of stock market transactions.

2) Required Increase in Corporate Incomes

To determine the likelihood of the capital markets component achieving the required level of economic returns, available data for the top 1,000 corporations of the Philippines compiled by the Philippine Business Day is used. The rates of return on assets of the top 1000 corporations were quite low in recent years: 0.18 percent in 1983, 0.89 percent in 1984, and 0.11 percent in 1985. This poor performance largely reflected depressed economic conditions and high financial charges due to substantial foreign-denominated borrowings and relatively high domestic interest rates. In 1985, total assets of the top 1,000 corporations amounted to ₱878,080.39 million while aggregate net income was ₱1,006 million. Even at this net income level, representing a very low rate of return on assets, net income of the top 1000 corporations would have to increase by only 1.2 percent to justify the economic cost of the capital markets component.

If under improved economic conditions, the rate of return on assets, for example, increases to 5.0 percent, and therefore net income based on 1985 asset levels would be ₱43,904 million. Net income of the top 1000 corporations as a result of the capital markets component would have to increase further by only 0.03 percent to justify the cost of the capital markets component.

The debt-equity ratio of the top 1,000 corporations has been increasing in recent years: 4.64 in 1981, 4.66 in 1982, 5.03 in 1983, 5.38 in 1984 and 5.31 in 1985. The economic cost of the capital markets component is so small in relation to absolute level of balance sheet items of the top 1000 corporations, that it is useless to show the required impact of the economic cost of the component on corporate incomes as a result of changes in the capital structure of these firms. However, a hypothetical example for a single firm is presented below to highlight the effect of capital structure changes on firm viability. The example assumes an average interest rate on debt of 15 percent per annum.

Debt/Equity Ratio	Total Assets ($)	Net Income Before Interest ($)	Interest Expenses ($)	Net Income (Loss) After Interest ($)
90:10	10,000	1,000	1,350	(350)
80:20	10,000	1,000	1,200	(200)
70:30	10,000	1,000	1,050	(50)
60:40	10,000	1,000	900	100
50:50	10,000	1,000	750	250
40:60	10,000	1,000	600	400
30:70	10,000	1,000	450	550

The example shows the effect of debt-financing on net income. Higher debt-equity ratios result in higher financial charges or interest expense, and lower net income after deducting interest expense. To the extent that a firm can attain high levels of net income and therefore increased returns to stockholders, it is worthwhile to utilize debt financing. However, capacity to contract debt decreases as the debt-equity ratio increases. In addition, the firm's financial viability and/or longevity is endangered if net income performance remains low and interest rates are high over long periods because of the high downside risk. Moreover, if maturity periods of loans are short, the firm is likewise subjected to serious cash flow problems. In a situation where debt is the predominant mode of financing, there is less incentive for firms to improve operating efficiency because debtors emphasize cash flow and/or interest rate coverage. On the other hand, investors in equity would put their funds in corporate securities with consistently profitable performance and/or growth potential. This creates competition among outstanding shares of companies and motivates these companies to be productive.

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FINANCIAL ANALYSIS

The most important financial consideration for this component is to achieve maximum effectiveness of the GOP's privatization program in order to help alleviate the GOP's enormous and continuing fiscal burden. However, the privatization component may be analyzed also as a purely financial proposition for the GOP.

The GOP has set aside $4 million to finance the five-year divestiture program. It will also receive an A.I.D. grant of $5.287 million through this project. The total amount of $9.287 million theoretically may be used by the GOP for some other program, i.e., its opportunity cost is not zero.

First to be considered is the case where there are no net flows between the corporations and the government, i.e., the government neither subsidizes nor receives revenues from the corporations. In this case, for the privatization component to be financially desirable, the GOP must be able to realize financial proceeds from privatization at least equivalent to the financial cost of the investment plus earnings that the GOP may derive if the cost of the component were invested in some interest-bearing financial instrument. If the GOP is able to place the $9.287 million in a time deposit or in Philippine treasury bills at 15 percent rate of interest for five years, then the future value of the investment would be $18.7 million or ₱392 million in five years. Total assets value of the 86 GOCCs approved for privatization amounted to ₱37,278 million as of 1985. Hence, to break even, the GOP would need to and should be easily able to sell the GOCCs for one percent of their asset book values, or sell one average GOCC for 90 percent of the book value of its assets.

In the case where the government is receiving net revenues from the GOCCs, the received sales proceeds must cover both privatization costs and the discounted capitalization value of future earnings minus outstanding liabilities. However, as a whole this case does not apply to the GOCCs in the Philippines, although a few individual firms are net earners, after allowing for all costs.

In the last case where the government is a net provider of resources to the GOCCs, such as the situation in the Philippines, the government will gain financially if the resulting reduction in the outflow to the firms exceeds the privatization costs. To break even under present circumstances, divestiture would need only to result in a one time 2.3 percent reduction in the 1987 budgetary support level for government corporations of ₱16.7 billion or a 0.47 percent annual reduction over 10 years (also assuming a 15% discount rate). In this case, any proceeds from divestiture and/or savings in GOP budgetary support to government corporations beyond privatization costs represents pure financial gain for the GOP.

ANNEX I

SOCIAL SOUNDNESS ANALYSIS

Over the past few years studies and evaluation of growth of capital markets in developing countries have been conducted. Examples of these are the Asian Development Bank's "Capital Markets Study" completed in 1985, which assesses capital markets in six developing countries; the Terrence Reilly report, "Report and Recommendation on Developing the Capital Markets of the Philippines". In addition, there are unpublished reports on the subject excerpts of which appear in the Philippine Media. Because these reports assess growth of capital markets, they invariably identify a number of constraints to its growth. For instance, the ADB study lists the following factors affecting growth of the securities market. These are: (i) the size, level of development, and degree of state ownership of the individual developing country's economy; (ii) the limited need for private sector companies to raise securities financing; (iii) the attitude of private owners to sharing ownership and control; (iv) the high financial cost of raising securities market funds; (v) the cumbersome listing requirements and procedures; (vi) the added disclosure requirements of a listed company; and (vii) the lack of inducements to go public. Other studies cite simila factors explaining the underdeveloped character of capital markets.

Responding to these constraints the project plans to implement a number of activities which essentially lay down the foundations or the appropriate conditions for growth of the capital market. For instance, the project will assist in the review of laws, regulations, and procedures affecting capital markets; it will assist in establishing necessary institutions to promote capital market development; it will support necessary structural changes in the Philipine stock exchanges, among others. All these innovations are designed to lessen the impact of identified constraints to growth.

Among these constraints, however, one appears not to fall within the purview of proposed innovations. A recurrent observation found in the studies earlier cited is the observation that existence of a strong tradition of family controlled and run companies significantly impedes growth of capital markets. That is, where family firms are the mode, it may be difficult for capital markets to function inasmuch as there is a built-in reluctance among potential beneficiaries to participate.

This section focusses on this question. It will attempt to describe the family firm, concerns and attitudes of owners, and their goals and objectives--as it affects growth of capital markets.

The Family Firm

What is a family firm? Which of its characteristics predispose owners to shun participation in securities markets? Drawing from a 1965 study of Filipino Marketing Entrepreneur prepared by John Carrol, we can characterize a family

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firm as having the following traits: a) major share of the original capital for the enterprise is provided in most cases by either the entrepreneur himself or his family; b) the entrepreneur or his relatives hold the office of chief executive at the beginning and perform key management function in most cases; and c) financial control and the office of chief executive tend to remain in the family of the entrepreneur. Pared to its bare essentials, the family firm, as found in the Philippines, is characterized by the premium placed on control of the firm.

Carrol proceeds, "it seemed clear that control of the major policies of the enterprise was desired by practically all entrepreneurs--as a means of protecting the investment of both effort and money which they had put into it, and probably also as one of the psychological rewards of entrepreneurship itself. The great majority of entrepreneurs attempted to control policy by means of majority ownership in the enterprise--either in their own names or as representatives of unified family groups."

From the perspective of owners, what then are the perceived disadvantages when one loses control of a family firm. Carrol cites a number of cases indicating the importance entrepreneurs ascribe to control.

"Thus one entrepreneur began with a partner, and then spent several years fighting him for financial control of the enterprise; he achieved his goal while the enterprise was expanding by buying up new stock issues, in the name of his family, more rapidly than his partner could afford to do. He remarked that in the Philippines the family corporation is the best arrangement, because outside stockholders tend to interfere in management, attempt to obtain jobs for their relatives, and are constantly demanding dividends rather than allowing profits to be reinvested."

"A number of similar struggles for control were noted in the histories of other firms, and even family enterprises were not entirely proof against them: there are cases in which the entrepreneur himself, a minority stockholder in a nonfamily enterprise, was later ousted from the firm by his former associates; and there is one case in which three brothers, formerly partners, are now operating three competing enterprises. Control which consists of majority ownership is not only the most secure form of control but has additional important advantages in that it permits the entrepreneur and his family to enjoy a greater share in the profits and allows him to leave to his family "a business" rather than a minority stockholding."

Other examples abound in the histories of Philippine corporations which apparently validate this perception. The most celebrated in recent history is the struggle within the biggest Philippine multinational, San Miguel Corporation, wherein because of the fight for control over management of the firm between the cousins Soriano and Zobel, the family ended-up losing overall control of the corporation. Although this is a highly simplified and shortened version of the complex affair, suffice it to say that from perspective of outsiders the event reenforced expectations of the dangers when corporate management does not own a majority of shares.

Nonetheless, there are also examples of family firms which realize too late the inherent danger of maintaining absolute control of firms. For instance, recent media reports show that the Palanca family which controlled the La Tondena, Inc., a firm engaged in production and distribution of local and imported liquor, realized albeit too late the disadvantages of absolute control. In this case, loss of control of the firm resulted from executive irresponsibility which led to inadequate checks on management decisions.

The Problem of Disclosure

Related to the problem of control is that of disclosurer. Studies show that one of the many reasons why owners of family firms prefer not to open ownership to the public is the requirement of disclosure of substantial information on the company's operational and financial procedures. To do so would open the company to a variety of perceived disadvantages.

Without going into the details of these perceived disadvantages, we can posit some of the reasons why businessmen resist disclosing information about their activities. A central reason appears to be that businessmen harbor distrust of government and its agencies. This may come from their perception that government is not a partner in development of business but rather act more as an obstacle to its growth. For instance, government is perceived as primarily interested in getting what it can from the private sector but not provide the necessary support for its growth. The private sector probably doubts the capacity of government to consistently apply business related policies. Their experiences over the past twenty years under the Marcos regime, probably reenforce distrust of government. Marcos' penchant for applying uneven treatment of cronies and noncronies is hard to forget, especially if perceptions of the current government have not erased previous beliefs.

Social Soundness Statement

The preceding discussion appears to offer a gloomy prospect for development of capital markets in the Philippines, for if it is a fact that control of companies is the only criterion entrepreneurs use in all aspects of their businesses, then, it is fruitless to expect them to open up their enterprises to external stockholders. The description, however, is limited. First, it takes a narrow and static view of the individual goals of entrepreneurs. Second, it does not take cognizance of the reactive nature of entrepreneurs. Third, it does not allow for the changing demands on firms as economies grow.

The primary goal of every business enterprise is to make profits, or if the conditions are not right, to minimize losses. To do so the successful entrepreneur must be attuned to a myriad concerns. Decision to expand a firm, to diversify, to retain its size, or to contract operations are not made in a vacuum. Company owners must assess potential impact of political events, government policies, behavior of markets, inter alia. They recognize, however, that regardless of access to information, it is impossible to arrive at a perfect assessment which could lead to a perfect decision. This is where the risk-taking nature of entrepreneurs come in. Given available information, if they perceive the times and conditions are appropriate for expansion, then, a decision to expand will be made.

This appears to be the area wherein the project will be of greatest benefit. By laying the foundations for a functioning capital market, the project provides entrepreneurs with additional means to make better decisions. The project will not cause radical changes in behavior and attitudes, it will not diminish desire for control of companies, but it will provide foundations for arriving at better decisions. If in the process, entrepreneurs discover that to increase profits expansion of business and the concomitant dilution of control is timely and necessary, then, appropriate decisions will be made.

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ADMINISTRATIVE ANALYSIS

In order to conform to the Government of the Philippines administrative structure, it will be necessary for the project to have two principal implementing agencies, one for the privatization and one for the capital markets component. Further, PAIICO would receive assistance directly from USAID, as would a number of other private entities involved in capital market development.

1. Privatization

The recipients of AID assistance in the privatization area would be the asset disposal units. As many as eight such units may be established to privatize a total of 107 Government Owned or Controlled Corporation (GOCCs). These are comprised of 5 parent corporations, 75 subsidiaries and 27 sub-subsidiaries. Five government departments, NEDA and the Office of the President control the GOCCs. A list of GOCCs giving their sectoral distribution (28 of the 107 corporations are agriculture-based) and a list giving their government departments are attached as annexes.

The asset disposal units would be established within the parent departments of the entities to be privatized and would be independent of the management of the entities to be privatized. This is important in that it would forestall interference with the privatization process by those in management who have a vested interest in a continuation of the present management.

In addition to the asset disposal units established to privatize the GOCCs, the APT, which will also receive AID assistance, has already begun its primary task of privatizing the acquired assets.

Because of the large number of entities involved, it is essential that implementation of the privatization component be the responsibility of a single agency to coordinate project activities, to serve as a central monitor, and to serve as a point of contact for USAID. This would include serving as the authorizing entity for AID contracting and procurement actions. Such an arrangement would make possible the procurement of a variety of services for the different asset disposal units under a general, "umbrella" contract.

a. Department of Finance

The logical choice for implementing agency is the Department of Finance, specifically the Office of the Undersecretary responsible for privatization. This selection is based on the fact that, in accordance with Presidential Proclamation No. 50, executed in December 1986, all privatization actions ultimately fall within the purview of the Committee on Privatization (COP) which is responsible not only for approving the sale of government-held assets, but for guiding, monitoring and reviewing the entire privatization program; and the COP Chairman is the Minister of Finance. Furthermore, the Undersecretary of Finance chairs the COP's Technical Committee, whose other members are the Undersecretary of Trade and Industry, Deputy Director-General of NEDA, and a Director of the Department of Budget and Management (DBM). DBM has assumed the functions (and acquired the analytical staff) of the now defunct Presidential Commission for Government Reorganization (PCGR) as regards privatization. PCGR was responsible for identifying the GOCCs to be privatized and recommending their privatization to the President. The Technical Committee's mission is to review all proposed privatization transactions and to recommend approval or disapproval to the COP. The Technical Committee provides essential coordination among the parent departments controlling GOCCs to be privatized, and would thus be a key entity in the implementation of the project. The concerned undersecretary's office has been functioning as a secretariat for the COP Technical Committee. It includes a staff of 4 professionals and one secretary concerned on a full-time basis with privatization, although future year staffing of 12 professionals and 4 clerical staff is expected to be approved.

b. Asset Disposal Units

The asset disposal units to be established will need assistance, and such technical assistance would constitute a major element of the project. However, in recognition of the difficulty involved in obtaining timely budgetary allocations for newly created entities, the project may also be required to provide for certain equipment and initial operating costs (with a declining AID and increasing GOP contribution over the life of the project) for the asset disposal units. Not all of these units have been established as the time of writing. However, the National Development Company (NDC) disposal unit will serve as an example of a large asset disposal unit. (The large units are expected to be those of NDC, Philippine National Oil Company (PNOC), and the Presidential Management Staff). The NDC disposal unit's 1987 costs are 500,000 pesos for personnel costs to top off the salaries of 32 people seconded from NDC's other operations, and 21 million pesos for advisory services, for a total of 21.5 million pesos per year. Less typical, because it is a much larger entity charged with a task of far greater magnitude, is the APT. APT has a staff of 50. Its operating budget of 38.7 million pesos per year includes staff salaries (6.9 million pesos), rent, insurance, etc. It also has a budget of 4.1 million pesos for capital expenses, i.e., purchase of vehicles, office furniture and computer equipment.

2. Capital Market Development

As in the case of privatization, a great many players are involved. However, the institutional picture is further complicated by the involvement of a number of key private sector entities, and by the fact that, unlike in privatization, the DOF will not be in the role of lead GOP entity, necessitating a separate lead implementing agency for this component.

a. Capital Market Development Working Group

The Working Group was established in February 1987 to examine ways in which promotion of the capital markets as mobilizers of term capital and

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enhancement of their capabilities could be supported at this time. Among its tasks has been the prioritization and time-phasing of recommendations in this area made in an AID-financed study. The working group is composed of all relevant public and private sector entities involved in the capital markets, but a smaller, core working group of regular participants has evolved. They are representatives of the Department of Trade and Industry (DTI), at whose initiative the group was formed; the Securities and Exchange Commission (SEC), an independent agency; the Bureau of Internal Revenue (of the Ministry of Finance); and the two stock exchanges (Manila and Makati). A consultant to DTI serves as chairman, and the staff of the Undersecretary of Trade and Industry responsible for Capital Market Development serves as its secretariat.

b. Capital Market Development Commission

A recommendation of the USAID-funded study that the working group has elevated to a recommendation for a Presidential Executive Order, the issuance of which is possible in 1987, calls for the creation of a Capital Market Development Commission. The Commission would be a public and private sector cabinet level body accountable to the President, tasked with providing policy guidance to promote the development of the capital markets and with interfacing with Congress toward that objective. The Commission would monitor and evaluate the on-going development of the capital markets and recommend the appropriate legal measures to enhance their development. Members of the Commission would be the Secretaries of Trade and Industry (chair) and Finance, the NEDA Director General, the SEC Commission Chairman, the Central Bank Governor, and four representatives from the private sector: one from the stock exchanges, one to represent other financial intermediaries, and two other unspecified private sector representatives. The commission would have a technical staff and secretariat, headed by an executive director. The recommended first year's operating budget of the Commission would be 5 million pesos.

Given its wide public and private representation, responsibilities for capital market development policy formulation, and its task of recommending legislation, it is reasonable that the Capital Market Development Commission, if approved by Congress, be the lead implementing entity for the capital market component of a project which places substantial emphasis on the examination and drafting of legislation. It is also appropriate that its secretariat serve as day-to-day contact point for USAID, and that, in the interim until the Commission is fully operational, USAID's primary point of contact for this component be the office of the concerned Undersecretary of Trade and Industry. The office has two professionals fully devoted to capital market development, including the consultant serving as working group chairman. The project may be required to shoulder some initial operating costs to insure effective start-up of the Capital Market Development Commission's secretariat or of the DTI group acting as the working group's secretariat in the interim period before the Commission is fully operational.

c. Governmental Entities to Benefit from Project Assistance

The Securities and Exchange Commission

The Securities and Exchange Commission (SEC), a quasi-judicial body, supervises the securities market. The SEC was created originally by the Securities Act of 1936 and it is also charged with the implementation of the Corporation Code as an administrative agency. Administrative tasks related to the registration of securities and approval of articles of incorporation occupy as much or more of the SEC's time as supervision of the securities market. This has led to somewhat loose enforcement by SEC of the regulatory rules in the market. Operational weaknesses include deficiencies in recordkeeping and in compilation of a necessary data base. These and reorganization issues are expected to be addressed by the project.

d. Principal Private Sector Players

An AID-financed study has identified numerous constraints to the efficiency and effectiveness of the capital markets that lie within the realm of the involved private sector entities, and has recommended interventions to assist these entities. Hence, the project would also provide assistance to a number of private sector entities, and it is expected that AID would channel its assistance directly to these entities. They include the groups represented on the capital markets working group, on the one hand, and PAIICO on the other.

(1) Stock Exchanges

The Philippines has two stock exchanges, the Manila Stock Exchange, established in 1927 and the Makati Stock Exchange, established in 1965. A presidential decree issued in 1973 provided that a share listed on one stock exchange should automatically be listed on the other. 130 issues are listed.

To list a stock on the exchanges, a company has to submit an application, together with the following documents:

Articles of incorporation and amendments thereto and by-laws and amendments thereto

Audited balance sheets and profit and loss statements

Certificate of registration and permit to sell Securities issued by the Securities and Exchange Commission

Certificate of the corporate secretary stating the number of shares fully paid, issued and subscribed and a list of stockholders

Names of directors, officers, auditors and bankers

Requirements necessary for listing are very lax. The only above requirement related to the financial condition of the company is the number of

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shareholders. Normally about 300 stockholders are required. Even a company without any previous operating record may be listed. This is a particularly common practice among mining exploration ventures, and makes these shares inevitably speculative.

In order to distinguish these speculative, venture undertakings from established companies, the stock exchanges classify shares into the two groups, the Big Board, and the Small Board. Shares listed on the Big Board are those of companies which are in commercial operation and regularly paying dividends. In contrast, the Small Board lists companies which have not started commercial operations. They are typically mining exploration ventures.

Trading Practices

The stock exchanges are open five days a week from Monday through Friday. Over-the-counter transactions may be done outside of trading hours. All transactions are done by members of each stock exchange. Membership in each of the exchange can be obtained through the purchase of a seat and subsequent election to membership by the Board of Governors. There are two types of trading accounts for investors in the stock market-- cash and margin accounts. In cash accounts, no credit has been pre-arranged and the customer is obliged to pay for his purchase within the settlement period which is no more than four trading days. In margin accounts, pre-arranged credit is extended to customers in accordance with a suitable margin agreement. The customer purchasers securities either by paying only fifty percent of the total purchase price, or by depositing with the broker listed and acceptable securities with a market value of two hundred percent of his debit balance.

Commission rates for common stocks are 1 percent of the amount, regardless of price, for amounts above ₱2,000. For amounts below ₱2,000, a flat commission of ₱20 is charged.

Foreign nationals may purchase shares of most of the companies. The companies issue two classes of shares. Class A shares may be purchased only by Philippine nationals, while class B shares may be purchased by foreigners.

In order to strengthen the efficiency of the stock exchanges, consolidation of the two stock exchanges is under consideration. Both list the same securities, hence the benefits of having two separate exchanges no longer exist. Consolidation of the two exchanges would increase the volume of trading on one floor.

Stock exchange officials have demonstrated deficiencies that project-funded training would address. Stock exchange officials may be trained in such self-regulatory methods utilized elsewhere as "stock watch operations."

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(2) Stockbrokers

The Manila Stock Exchange has 58 members, of which 37 are active; the Makati Stock Exchange also has 58 members, of which 34 are currently active. Securities brokers/dealers are in general small enterprises; many of them are individual proprietorships. Nevertheless, the few larger brokers account for most of the trading. On the Manila exchange, 6 percent of the brokers account for 55 percent of the trading; 20 percent of the brokers account for 90 percent of the trading. On the Makati Stock Exchange, 5 percent of the brokers account for 55.6 percent of the transactions, 10 percent of the brokers account for 84.4 percent and 20 percent of the brokers account for 95 percent of the transactions. Even though there are a number of corporate members at the exchanges, professional brokers and dealers are few. In particular, their research capabilities are limited. They are not fully capable of supplying enough information to the general public. This does not help enlarge the stock ownership among individual investors. Selected brokers may be provided project-funded training in such subjects as financial analysis and proper recordkeeping.

(3) Investment Houses

The growth of the investment houses accelerated after the enactment of the Investment House Law in 1973. The law prescribed a greater role for investment houses in long-term financing. It removed from stockbroking firms and gave to the investment houses the right to act as underwriters. Consequently, activities of investment houses grew rapidly in the 1970's. Their total assets expanded at an average 14.4 percent annually during 1974-80. However, their activities were mostly concentrated in short-term financing, done through the trading of commercial papers and other money market instruments under quasi-banking licenses. The introduction of an expanded commercial banking system in 1980 undermined their activities. The money market crisis in 1981 further weakened the positions of many of them. This accelerated the reorganization of the sector, and many investment houses were consolidated with or placed under the control of commercial banks.

There are 12 operating investment houses. They account for less than 3 percent of total financial sector assets. Investment houses depend mostly on short-term borrowings for their funds, mainly through their quasi-banking functions. The funds are utilized for loans and securities investments.

The Investment Houses Association of the Philippines (IHAP) is represented on the capital markets working group and may also benefit from project funded seminars and training activities.

(4) Universal Banks

Commercial banks that have obtained "expanded commercial banking" licenses under the 1981 universal banking law amendments are authorized to act also as merchant banks and engage in underwriting. The objective of universal banking was to encourage term transformation, whereby banks would provide

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longer term financing to companies. In 1973 brokers were eliminated from acting as underwriters when underwriting authority was given to investment companies. In 1981, the right to engage in underwriting was given also to commercial banks which qualify as universal banks. (Brokers were not reinstated as underwriters).

Investment banks and merchant banks may be considered as the "engines" that make the new-issue securities markets function. They make "new business calls" on potential client companies to persuade them to use their services to raise finance through public offerings of securities, compared to direct loans from banks. They compete to create new types of financing approaches and instruments, and to get companies to use these to raise finance.

Universal banking has not brought any appreciable increase in merchant banking activities or term transformation. It has not increased the number of underwritings and public offerings.

For merchant/investment banking to flourish, several elements are required:

(a) Relative ease by firms to engage in a full range of services, including underwriting, and freedom of activity.

(b) Ease of companies to issue securities of all types.

(c) A clear legal framework.

These are among the concerns project-funded technical assistance would address.

(5) <u>PAIICO</u>

Assistance to PAIICO would also be channeled directly from AID to PAIICO. This would ensure that business decisions are made in response to the market place with a minimum of political interference. Operations of PAIICO would be outside the purview of the capital markets working group. However, a purely private investors' promotion group will provide for the initial equity investment and prospectus development.

TECHNICAL ANALYSIS

This analysis will focus on the technical rationale for selecting each of the project's components and their elements. It will discuss why the appproaches discussed in Section II of this PP were undertaken relative to the present situation in the Philippines.

A. Privatization

Section I of the PP provides the setting for this component of the project and section I.D. discusses the roles of other donors. But to summarize, the Medium Term Philippine Development Plan (MTPDP) delineates the GOP's economic growth objectives and strategies for achieving those objectives. The GOP's objectives are directed principally towards the:

- alleviation of poverty
- generation of more productive employment
- promotion of equity and social justice; and
- attainment of sustainable economic growth.

The MTPDP envisions a strong private sector as the engine of growth with private investment expected to outpace that of government and for government to play its proper role in the economy of providing public services only, and not to compete with the private sector.

To achieve these objectives the GOP must achieve the following goals:

- Reduce its budget deficit burden caused by public corporations and the acquired assets of government financial institutions; and

- Maximize the production and net added values from the revitalization of existing companies, and the employment of stocks of assets already installed in the Philippine economy which, at present, are underutilized or idle.

As discussed in Section I.B.3., the GOP has formulated public corporate sector rationalization and privatization programs as strategies to reach its goals, and ultimately its objectives. Elements of the public corporate sector rationalization program include rationalizing the GFIs (e.g. PNB/DBP), and increasing the operating efficiency of selected GOCCs through planning and performance evaluations, and consolidations/mergers. The GOP's privatization program involves the partial or total divestiture of GOCCs, the dissolution or liquidation of GOCCs, and the total divestiture of the acquired assets of GFIs. The GOP has not expressed an interest in the "contracting out" or "partial privatization" techniques.

The GOP has demonstrated its political will to execute its rationalization and privatization programs. Under its rationalization program, the financial restructuring and rehabilitation of the major DFI's, including PNB and DBP, are underway and a special unit--the Government Corporate Monitoring and Coordinating Committee--has been organized to design and implement a system of public corporate planning, and performance monitoring and evaluation. Under its privatization program (also discussed in Section I.B.3) the COP and APT have been established and staffed; operating guidelines for both have been developed and executed; assets have been transferred from PNB and DBP to the APT, with some having already been bidded out and sold; the parent companies of selected GOCCs have themselves established Asset Disposal Units (ADUs); and the President of the Philippines has approved a partial list of GOCCs to be privatized.

In deliberating on how AID could best be of assistance to the GOP in achieving its very laudable objectives and goals, a number of alternatives were considered, including providing:

- working capital credit to compliment the term credit requirements of investors;

- term credit facilities for the private sector purchase of assets;

- capital for direct investment on a quasi-equity or subordinated debt basis in selected acquired assets and/or GOUs to be privatized;

- technical assistance to the GOP in the execution of its "Rationalization Program"; and

- technical assistance to the GOP in the execution of its "Privatization Program".

The provision of working and/or term capital facilities, or investment capital are not viable options for A.I.D. The commercial banking system in the Philippines is presently highly liquid and short term working capital resources are available. The past easy provision and use of term debt resources from GFI's is one of the reasons why there is a need for a "Privatization Program" now. Accordingly, this alternative is out of the question. As for investment capital, there is no need for A.I.D. or any other donor to play a catalytic role here. Equity investment capital is readily available from both domestic and foreign sources to take advantage of the GOP's Privatization Program. This is the principal reason why the stock market is on a bull run. Investors are looking for investment grade securities, but they are not available in the current environment. A number of private foreign and domestic investment funds have already appeared on the horizon (i.e., First Philippine Capital Fund), and the GOP's Debt/Equity Swap and Philippine Investment Notes Programs provide further equity investment incentives. In addition, considering the level of resources required to purchase privatizable assets - estimated to be in the neighborhood of $1-2 billion, the Mission's current OYB of $13 million would not put an appreciable dent in this requirement. In short, to provide the funding necessary to adequately finance the short to long-term financing needs of investors, even if it were needed, would be beyond the capacity of this Mission.

It is A.I.D.'s policy not to undertake activities which would strengthen the efficiency of GOCCs, particularly where they are in competition with the private sector. As such, AID is not in a position to provide technical assistance for the GOP's "Rationalization Program". The WB has under consideration technical assistance to the GOP for this effort under its proposed Government Corporation Rationalization Loan, now in the appraisal stage.

However, as discussed in Section II.B.1, there is a tremendous need to assist both the APT and ADUs of selected GOCCs execute their partial/complete divestiture plans within the five (5) year life span of the program, particularly in light of the inadequate resources to carry out their respective privatization programs, but also, and understandably so, their lack of experience in this area. This identified need is the basis of the Mission's Privatization Plan (See Annex K1).

As presented in the AID-financed First Boston Memorandum on Privatization, the work programs or actual operating stages involved in the privatization process are extremely important to achieving privatization targets and goals. The GOP has taken the recommendations of First Boston and provided for the following in its privatization program through Proclamation No. 50:

- A clear legal framework;
- Centralized decision making power; and
- An overall privatization unit with detailed operating guidelines.

With this accomplished, and although the APT and selected GOCCs have initiated the privatization process, the services that can be provided by expatriate and local consultant and to be funded by the project are critical to the timely completion of their tasks.

The nature of any privatization program requires the application of diverse and specialized disciplines. The objectives of the Philippine Privatization Program, the degree of sophistication of the Philippine market and the structural layout of the sectors to be privatized, and the desire not to "reinvent the wheel", make it advisable to contract the services of various specialty firms. Since the ultimate price that investors might be willing to pay for any enterprise is normally a function of the accuracy of available information, ensuring the quality of information is a top priority. To this end, firms with specialty backgrounds in the preparation of information, in the appraisal of assets, in the conduct of sectoral strategic studies and in the execution of divestiture programs, must be looked upon as providers of needed services.

Auditors: The supply of accurate and updated financial information is a key requirement in any type of divestiture process. To this end, the participation of an outside accounting firm in the audit of historical as well as current financial performance is needed. Similarly, in cases where financial restructuring is being considered, accounting firms are best qualified to perform the task. If attracting foreign investors is one of the objectives, having financial statements be endorsed by one of the "Big Eight" U.S. accounting firms, and their associates here in the Philippines would become a priority.

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Technical Advisors/Specialty Engineering Firms: In order to obtain a thorough understanding about the real value of a company, alternative valuation methodologies should be utilized. Among these, replacement cost and liquidation value are parameters that only experts in the specific field would be able to provide. Thus, the involvement of technical/specialty engineering firms is necessary.

Investment Banks: The participation of an investment bank has a two-fold objective: (1) as financial advisor to the government, in working together with the privatization unit (in this case the APT and/or ADUs of GOCCs) in the sale of smaller enterprises; and (2) as financial intermediary for the sale of larger enterprises. The investment bank is able to provide the technical assistance normally associated with the sale, merger and acqusition of companies and can thus define and execute marketing strategies tailored to the specific characteristics of each enterprise.

Legal Advisors: The assistance of lawyers is important for solving numerous issues prior to the sale such as labor contracts, and contingent and hidden liabilities, and ultimately for executing on behalf of the seller the actual disposal of assets to a new owner.

Management Consultants: Strategic studies on the sectors to be privatized should be conducted by management consulting firms. The objective of their work is normally geared to identifying entry barriers in Government-controlled sectors with a view to designing policy measures to encourage private investment. The scope of these measures will also involve, but not be limited to, specific pricing recommendations, labor and management issues, etc.

Other governments, including Great Britain, Spain, Costa Rica and Jamaica have recognized the effectiveness of utilizing outside advisors to provide professional assistance in the expeditious privatization of assets and have used them quite effectively in executing their privatization efforts. The experience gained by advisors to those governments is certainly applicable here in the Philippines.

The project's privatization component corresponds to these requirements and will provide these services to the APT and ADUs of GOCCs and provide for the professional, timely and efficient disposal of GOCCs and acquired assets.

The momentum provided by the 1986 PHOENIX Conference kicking-off the GOP's Privatization Program is beginning to falter. It was thought that the partial divestiture of the Philippine National Oil Company (PNOC) marketing subsidiary would be the success story paving the way for privatization that the First Boston report identified as being crucial to reversing the criticism and skeptism that is inevitable due to the special interests and ideologies involved. Instead, the President has deferred making a decision on the privatization of PNOC, yielding to political pressure, and has approved for privatization only 86 of the originally listed 121 GOCCs. Those companies on which action has been deferred yield 64% of the gross revenues of the entire list of companies originally proposed for privatization.

It is now more important than ever to have these specialized services placed as quickly as possible to keep the privatization process moving and alive. The technical assistance and equipment in support of the APT's and selected GOCC's information and data management needs will put into place file and retrieval systems that will allow their staffs to be more efficient and, in turn, more productive. By using donor financed outside consulting assistance in their legal, valuation and marketing efforts, the APT and ADUs of GOCC's can more effectively utilize their scarce resources and lean staffs to manage the privatization process. Because this assistance is experienced in the privatization process, as mentioned above, the wheel is not reinvented and the GOP will certainly realize a greater return on the assets being sold than if these services were not in place.

The technical assistance to the GOCC's in the establishment of independent ADUs, the refinement of their privatization objectives, the identification of impediments to privatization and the development of privatization strategies will provide order to what is now a chaotic state of privatization implementation; keep privatization objectives focused, and on track with the government-wide privatization objectives; and insure against the special interests, turf protectors, and hidden agendas always evident in the privatization process.

The approach taken in the project's privatization component will assist the GOP achieve its privatization goals.

B. Capital Market Development

The development of the securities (stocks, bonds) component of the capital market has suffered for two basic reasons:

- The past GOP administration promoted macro-economic and financial policies that fostered the non-securities market (short- to medium-term commercial and development bank loans), and retarded growth in the securities market for equity and term debt. (Please See Section I); and

- Corresponding to the lack of a policy for capital market development is the legislative/statutory, regulating, procedural and operational impediments/deficiencies that have directly stunted the growth in the supply of and demand for securities.

Since coming to power in February 1986, the Aquino Government has accomplished major achievements in macro-economic management and policy reforms. Notwithstanding a severely depressed economy, a heavy external debt burden, and political challenges, the Aquino Government achieved significant progress in undoing the cumulative damage wrought by the previous administration's policies as well as the policies themselves. Major accomplishments include:

o Economic recovery and stability, including

  - Price Stability, and
  - Reduction in interest rates;

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- o Development planning, including:
  - Completion of a new Philippine Medium Term Development Plan, and
  - Completion of a new Public Investment Program;
- o Alleviation of the foreign debt service burden, including:
  - Agreement with the IMF on a new stand-by arrangement and a Compensatory Financing Facility purchase,
  - Agreement with donors on official debt restructuring, and
  - Completion of negotiations on commercial bank debt restructuring;
- o Fiscal expenditure and tax policy reform, including:
  - Implementation of eighteen tax measures to improve incentives and efficiency,
  - Budget realignment in favor of basic services and maintenance and operating expenditures, and
  - Constraining the public sector deficit;
- o Privatization, including:
  - Creation of the COP and APT,
  - Transfer of a substantial number of acquired assets to the APT,
  - Completed guidelines for disposal of acquired assets, and
  - Approval by the President of the Philippines of 86 non-financial government corporations for privatization;
- o Public Corporate Sector Rationalization, including:
  - Creation of a Government Corporate Monitoring and Coordinating Committee, and
  - Implementation of the plan to financially restructure and rehabilitate PNB and DBP, as well as, drastically change their operating policies and procedures with a view to the GOP eventually divesting these entities;
- o Trade Liberalization, including:
  - 1000 additional import items liberalized, and
  - Abolition of tariff exemptions;
- o Simplification/clarification of investment rules, including:
  - establishment of "one-stop-shop" for exports; and

o Rural finance development, including:

- Abolition of selective credit policy and credit subsidies, and
- Central Bank adoption of uniform and market-aligned rediscount rates.

The above achievements provide ample evidence that the GOP is moving ahead on the macro-economic and financial policy front. However, much more needs to be done to speed up the implementation of announced policy reforms. For example, interest rates have declined and the CB has eased monetary restraint allowing reserve money to expand. However, interest rates remain high in real terms. This means that investors continue to clamor for short term as opposed to longer term instruments. With yields on short term instruments at current levels (even though they are historically low), it is difficult to develop a longer term, fixed rate market. The GOP must take further overt action to establish that its policy is to bring about a longer term market.

The major donors to the Philippines, including the U.S., WB, ADB and IMF, have been coordinating their policy dialogue efforts to assist the GOP achieve its economic growth and development targets and objectives.

The continuing pursuit of policy reforms by the GOP, its stated policy of encouraging Capital Market development and the considerable pool of investment funds with few investment grade securities available has already fueled a stock market boom. However, this stock market boom will certainly go bust and confidence in the markets will again turn sour unless the GOP operationalizes its policy pronouncements through statutory, organizational, regulatory and operational changes that affect the supply of and demand for term securities. Assisting the GOP operationalize its policy pronouncements is critical at this juncture. This capital market component of this project will assist the GOP do this.

To achieve this objective, there is no alternative to the following operational actions being taken:

- Conduct thorough review/legal audit of laws, regulations, rules, procedures, etc. to identify the impediments to increasing the supply of and demand for term securities, and the drafting and adoptation of new legislation, regualations, rules, and procedures by the Congress, DOF, SEC and other pertinent GOP entities.

  Project funds will be used to finance the TA required to conduct the legal reviews/auditis. The subtasks will be performed simultaneously to formulate and coordinate a singular legislative thrust on the subject. Draft legislation, policies, regulations and rules/procedures will be the primary output and will be utilized by the GOP Departments/Agencies involved in a coordinated presentation to Congress for deliberation and action. For those regulations, rules and procedures not subject to the legislative process, an Action Plan will delineate responsibilities and timeframe limitations for making the changes.

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- Develop a capital market development capacity in the SEC or other government entity with its primary purpose the promotion of the capital markets within an economic development context. Also reorganize and enhance the staff capabilities of the SEC to not only reduce its over bearing securities industry regulatory function, but also to strengthen selected regulatory functions to provide and instill confidence in the capital market, protect the public interest and be more responsive to the needs of investors, the securities industry and the corporate sector.

  All concerned GOP entities, including the SEC, accept the fact that the SEC needs to be reoriented, reorganized, its staff capacity enhanced and its capacity to accumulate, retrieve, analyze and dessiminate data in an accurate and expeditious manner needs upgrading if it is to play its appropriate role in the development of the capital market.

  The project will fund technical assistance for an organizational assessment of the SEC to achieve these objectives, but will also do more. It will determine if the SEC is the appropriate agency to promote capital market development. And if not, provide the GOP with an organizational framework to achieve that goal.

- Professionalize, reorganize and upgrade the capacity of the stock exchanges to provide an efficient, stable and reliable secondary market environment that will also instill investor confidence and reduce their perceptions of risk. A major objective is to merge the stock exchanges.

  It is important that the stock exchanges not be viewed as gambling dens. The stock exchanges have already recognized the need for this change in perception. Using the AID financed capital market study as their basis, they have already opened the discussion on professionalizing the management of the exchanges and organized a "unification committee" with DTI and the SEC on merging the two stock exchanges.

  The project will fund TA that will make an organizational assessment of the stock exchanges, and provide recommendations on their management, governorance and operations. Based on an assessment of their equipment needs by the TA contractor, commodities will be provided that will significantly increase their efficiency and productivity in the management of information needed to conduct their oversight and procedures/rules enforcement responsibilities of the management of the stock exchanges and to respond to the securities informational needs of its clients. The stock exchanges should have no problem absorbing the new technology that comes with the commodities as their is an ample supply of qualified technical talent in the Philippines to respond to the technical needs of the stock exchanges.

- Enhance professionalism and the managerial capacities of the securities industry itself so that it can be more responsive to the investment needs of its clients. The project will fund training, seminars and observation tours to achieve this objective based on an operational assessment of selected stock brokerage, investment houses; etc. in association with the stock exchange organizational assessment.

- Standardize financial reporting through the application of uniform accounting and auditing principles and standards as a means of improving the reliability of the financial statements and disclosing this information on a uniform basis, so that investors can make informed judgements on the placement of their investible funds.

  To assist the accounting profession achieve this goal, the project will fund TA in the establishment of generally accepted account and auditing principles.

  The accounting and auditing profession in the Philippines is very well developed with Asia's premier accounting/auditing/management consulting firm headquartered in the Philippines and others associated with the U.S. "Big Eight" accounting firms.

- Conduct a public media campaign that will educate the corporate sector and the public on the economic development need for capital markets, the corporate personal benefits, and how to achieve their respective capital and investment objectives as a means of disspelling distrust of the market and creating a more sophisticated market for securities.

  The capital markets in the Philippines have been dormant for so long and the growing sophistication of the world capital markets has left much of the small to medium scale corporate sector and the general populace basically uninformed on the types of available securities, and the benefits and mechanics of investing in securities. To address this problem, the project will fund the production costs of films, TV and radio spots, and written materials from the perspective of both the GOP and securities industry. This information will be designed in such a manner that it can be utilized throughout the country irrespective of the sophistication of the audience.

- As was done for the GOP's Privatization Program, publicly announce the GOP's policy for capital market development and put the legal/regulatory/operational impediments to increasing the supply of and demand for securities on the table in an open forum such as a Capital Markets Conference. The project will partially fund a capital markets conference in and for the Philippines. It is envisioned that this will be a sharply focussed one or two day conference that will be used as a forum for formally and publicly announcing the GOP's policy on capital market development in much the same manner as was done for the GOP's "Privatization Program". Selected peso operational costs including the conference organizer, will be funded, as will the support costs for 3 or 4 U.S. capital market experts to participate.

The institutional development/technical assistance component of this project has a number of established GOP Departments/Agencies and private sector entities involved. This effort will be coordinated through the Capital Market Development Working Group (CMDWG) organized at the instigation of DTI to promote the activities presented in this paper. CMDWG is supported by a Secretariat funded and housed in DTI.

A "General Contractor" will be procured and will have a consortium of subcontractors with specialized expertise in the various elements of the project. The General Contractor will have the extremely important task of coordinating the accomplishment of the various elements of the project, all of which will be implemented simultaneously because of the very close interrelationships among the elements. The General Contractor, while responsible to USAID under AID-Direct contract, will liaison very closely with the CMDWG on the implementation of this component of the project.

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