

ADDRESSING LABOR CONCERNS DURING PRIVATIZATION:  
LESSONS FROM THE METROPOLITAN WATERWORKS AND  
SEWERAGE SYSTEM (MWSS), MANILA, PHILIPPINES

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JULY, 2001



PUBLIC-PRIVATE  
INFRASTRUCTURE  
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# **Addressing Labor Concerns During Privatization: Lessons from the Metropolitan Waterworks and Sewerage System (MWSS), Manila, Philippines**

## **Part 1. Introduction and Methodology**

### **1.1 State-Owned Enterprises and Labor Force Issues**

The Philippines, like many other developing countries, depends upon a large governmental role for the provision of services that have public goods characteristics. These often are services where the price that producers would be able to charge will not reflect production cost and where private incentives are likely to result in a less than socially optimal level of production. Thus, national governments have traditionally intervened through establishment of state-owned enterprises (SOEs), in this case, the Metropolitan Waterworks and Sewerage System (MWSS), a public water utility.

In recent years, there has been growing realization that depending solely upon government utilities or SOEs to provide services, such as water supply and sewerage, results in too much inefficiency<sup>1</sup>. However, the practical steps needed and the various efficiency and social implications of privatizing such utilities are still not well known, and many governments remain reluctant to experiment. This report hopes to contribute to improving the understanding of the process and implications of privatization. Specifically, it will address a particular aspect, labor impacts, of the privatization process for a large water utility, MWSS, in Metropolitan Manila, Philippines.

### **1.2 Labor Impacts of Privatization**

The traditional concerns associated with the privatization of state-owned enterprises have included improving efficiency, promoting social equity, and protecting national security. The potential efficiency gains from privatization are usually well understood. However, with respect to equity, there is the concern that if utilities were in the hands of the private sector, service would be concentrated only in densely populated areas and would be biased for the richer households or consumers. Respecting national security, a common view is that utilities, such as water and power, are so important that private interests should not control their production and distribution.

In addition to these, there has been growing interest on the implications of privatization on employment. In many instances, workforce expansion has been associated with SOEs and government agencies. While there may be inefficiencies associated with the large labor force, the privatization process cannot ignore the economic and social impact of labor force reduction. When public utilities or SOEs are privatized, the presumption is that service efficiency would improve. Indeed in the case of the MWSS privatization program, the indicators all show improvement in water supply.

In addition, there is indication that equity goals are also being served as more lower income households have access to the water system. However, the concern regarding the employment impacts of privatization persists, that the process leads to laying off a substantial number of public utility workers and that this may have been achieved without attempts to compensate or assist those who are negatively affected.

### **1.3 Approach and Scope**

This report will assess the particular issue of labor impacts resulting from privatization. While the focus on labor issues is very specific, the assessment will also describe the overall objectives and processes associated with the privatization program, to set the appropriate context for the discussion.

Background information on the utilities sector in general and on the MWSS in particular are available from published reports and government data. However, the detailed information on the MWSS privatization process is based on interviews and personal records that have been provided by various individuals who were directly involved in the privatization program. The list of interviews conducted during the study is attached below.

To focus the assessment, the time period identified for the assessment has been classified into three: (1) the preparation of the privatization effort, starting about August 1996; (2) the transfer of MWSS to two concessionaires, January to August 1997; and (3) the probationary employment period under the new concessionaires, August 1997 to January 1998.

### **1.4 Outline of Sections**

In Part 2, the key features of the MWSS privatization are described to set the context for the labor force reduction process. Both efficiency and social equity improvements are associated with the privatization process and help put the social concerns associated with loss of jobs in better perspective. Part 3 presents the detailed process of work force reduction that was carried out as part of the privatization process. This is divided into two main periods – Period I refers to work force reduction as part of the preparation for privatization that was carried out by MWSS management; Period II refers to the further reduction of labor force carried out under the first six months of the takeover of private concessionaires. Lastly, Part 4 highlights some of the lessons learned and remaining issues from the privatization process.

## **Part 2. Key Features of the MWSS Privatization**

### **2.1 Overview of Water Resources and Institutional Issues**

#### **2.1.1 Background of MWSS Service Area and Water Resources**

The MWSS serves more 11 million people in the 8 cities and 29 municipalities of Metropolitan Manila, which includes the National Capital Region, parts of Cavite Province, and all of Rizal Province. The MWSS system, with a geographic area of 2,100 square kilometers, has about 850,000 water connections, 90,000 sewer connections, and produces 3 million cubic meters daily. The annual revenue during the mid-1990s averaged 6 billion pesos (about \$230 million, with the 1996 Peso-US\$ exchange rate of 26)<sup>2</sup>.

Most of the water supply to the system (97%) comes from Angat dam, with the balance coming from groundwater. Angat dam is located in Bulacan province, north of Manila. (Refer to Map 1.) The dam is a multi-purpose facility, and water use is shared by MWSS with the National Irrigation Administration (NIA) and the National Power Corporation (NAPOCOR). The dam itself and the reservoir are managed by NAPOCOR<sup>3</sup>.

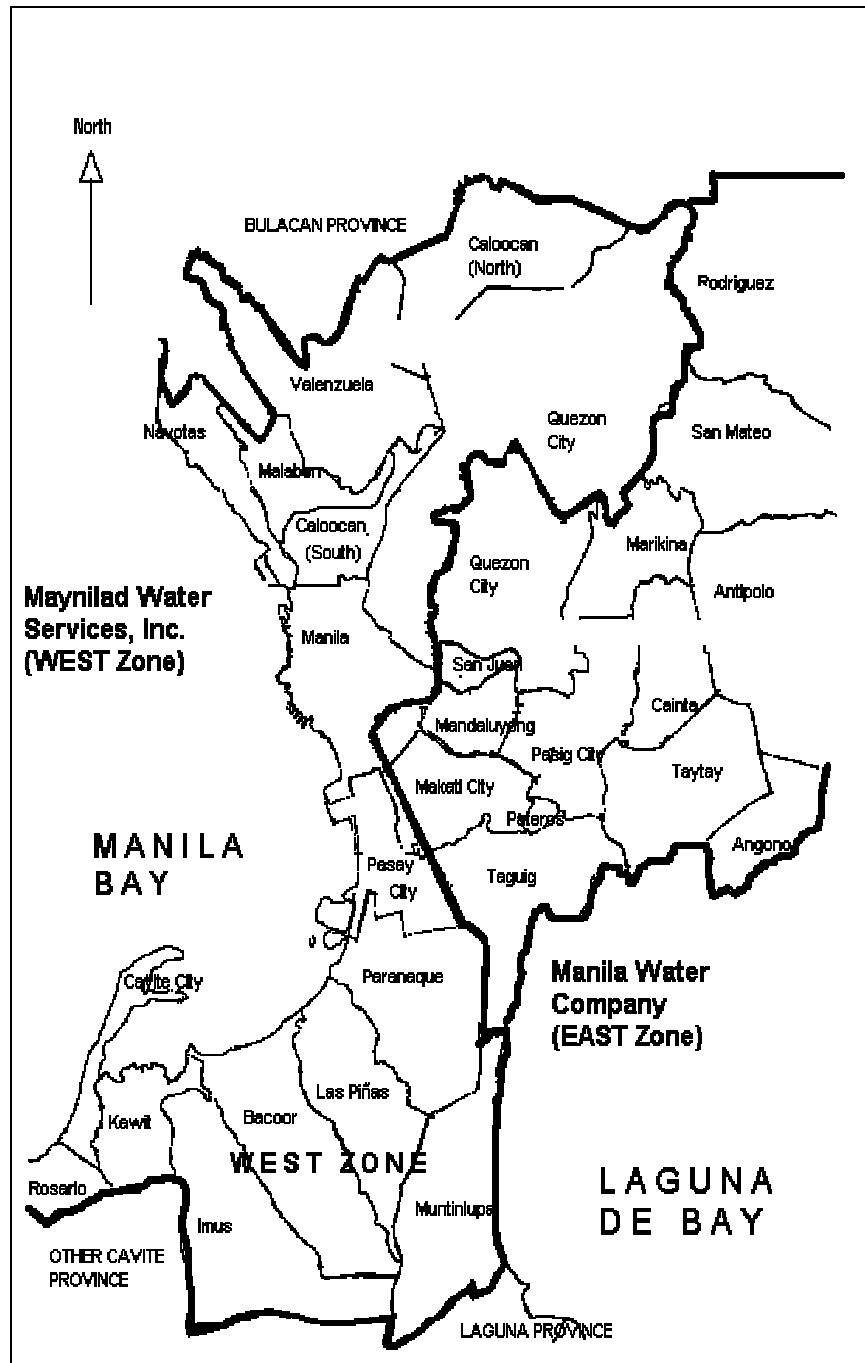
Water allocation follows a system of water rights, based on the National Water Code and is managed by the National Water Resources Board. MWSS's share of water from the Angat Dam has increased through the years and currently averages 28.8 cubic meters per second. The NIA has historically had a water right of 36m<sup>3</sup> per second, but water laws recognize the importance of water supply for urban areas. Thus, in the event of a drought, urban water use has priority over other uses, mainly irrigation water supply and the associated generation of electricity. The emergency needs of Metropolitan Manila have increased in recent years, with greater incidence of drought. For example, in 1998 with the severe *El Niño* drought, all the water was used for Metro Manila, and no irrigation water was released from the Dam<sup>4</sup>.

#### **2.1.2 Legal and Institutional Context of Water Use<sup>5</sup>**

The National Water Code of 1976 provides the legal framework for the water resource use in the country and incorporates efficiency, equity, and sustainability concerns in the management of water resources. Under the code, the National Water Resources Board (NWRB) has overall responsibility for water resource management: including control, supervision, and regulation of the utilisation, exploitation, development, and protection of water resources. Despite this broad mandate, however, implementation problems remain due to the Board's limited financial resources and the presence of over-lapping jurisdictions.

A particularly difficult problem is that the regulation of water resources is included in the jurisdiction of several other government agencies. MWSS, as noted previously, has overall responsibility for water supply and sanitation in Metropolitan Manila. (In terms of government administrative structure, MWSS is an independent agency attached to the Department of Public Works and Highways and governed by a Board of Directors appointed by the President of the Philippines.) In urban areas outside

Map 1. MWSS Service Area



Source: C. David 1998.

the MWSS service area, water supply is generally the responsibility of local water districts. These, in turn, are managed (and subsidized) by Local Water Utilities Administrations (LWUAs). In few municipalities, the Local Government Units (LGUs) have direct responsibility for the water utilities. To further complicate the jurisdiction and institutional framework, the Local Government Code passed in 1991 assigns the responsibility for the construction of wells for low-income households to the LGUs. Previously, tubewell construction was under the Department of Public Works and Highways (DPWH). Lastly, water use for irrigation and power generation are by the National Irrigation Administration (NIA) and the National Power Corporation (NAPOCOR), respectively.

With regard to water allocation rights and pricing, the Water Code gives the NWRB the authority to grant rights and issue permits for exploiting surface and groundwater resources in general. However, in practice this regulatory power is shared with the MWSS and water districts since the latter have the authority and mandate on the provision of water to their respective jurisdictions. Also, the experience is that most local jurisdictions issue permits for private wells liberally since they have not been able to provide for local needs. Such private business and household water exploitation has not been sufficiently monitored, and only a very small number of private groundwater users (less than 15%) are registered with local utilities and with the NWRB.

The pricing of water is similarly assigned to different agencies. The MWSS Board has jurisdiction to set the water tariff for Metro Manila. Its charter implicitly sets a cap on water price since it limits the MWSS rate of return on book value of assets to 12%. However, although MWSS has the jurisdiction to set prices, pricing of water in Metro Manila has been such a sensitive political issue that in practice this decision has been made by the country's President. For the less politically sensitive local water districts the local water authorities have made the pricing decisions.

With regard to sewerage, only MWSS has a mandate for the construction, operation, and maintenance of sewers and water sanitation facilities for its service area. All the other water supply agencies deal only with water provision. The construction and maintenance of storm sewers and drains are the responsibility of the DPWH in Metro Manila and the respective LGUs in other urban areas. Lastly, drinking water quality regulation and monitoring have been the responsibility of Department of Health, and the Department of Environment and Natural Resources is in charge of regulating pollution from sewerage discharges and industrial effluents.

## **2.2 MWSS Before Privatization: Inefficiency and Social Failures**

The political nature of water is one of the reasons developing countries depend upon SOEs for water provision. Since water is essential for human life, a popular perception among developing countries is that it must be provided at low cost. Therefore, SOEs are often seen as ideal water suppliers because, as government owned institutions, they are not profit-seeking. In addition, as government-operated institutions, they are supposed to be better equipped to address social concerns (such as providing access to safe drinking water even to poor households) that private companies will normally not take into account under profit-seeking and efficiency considerations. Indeed government subsidies to SOE operations are often justified on the grounds that they are responding to pressing social needs.

However, the record of the MWSS before privatization was not only remiss on efficiency; it also failed to deliver on the need to provide basic services to the population of Metro Manila, especially to the poorest households and communities. MWSS was generally characterized by inefficiency, poor service, and a heavy reliance on government subsidies.

To illustrate, in 1994 MWSS was supplying water to just two-thirds of its intended coverage population, and for an average of only 16 hours per day<sup>6</sup>. In addition only 8 percent had sewer service connection<sup>7</sup>.

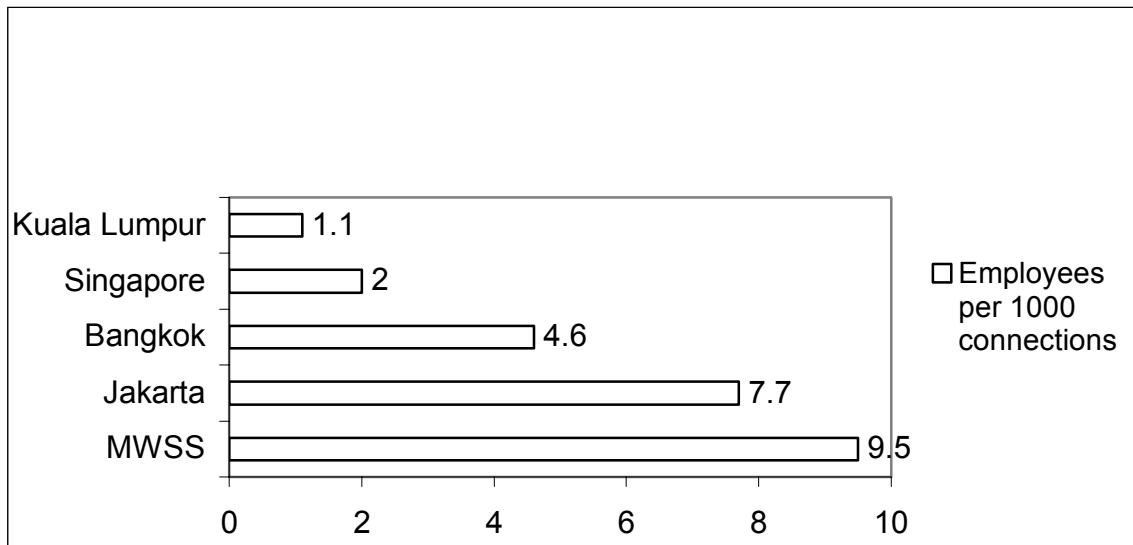
One key measure of inefficiency in the water services industry is the extent of non-revenue water. This is water that is stolen or leaked from faulty pipes, and no revenue is earned. In the pre-privatization period, MWSS was receiving 3 million cubic meters of water per day from the Angat reservoir, but about 60% was “non-revenue” water<sup>8</sup>. By comparison, the average rate of non-revenue water in other developing countries was 20% to 30%<sup>9</sup>. In fact, MWSS had the highest rate of non-revenue water among the main cities in Asia.

In addition to the problems with inefficiency, a recent study indicates that during this period MWSS also was not delivering on its social objectives. Large segments of the urban poor did not benefit from the water utility because they either were outside the distribution network or could not afford a water connection. Most poor households do not have formal ownership of their land, and as a consequence they cannot qualify for water connections. Only 20-25% of low-income households have individual connections—a proportion that is decreasing because of the use of public pumps, water vending, and sharing existing connections<sup>10</sup>.

Unfortunately, there are few standpipes available to the urban poor: the ratio of standpipes to ordinary connections is less than 0.2 percent. In fact, according to a 1995 survey, 23% of low-income households rely on vended water. This, ironically, tends to be either purchased at low MWSS prices and resold for profit, or non-revenue water stolen from MWSS connections. Thus, despite all the subsidies and emphasis on low water prices, poor households that are primarily dependent on vended water could end up paying as much as ten times more for water than high-income households connected to the MWSS distribution network<sup>11</sup>.

With respect to labor, having a large number of employees per 1000 water connections is often used as a simple indicator of low productivity. In this period (end-1995), there were 7,958 employees and 837,000 connections; thus the number of employees per 1000 water connections was about 9.5. By contrast, other developing countries in the region had substantially less employees per thousand water connections<sup>12</sup>. (Refer to Fig. 1.)

Figure 1. Employees per 1000 Water Connections, MWSS and Other Water Utilities In Different Asian Cities



Source: David 1998, Dumol 2000.

## 2.3 Steps to Privatization

### 2.3.1 Need for Leadership and Political Support

Under the administration of President Fidel Ramos, from 1992-1996, there was increasing recognition of the need for decentralization and privatization. Thus, the case of MWSS, with the inefficiency and equity problems made it an early priority SOE for privatization discussions. However, there were many constraints that would delay any progress in this process until the closing years of the Ramos administration.

As a corporation, the MWSS has greater financial flexibility than the standard government agency since it can generate revenues and use its income as needed. By contrast, a regular government agency would have to turn yearly to the Congress for a budget allocation. However, as a government-owned corporation, MWSS still is governed by the usual government rules for procurement and personnel issues. For the latter, MWSS had to follow very rigid hiring and employment practices because of the procedures of the Civil Service Commission. Thus, even assuming that internally MWSS officers and staff had agreed on the need for privatization, within MWSS's legal mandate and functional organization they could not independently implement the process. Specifically the necessary financial and employment changes were not within the scope of MWSS's authority.

In fact the motivation for privatization and the process originated from outside the MWSS system. With respect to motivation, the main concerns identified by the administration of President Fidel Ramos, about 1995, focused on the procurement, financial, and personnel constraints<sup>13</sup>. Among the professional and career officials



dealing with MWSS, the inefficiencies and social problems were well understood. However, to resolve the problem within the MWSS framework was deemed impossible. For example, regarding procurement a senior DPWH official noted:

MWSS had the habit of tying itself up into knots, to such an extent that it could not sort out its bidding for janitors and security guards ... These ... were locked in so much controversy that awarding them usually took two years or more. MWSS was ... locked in a bidding controversy over large-diameter ... pipes, which was ending up in a multitude of court cases ... This bidding took seven years to resolve<sup>14</sup>.

Although it was financially flexible to an extent, MWSS could not borrow except from official development agency sources, and much of this required long processing times. With respect to labor force, most officials were career professionals, but the MWSS Administrator was a political appointee, together with all the Board Members. While MWSS certainly had some very capable appointees, within the institutional structure there was not the capacity to build up a long-term core of mid-and high-level managers. In general, recruitment was influenced by political patronage. Once employees were hired, Civil Service Commission rules dictated rigid job protection and made it difficult to remove even those employees who were abusing their regular status. Thus, MWSS employment reflected the over-staffing found in many government agencies.

Given these constraints, privatization clearly had to be pursued from outside the framework of the MWSS structure. In addition the privatization process would have to be carried out in a politically controversial environment, with criticism from politicians on the right and from socialist activists on the left. This sensitive process required a legal mandate and strong political support. DPWH officials supporting the privatization appropriately recognized the need to form a competent staff to implement it, flexible financial resources, and transparency at all levels of the process<sup>15</sup> (Dumol, Lazaro).

To ensure committed and qualified leadership for the transition process, President Ramos appointed Angel Lazaro III as administrator of MWSS in 1995. Lazaro was an outstanding engineer, with broad experience in management and business. He had his own successful engineering firm, and he accepted the appointment with the understanding that his role was to lead the transition of MWSS into private management, after which he would return to the private sector<sup>16</sup>. With a clear mandate and without any of the political interests that may be associated with government appointees, Lazaro was able to take aggressive and decisive actions to initiate the privatization process. At about the same time, DPWH officials were able to get a grant from the French government to prepare the privatization plan.

### **2.3.2 Preparation of the Legal and Business Aspects**

Because they were aware of the challenges involved, MWSS officials studied various approaches before implementing privatization. They were especially interested in the experience of other developing countries and even visited Argentina, to discuss privatization first-hand with the architects of the largely successful water-supply privatization in Buenos Aires.

*Legal issues and consultation.* Because of the existing system governing water supply for Metro Manila, a key step needed was to identify the appropriate legal basis for privatization. There were three options considered: Presidential Proclamation 50 (which created the Committee on Privatization), the BOT (Build, Operate, Transfer) Law, and the Water Crisis Act (WCA). DPWH and MWSS officials decided to go with the WCA. Both Proclamation 50 and the BOT law dated back to the term of President Corazon Aquino (1986 to 1992), and they were viewed to be too general in scope.

The WCA was enacted during President Fidel Ramos term. The congressional bill creating the WCA was filed in February 1995 initially as counterpart of the Power Crisis Act, which was used to promote quick turn-around power generation projects, as a response to energy shortages in the early 1990s. The key provision in the WCA was to give the President the power to “fast track” water projects by directly negotiating water project contracts. DPWH officials did not consider this provision particularly helpful because most water sector projects were funded by official development assistance and had to conform to external development agency procurement procedures<sup>17</sup>. However, the WCA also provided for the reorganization of MWSS, primarily through an early retirement program, and it also included provisions for the criminalization of water theft. Most importantly, during its deliberation in Congress, DPWH had managed to add a flexible privatization component in the WCA. This component gave the President the authority to privatize MWSS, without prescribing a specific process or form. Thus, the WCA became the main legal basis for privatization.

While it was extremely useful due to the flexibility accorded to the process, one constraint of the WCA was that it required that the privatization process had to be initiated within six months of the enactment. This meant that the plan had to be in place by December 7, 1995. To ensure that there would be no legal challenges based on timing delays, the lawyers engaged by the privatization team pushed for issuance of an explicit Executive Order (EO), to implement the WCA. EO 286 was issued on December 7, 1995, but it failed to provide enough detail on the privatization of MWSS. Thus, a follow up executive order had to be issued, EO 311 of March 1996, which spelled out the details of privatization of MWSS. These executive orders turned out to be crucial components of the process, since litigation did follow in the course of privatization and these EOs strengthened the legal position of the privatization team<sup>18</sup>.

To complete the privatization team, DPWH engaged the International Finance Company (IFC) as its advisers for the privatization plan. DPWH officials were aware of the extensive experience of the IFC in privatization programs, particularly in the power sector. Also, the World Bank had assisted in the successful privatization of the Buenos Aires water utility in 1992, and IFC as part of the World Bank group would know about the Buenos Aires case. In addition, it was felt by DPWH staff that the international reputation of IFC would also help emphasize the seriousness that the government was attaching to the privatization effort.

*Concession approach.* Because the main goal of the privatized water utility would be on water distribution, it was decided early in government discussions that the approach would be to bid out MWSS to potential concessionaires<sup>19</sup>. The concessions would be for 25 years. Concessionaires would have rights to water from the existing dam but would have to supply all additional water and would be responsible for all operation and maintenance of the water system. The concessionaires would assume existing debts (about US\$1.2 billion) and projects for water supply and sewerage. The

MWSS would handle the accounting for its debt, which would still remain in their books although debt repayment was the responsibility of the concessionaires. The government would continue to own all facilities, and concessionaires would use only facilities directly related to MWSS water use. MWSS would manage the remaining assets under its control, particularly real estate. Within MWSS, a separate Regulatory Office would be created, largely independent from MWSS management, and would be mandated to regulate the concessionaires with respect to their compliance with the Concession Agreement.

To promote competition and efficiency, the government decided to divide Metro Manila into two service areas, the West and East sectors, to be run by different concessionaires. It was also expected that having two concessions would help generate more information for the regulatory body. The West sector is the more densely populated region and encompasses about 60% of population and water connections. The East sector is the newer part of the system, and the expectation is that it would experience greater growth. The privatization team believed that having the benefit of two competing concessionaires would be worth the difficulty in dividing the service area, the distribution network, and establishing two water supply zones. The competition would foster an incentive for efficiency as well as establish a method of comparison for the regulatory office in monitoring and assessing the concessionaires' performance. The operation of common upstream facilities would be a joint venture between the two firms.<sup>20</sup>

*Role of foreign firms.* Early in the privatization discussions, DPWH officials clearly indicated a preference to involve foreign water utility firms in the bidding for MWSS. Their view was that the scope of the water distribution was so large and difficult that only the biggest and most experience companies in the world would be able to respond adequately. However, the Philippine constitution specifically mandates that all utilities have to be owned and controlled by Filipinos, with a minimum of 60% of equity to be Filipino-owned. Based on these requirements, the privatization team decided to focus on pre-qualifying only the most capable Filipino companies who would then set up partnerships with international water utility firms. Additionally, they required that the main Filipino firm must have at least 20% of equity (with the balance of 40% to be held by other Filipino partners). Of the 40% foreign equity, they also required that the main international partner should provide at least 20%. The intent was to ensure significant involvement of the key Filipino and foreign firms. Lastly, 10% of the Filipino component (or 6% of total equity) should be made available to employees, as part of the worker compensation package (to be discussed in detail below).

### **2.3.3 Promoting Broad-Based Support**

*Early discussions with labor leaders.* The involvement of MWSS workers in the discussion of the need to address the excess labor force problem and the need to emphasize fairness in the treatment of employees was clearly recognized by the privatization team at an early stage. Because it was a government corporation and was governed by Civil Service Commission rules, MWSS did not have a labor union. Instead like many other government agencies, what it had was an employees' association, the KKMK (Kaisahan at Kapatiran ng mga Manggagawa at Kawani ng MWSS or Unity and Brotherhood of Workers and Employees of MWSS). It should be noted that the term MWSS "labor union" is mentioned in various documents, but this refers to the KKMK. Most of the employees of MWSS were members of the KKMK, and

its leadership was active in the discussions during the privatization period. The privatization team believed that it was important to involve labor in the privatization discussions, and to have the assistance of KKMK in managing the difficult transition that was foreseen. There were also other labor organizations active in MWSS during the privatization period, but they were all very small, and KKMK generally represented labor in negotiations with management. (More detail on the role of KKMK is noted in the labor force reduction process described below.)

*Building public support: pricing incentives and media campaign.* Aside from its employees, the average Metro Manila water consumer was also identified as an important part of an information campaign for privatization. The privatization team engaged both foreign and local media consultants to prepare information materials and to circulate these through the local media. At the same time, the planners wanted to ensure that the transition of the water utility into private control would have clearly beneficial impacts on consumers. Thus, the plan for the concessions included the requirement that the concessionaires must decrease the water tariffs. According to the concession bidding rules, bids had to be submitted as a percentage of the existing water rate (US\$ 0.23 per cubic meter), and could not to exceed 100% of the existing tariff. To assist the concessionaires, the government would provide a six-year tax holiday to concessionaires, as additional incentive to reduce water tariffs and win consumer support.

The positive effect of these efforts was instrumental in getting widespread support for the privatization process among the average Metro Manila consumer. The overwhelming response from the print media was positive, as articles and editorials were issued applauding the government's efforts to improve the efficiency of the water utility and to reduce tariffs. It is noteworthy that with the Philippine press, which is widely recognized as one of the most independent and critical in Asia, various journalists supported privatization. Indeed one editorial supporting the process carried the title "The Joy of Privatization" (The Manila Standard, January 26, 1997), referring to the prospects of both lower prices and improved water availability for the urban poor.

#### **2.3.4 Emphasizing Transparency in the Bidding Process**

The privatization of MWSS was implemented in 1997, after many months of preparation. To protect the integrity of the process, an emphasis on transparency was deemed absolutely essential by DPWH and MWSS authorities early in designing the privatization process<sup>21</sup>. The pre-selection criteria (to guarantee minimum technical qualifications for the potential concessionaires) coupled with the public bidding process contributed to political acceptability of privatization by ensuring both legitimacy as well as the lower prices for water. The bidding procedure adopted in the MWSS effort was based upon the Buenos Aires model. However, the two-concession approach introduced some elements of competition into the process. While bidders were encouraged to bid on both concessions, no single bidder could win both concessions.

#### **2.4 Benefits Following Privatization**

Once implemented, the MWSS privatization, at U.S. \$150 million annual revenue with a service network of 11 million people, became the "world's largest water privatization" effort<sup>22</sup>. Recent reports on the case of the privatization of the Metropolitan

Manila Water and Sewerage System (MWSS), suggest that the process has resulted in some efficiency improvements.

Since the bidding rules for the concessions explicitly required a decrease in the water tariff, the immediate impact of the privatization was a decrease in what consumers had to pay for MWSS water. At the time of the bidding, on January 23, 1997, the average water tariff was \$.23 per cubic meter. The East Sector went to Manila Water Company, Inc. (Ayala-International Water) for average price of \$0.061 per cubic meter. The West Sector went to Maynilad Water Services, Inc. (Benpres-Lyonnaise) for average price of \$0.131 per cubic meter. For the whole water system, consumers benefited and were paying about P7 million less per day<sup>23</sup>. The cost of water service went down for all consumers, but much more for consumers in the East zone<sup>24</sup>.

Even with the severe drought in 1998 that followed the El Nino phenomenon after privatization, water utilization and management improved. An orderly rotation of water service was implemented; mobile and stationary water tankers were deployed in depressed areas; and public expenditures for well drilling was increased<sup>25</sup>. However, the shortage of water from the Angat Dam (25-30% reduction) and dramatic drop of the peso relative to the dollar (about 60%) during the first year of privatization significantly reduced the concessionaires' income, and this led to petitions for a rate increase, in March 1998.

Other indicators of service improvements were also positive. Non-revenue water decreased. The productivity of leak repair, connection and meter installation/repair crews increased, and the number of employees per 1000 water connections declined significantly.<sup>26</sup> (Refer to Table 1.) An indirect indicator, customer calls for water service per month increased from 1,000 to 18,000. The increase in calls is viewed as a positive indicator since in the past consumers did not even bother to try to get customer service<sup>27</sup>. Similarly, significant headway was made in apprehending and regularizing illegal connections.

In the East zone, of the 33,000 leaks identified during the first three years of operations, 98 percent have been repaired (MWSS Regulatory Office, Third Anniversary Report, August 1, 2000). Non-revenue water declined from about 60% in 1996, to about 43% by early 2001. For this same time period, the number of water service connections increased from 308,000 to about 405,000 in 2001. Using the number of regularized employees in Table 4 (in the following section), this indicates a significant decrease in number of employees per 1000 water connections, from 9.5 before privatization to about 4.1 by early 2001.

Water quality also improved, with an increase of proportion of water meeting Department of Health quality standards, from 96% to 99.8%. With regard to improvements in customer service, the East's reform of business processes allowed a reduction in response to water connection application, from 21-56 days to 1-15 days. The number of forms that applicants had to complete to initiate the process declined from 18 to 6 forms<sup>28</sup>.

In the West zone, the proportion of non-revenue water was still about 58 percent in 2000. However, other indicators of service have improved. Of the 4.7 million customers in the West Zone, 57 percent had 24-hour water supply by the third year of

privatization<sup>29</sup>. In addition, the concessionaire introduced a community-based water access program, called “Bayan Tubig” (Community Water). Through this program, started in September 1998, the concessionaire, at times with assistance from the local communities, constructed 547 public standpipes. More than 70% of these provides for a water billing system. The billing process is managed either by the local government unit (Barangay) or by community-based organizations. The later is made possible by the presence of very active community organizations in many part of the service area. The public standpipe system, though not as desirable as individual connections, is an important concessionaire response since it provides immediate access for many low-income residents.

The construction of public access standpipes has helped improve access to water for low-income households and has contributed to progress on social or equity concerns. For example, the community water project mentioned above has provided direct water connections to some 500,000 poor people in the concession area. A recent report from MWSI indicates that for the households in the program, water consumption has increased by 3.5 times while their water costs have been reduced by more than half. (Please refer to the executive summary of the Bayan Tubig Report in Annex 2.)

In addition to the community standpipes, the Bayan Tubig program has also contributed to a significant increase in the total number of individual connections, from 451,142 at the time of turnover in August 1997 to 556,772 by early 2001. The Bayan Tubig approach was to provide a main connection to an accessible location in the low income area. A battery of water meters were made available at this distribution point, and low-cost plastic pipes were then used to distribute water from the battery of water meters to individual households. Using the number of employees regularized by the West Zone concession in Table 4, this indicates a decrease in number of employees per 1000 connection from 9.5 before privatization, to about 4.2 by early 2001.

While there has not been a detailed evaluation of the efficiency and social gains associated with privatization, the discussion above indicates a pattern of improvement that has followed privatization. Table 1 summarizes the various efficiency and labor productivity indicators mentioned above.

Table 1. Summary of Indicators of Efficiency and Labor Productivity.

Indicators of efficiency and labor productivity	Prior to Privatization (August 1997)	After Privatization (Early 2001)
1. Proportion of Non-Revenue Water	60 percent (average for entire MWSS service area)	East Zone: 43 percent West Zone: 58 percent
2. Number of employees per leak repair crew	4-5 workers	2-3 workers
3. Number of employees per 1000 water connections	9.5 (for entire MWSS service area)	East Zone: 4.1 (1,643 employees; 405,000 connections) West Zone: 4.2 (2,333 employees; 556,772 connections)



### **Part 3. Description and Analysis of Labor Issues in the Privatization of MWSS**

In this part, the focus will be on the aspects of the privatization process relevant to labor. Since the number of MWSS employees appeared excessive compared to similar utilities in the region, it was clear from the start of preparation of the privatization process that reduction of the number of employees would be a one of the critical transition issues. During the transition period, starting with one of the highest employee-to-water connection ratios in the region, MWSS was able to significantly reduce its labor force as part of the privatization process. The process through which the number of employees was reduced is described in detail.

#### **3.1 Privatization Phases Relevant to Labor**

There were two key periods involved in the reduction of the labor force. First was a preparation phase for privatization implemented early in the process by MWSS (Phase I). This was followed by a brief transition period (Phase II) between the bidding date and the actual takeover by the Concessionaires or Commencement date. Lastly, there was a probationary period (Phase III) when the Concessionaires absorbed employees on a temporary basis and decided on regularization at the end of the period. During the first period (Phases I and II), MWSS was in charge of the process, and in the second period the Concessionaires took over:

Period I. Under MWSS Management --

Phase I: MWSS Reorganization (August 1996) – this involved implementation of an early retirement program (ERP), before the concession bidding.

Phase II: MWSS Privatization and Transition (January to August 1997) – this included a second round of ERP and issuance of probationary employment contracts.

Period II. Under Concessionaires' Management --

Six-Month Probationary Employment Period (August 1997 to January 1998) – the final step of labor transition; employees became permanent or were separated from the concessions.

Starting with 7,370 employees before August 1996, the transition eventually led to the concessionaires' regularized workforce of 4,306 or 58.4 percent of the pre-privatization workforce. (See Table 2.)



Table 2. Overview of Transition of Workforce to Private Concession System

Workforce by Time Period	Number of Employees	Percent of Starting Workforce
1. Starting Work Force, Pre-Privatization, (equal to Items 2+3+4+5)	7370	100
2. Aailed of First Early Retirement Program, prior to January 23, 1997	2033	27.6
3. Aailed of ERP on Concession Commencement date, August 1, 1997	190	2.6
4. Retained by MWSS Residual Agency on Commencement date, August 1, 1997	90	1.2
5. Absorbed by Concessionaires on Commencement date, August 1, 1997	5057	68.6

Reducing the workforce was a difficult process, but it was made manageable by the privatization team by working closely with the employees association and by developing an attractive voluntary retirement program. Of course, the process was not smooth throughout the transition. In fact, there were instances of protest and even an illegal strike organized by an extremist labor group just before the turnover of operations to the winning bidders. However, these were isolated incidents, and given the difficult challenge of reducing the workforce it is remarkable that there were not more. As one of the MWSS career officials who had to help manage the transition noted, the MWSS employees, of course, would rather have the agency remain as a government corporation. As government employees they had greater job security than workers in the private sector; as employees of a government corporation, they had better salaries and benefits than the regular government worker<sup>30</sup>. The following sections describe the transition process in detail.

## 3.2 Period I. Labor Force Reduction under MWSS Management

### 3.2.1 Phase I

Early in the planning of the privatization process, MWSS recognized that one of the key potential problems with privatization would be the necessary reduction in the labor force<sup>31</sup>. Management was aware of the experience of Buenos Aires where the number of employees was reduced to 50-60% of pre-privatization levels. Thus, there was a conscious effort to put together a labor force reduction program that could be acceptable to the employees. The two most important factors that reduced the expected opposition to labor force reduction were the consultations that involved key labor leaders early in the process and an attractive voluntary retirement program.

Management efforts to involve employees in the privatization discussions were coursed through the MWSS employee association, the KKMK (Kaisahan at Kapatiran ng mga Manggagawa at Kawani ng MWSS). Based on Philippine law, MWSS employees as government workers could not have a labor union. Thus, the KKMK was primarily a self-help association and did not have any bargaining agreement with MWSS management. Through their association, the employees were able to convey to management that the workers' main concerns were harder working conditions expected from private companies and job security.

MWSS management was able to point out the excellent track record of the companies that were pre-qualified for the bidding. (See Box 1.) Due to government concern to ensure capable bidders, only companies with excellent track records were included in the list, and MWSS management could reassure the workers that they would be working for some of the best companies in the country.

#### **Box 1. Corporations Pre-qualified for MWSS Concession Bidding**

The pre-qualification process for the MWSS privatization read like a who's-who of the most prestigious companies in the Philippines and first-rate international partners:

##### **Philippine Company**

Aboitiz Equity  
(Shipping, Trading)

Ayala Corporation  
(Property Development,  
Banking)

Benpres Holding Corporation  
(Power Utilities, Banking)

Metro Pacific Corporation  
(Property Development)

##### **International Partner**

Compagnie General des Eaux

International Water

Lyonnaisse des Eaux

Anglian Water International

A specific contribution to the dialogue with labor was the participation of labor leaders in an MWSS study tour to Buenos Aires. The World Bank organized this particular activity in April 1996, to give MWSS officials an opportunity to observe first hand how privatization had progressed in the Buenos Aires water utility. Instead of involving just the usual high-level officials in the visit, the privatization team decided to invite three labor leaders from KMK. These included the KMK president and two vice-presidents.

The study tour turned out to be one of the most helpful activities in opening up the views of the KMK leaders to privatization. This visit was very fruitful since it allowed everyone to see first hand what had been accomplished in Buenos Aires<sup>32</sup>. Also, because the visit took place about three years after the implementation of the privatization program, the group was able to discuss with the Argentinian labor leaders how the process had affected laborers. In general, the Argentinians were satisfied with the privatization effort, even though there was a significant percentage of workers who had to take early retirement. For the labor leaders, what was most impressive was that even with a 50-60% reduction in the workforce it appeared that the overall result of the transition was positive for labor. One of the labor leaders during the privatization period noted that the study tour participants were very impressed because their visit coincided with the labor union elections, and the Argentinian labor leaders who were active during the privatization period were running unopposed for re-election<sup>33</sup>.

While involving the KMK in the transition process was an important contribution, MWSS officials still had to develop a voluntary retirement package that would be able to attract a significant number of employees. The basic principle they followed was that the package should be worth about double what would be expected from the standard government retirement benefits. The various components added up to about 50-200% more than the standard retirement package<sup>34</sup>. The specific terms of the retirement package were based on years of service:

- for 20 years or less service, 1.5 months of "Adjusted Monthly Pay" (instead of the usual "Basic Monthly Pay") per year of service;
- for more than 20 but less than 30 years of service, 2 months of "Adjusted Monthly Pay" per year of service;
- for more than 30 years of service, 2.5 months of "Adjusted Monthly Pay" per year of service;

"Adjusted Monthly Pay" was about 30% more than "Basic Monthly Pay" since it included a salary increase from an expected government salary standardization program and several allowances -- Personal Economic Relief Allowance, Additional Compensation Allowance, and Longevity Pay. The various allowances are added to the salaries of all government employees, but these are not normally included in computation of regular retirement benefits. As an example, a typical package that could be received by an employee with an adjusted monthly pay of P10,000 and 20 years of service, would be P400,000. (The exchange rate at the time was P26 = \$1.) As a whole, the cost of implementing the first retirement package was about P1 billion or \$38 million (Lazaro). While not insignificant, the amount could be considered reasonable within the context of the entire privatization effort. About half of the package cost would have been the cost of standard retirement. In addition, this expense would allow progress in

implementing the concession, including the transfer to the concessionaires of about \$1.2 billion in existing MWSS debts<sup>35</sup>.

The early retirement program was initiated in August 1996, a full year before the privatization itself. The program was introduced as part of a general MWSS reorganization plan. This package turned out to be sufficiently attractive to get about a third of MWSS employees to opt for early retirement (Lines 2 and 3 of Table 2).

### **3.2.2 Phase 2**

Between the bidding for concessions in January 1997 and the actual takeover date in August 1997 (referred to as “Commencement” date in MWSS records) by the concessionaires, there was a second series of labor-oriented transition activities involving the 5,337 employees who remained after the first early retirement program round (Line 1 less Line 2, Table 2). First, the new concessionaires started identifying the employees that would be employed in the two Concession areas. The agreement with MWSS management was that all employees who wanted to work for the concessionaires would be accepted during a 6-month probationary period.

The actual process of determining assignment primarily depended on the employee’s work location (for those whose work was clearly linked to a geographical site, e.g., the supervisor or a branch pumping station). For those whose work was not geographically linked (e.g., employees in the accounting department), the employee’s residence and recruitment discussions with the concessionaires during the transition period were the main considerations.

The Human Resource (HR) teams of the two Concessionaires organized meetings and presentations to make the employees aware of what the organizational policies and plans of the Concessionaires would be. For example, the East Concession (Ayala) group launched its planning and information campaign in March 1997. They brought in one of their most experienced HR managers to run the program. The first feedback they received from the employees were their generally negative view of privatization and their concerns regarding job security. To respond to these concerns, the Ayala group organized informal discussions and also made audio-visual “employee orientation” presentations. These sessions were designed to inform the employees of the broad corporate vision of the Ayala group. The immediate goal was to educate employees of the strong customer and service orientation of the different Ayala businesses, in contrast to the bureaucratic culture of government agencies. The longer term, underlying goal was to instill a sense of vision and pride among employees. This was viewed in the Ayala group as a very important part of its work culture, and it involved a wide range of practices, from patriotic singing of the national anthem at the start of each workday to organization of employee discussion groups on improvement of office cleanliness.

While the preparation for the Commencement date and conversion of employment status was being made for most employees, those who decided during the transition period not to join the Concessions were offered a second opportunity for early retirement. For these employees, formal MWSS employment would end in August 1997. Thus if they were eligible for retirement, the regular retirement process was facilitated during the transition period. For those who were not yet eligible for retirement, a severance package was prepared. This included a severance pay of one-month basic

pay for each full year of service. Unlike regular severance pay, the severance pay offered was exempt from taxes, an additional benefit for those who took the early retirement package.

One month before the Commencement date itself, each concessionaire offered employment contracts to all employees. By the concession agreement, the following procedures had to be followed:

- the salary and benefits associated with the offer had to be at least equal to those enjoyed by each employee before the MWSS privatization;
- all employees who accepted the probationary employment contract would be hired;
- each concessionaire for a period of one year agreed not to hire without the prior consent of the other concessionaire any employee who had not been assigned to it at Commencement.

There were also additional benefits that the Concessionaires were required to provide for those who would leave before the actual takeover took place. If an employee decided not to accept the probationary employment contract, the Concessionaires had to pay the difference between the retirement or severance pay he received from MWSS and the benefits offered by MWSS in the first round of the ERP. This amounted to roughly an additional half-month salary for each year of service, and was meant to ensure that those who left in the second ERP round received the same benefits as those who left in the first round.

At the Commencement Date of the concessions, all the preparations and employment decisions made during the transition period became effective. At this time, the official count of remaining employees was 5,337 (Line 1 less Line 2, Table 2). Of the remaining employees, 190 employees officially took advantage of the second ERP and did not to accept the probationary contract (Line 3, Table 4). Ninety employees remained with the MWSS to continue with residual functions, such as managing facilities not turned over to the concessionaires and handling foreign loan transactions (Line 4). The rest, 5057 employees, accepted the probationary employment contracts offered (Line 5): the West concession absorbed 2,982, and the East concession absorbed 2,075 employees.

Of the more than 2000 employees who took the two early retirement packages, about 80 percent were rank and file workers. Of the balance, about 15 percent were at the supervisors' level and 5 percent were at the managerial level. Most of these employees had been with MWSS for 20 or more years, and would have been eligible for standard government service retirement (Polloso). However, unlike the standard government service retirement program, the MWSS early retirement packages provided for benefits for those with less than 20 years of service. In addition, for all employees the MWSS packages increased benefits by giving an additional .5 months of salary per year of service and upgraded the base salary by about 30 percent. A detailed accounting of the total cost of the retirement packages is not available. However, using the number of retirees and estimates of average salaries per type of retirees, the total cost of the early retirement packages (ERP I and II) can be estimated. This estimated cost MWSS is P1.1 billion or about \$44 million dollars. (Refer to Annex 1, for the details of this estimate.)

### **3.2.3 June 1997 Strike**

Despite the efforts of management to work with the employees association during the transition, a small group of workers organized a strike and a picket line at MWSS offices in Balara, on June 30, 1997, only a month before the scheduled turnover of operations to the concessionaires. As background, KMK was the dominant labor association at MWSS, which had about two thirds of employees as members<sup>36</sup>. The strike was organized by COURAGE (Confederation for Unity, Recognition, and Advancement of Government Employees), a labor organization associated with the KMU (Kilusang Mayo Uno or May 1 Movement), an extremist labor movement in the Philippines. The KMU is associated with the National Democratic Front and the Communist Party of the Philippines<sup>37</sup>.

The main demand of the strike organizers was to make all employees regular without having to go through the probationary period. Most employees of course, supported this, and about 200 workers joined the picket line. The strike was clearly illegal -- MWSS employees were still government employees at that time and MWSS operations affect a vital public utility. On both these counts, strikes are not allowed, and MWSS was able to get a court order directing MWSS employees to return to work. To conclude this incident, MWSS management did not pursue any legal actions against the strike organizers<sup>38</sup>. However, the incident did highlight the problem that a small minority among employees could very easily drum up support for disruptive activities during transition periods, by capitalizing on the job insecurity of other workers.

### **3.2.4 Period II. Labor Force Reduction under Concessionaires' Management (August 1997 to January 1998 – 6 month probationary period)**

The probationary period was essentially a third phase of the labor reduction process, with the distinction that it took place under the new concessionaire's management (from August 1997 to January 1998). During this period, the concessionaires implemented a wide range of Human Resource (HR) activities for those who would be regularized or be terminated after the 6-month period.

In general, both Concessionaires expected that there would be additional reductions in employee number. During this phase, the biggest challenge to the Concessionaire was to reduce employment while delivering short-term improvements according to the Concession agreements. As described in the previous section, several key targets had been agreed upon for the first year of operation. Some of these targets, especially those linked to system maintenance and customer service response, imposed constraints on manpower needs and productivity. For example, the ambitious targets required more leak repair crews and water meter and connection teams and greater productivity from each crew.

Within this context of increased productivity requirements, the total number of workers would have to be reduced. Thus, significant improvements in labor productivity had to be pushed by the concessionaires. The leak repair crew is one of the basic units of water distribution operations, and under the concessionaire the traditional crew size changed from 4-5 persons to 2-3 persons, with comparable or even improved effectiveness<sup>39</sup>.

Another constraint that the Concessionaires had was limited opportunity for using pay incentives to encourage workers. MWSS salaries for middle (supervisor) and high (managerial) levels were equal to or less than private sector salaries for comparable levels. However, for rank and file workers, MWSS salaries were actually greater than those in the private sector. Thus, the new Concessionaires had limited working room with respect to offering economic incentives for rank and file workers as part of its HR program because the average compensation levels inherited from MWSS was already quite high compared with private sector remuneration. For example, at the time of the takeover, the East Concession assessment of the remuneration structure was as follows:

Table 3. Comparison of MWSS Government Salaries with Private Sector Salaries

Employee Group	MWSS Monthly Salary + Benefits (Average or Range) (in Pesos)	Comparable Private Sector Remuneration (in Pesos)
1. Rank and file	10,000 --11,000	8,000
2. Supervisors	21,000 – 22,000	same
3. Managers	26,000 – 27,000	50,000
	Note: MWSS estimates of salary benefits are based on Annex 1.	Note: Source of private sector remuneration estimate is De Leon interview.

This meant that the changes in incentive structure would have to focus on non-salary issues, such as improved working conditions and job security.

The East Concession assessment of the major labor issues at the start of the probationary period, identified the following areas for improvement:

- job security;
- low employee morale;
- lack of understanding/acceptability of operational practices introduced by Foreign technicians;
- highly hierarchical organization structure/poor communication of work problems;
- complex pay system and structure.

To address these problems, the Concessionaire launched a range of programs, focusing on improving communication:

- created a special internal telephone “hotline” to address all HR related concerns or problems;
- published an employee-oriented newsletter, AGOS (flow);
- launched a bulletin-board system;
- continued with audio-visual awareness raising program.

With regard to the regularization program, management focused on improving selection and placement:

- Introduced a “performance appraisal system” for regularization;

- developed a method of selection that emphasized transparency, openness and fairness (involving job postings and panel interviews), in contrast to previous problems of favoritism and patronage.

The organizational structure of management itself was significantly changed, to a much simpler and “flat” structure. In the previous MWSS system, management had at least 6 main levels – Administrator, Senior Deputy Administrator, Deputy Administrator, Department Manager, Division Manager, and Section Chiefs. In the new system, this was reduced to 4 – President, Group Director, Department Manager, and Section Manager. The system of salaries under the government system of MWSS included more than a dozen various items and supplements. While keeping the total amounts similar, the system was simplified to one basic pay and allowance with periodic bonuses.

To improve employee morale, simple, everyday improvements were made:

- A regular flag ceremony was instituted;
- Rotating informal lunches with the CEO was organized;
- ID cards and company uniforms were issued;
- Workplace cleanliness and “housekeeping” practices were set up.

Finally, for those who wanted to leave the company or to prepare if they were not regularized, training and work opportunities were organized:

- Livelihood seminars for employees and their spouses;
- Training seminars for cooperatives;
- A service cooperative for former employees was organized (WASSECO—Water and Sewer Service Cooperative) and was given preferred contractor status for one year after end of the probation period;
- Rental system for employees’ personal vehicles, to use for leak repairs and emergency calls;
- Employees were included the job referral network of the Ayala Group of Companies.

The outsourcing of work using former employees mentioned above was part of the general program of both concessionaires at the time of turnover. Both concessionaires agreed to give preferential treatment to former employees through contracts with individual former employees or through WASSECO. If projects are sourced through WASSECO, the cooperative earns a commission of 9.5% of the contract value, and a team of former employees is hired to do the work. During the first year after turnover, WASSECO officials reported that the cooperative was able to get over P20 million worth of projects. However, this has declined over time and in 2000, the total amount of projects was less than P10 million. A major reason for this decline was a decision of Maynilad Water Services to stop using WASSECO for its projects after the first 2 years.

By the end of the probation period, both Concessionaires reduced the labor force further. By February 1998, the total number of employees was reduced to 3976. (Refer to Table 4.)

<b>Table 4. Final Reduction of Employees at End of Probation</b>	
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<b>Period (February 1998)</b>	
1. Number of Employees Absorbed in Both Concessions, August 1997	5,057
2. Employees Regularized by both Concessions	4306
-- Employees Regularized by West Concession: 2333	
-- Employees Regularized by East Concession: 1643	
4. Voluntarily Separated	649
5. Involuntarily Separated	102

The group of employees in Line 4, "Voluntarily Separated," represented those who decided to apply for the last round of retirement benefits. The employees in Line 5, were those who were deemed not acceptable by the Concessionaires for regularization. By agreement with MWSS, these two groups were eligible to the last round of retirement benefits. This round was designed to be equivalent with the first two ERPs. This meant that at the time of separation, they received the difference between the MWSS severance or retirement pay that they received in August 1997 and the original early retirement program benefit. Indeed, the agreement with Concessionaires allowed employees who may be laid off up to one year after the end of the probationary period (up to January 1999) to avail of the same benefit.

Thus, even with all the different rounds of selection and retirement, the MWSS process ensured that all the employees were equally treated and had the same options for severance pay or retirement benefits. In summary, a total of 2,974 employees, more than 40% of the starting work force, left as part of the privatization process. However, of this number, only 102 (less than 2% of the initial workforce) were involuntarily separated.

## Part 4. Lessons Learned

Any workforce reduction program, because it will probably have severe impacts on the poorer groups in the workforce, will almost always lead to actual personal hardships for those affected and to potential problems at the broader level of public assessment of openness and fairness. The positive net social benefits following from the general privatization impacts may then be compromised if the managers of the reform program are not able to demonstrate that potential benefit transfers, or alleviation of hardship, can effectively take place. This concluding section reviews the strategy and main approaches that helped in responding to labor concerns and the constraints that may hold back similar efforts in the future.

*Include Labor Assistance Efforts Early in Privatization.* It was of crucial importance that the government officials who designed the privatization strategy included a key role for the labor force reduction program from the very start of the process. MWSS engaged a team of labor lawyers to evaluate relevant labor constraints and to ensure that MWSS and the Concessionaires would have legal basis for a generous early retirement program.

*Promote Consultation and Involve Labor Representatives or Leaders.* In the case of the MWSS privatization, the managers of the reform had the benefit of observing previous exercises of privatization and learning from models that were available to them at the time. This view of “learning from experience” was emphasized in at least three of the interviews conducted with senior administrators involved in the process. To this end, the study visit to Argentina probably had benefits much greater than the cost of organizing the trip. Different officials and labor leaders who were involved mentioned the value of discussions with counterparts from another country in various interviews. As one labor leader mentioned in an interview, “seeing (the progress) is really believing.” In addition, although MWSS did not have the benefit of a true labor union, management consistently made an effort to negotiate and plan with the informal association of employees.

*Increase Public Awareness of Issues.* The role of public opinion is potential critical, and MWSS involved media consultants and writers to get their views into popular media. Initially, a foreign public relations firm was engaged, but officials felt that the role of local writers would be more effective. The public relations effort helped to present the process to the public in a positive light.

*Provide Labor Assistance and Generous Benefits.* In comparison with the potential problems that could arise from labor unrest, MWSS officials recognized that the cost of putting together a good retirement or severance package would be relatively inexpensive. This view generally guided the approach of MWSS officials. As noted by the former MWSS administrator, the government should be as generous as possible in dealing with the employees. Thus, throughout the various phases of labor force reduction, the basic strategy was to try to double whatever would have been the standard government retirement benefits for workers. A rough assessment of the labor reduction package cost was about P1 billion, an amount which officials considered to be quite small relative to the long-run value of privatizing the sector<sup>40</sup>.

*Government Should Continue to Work with Concessionaires after the Transition.* Even after the turnover, the role of government with respect to labor force reduction should be to continue assisting employees. In the case of MWSS, Concessionaires were open and willing to provide assistance such as training programs for all employees and financial help to employees who would be laid off. The creation of cooperatives and other self-help organizations allowed employees to develop new livelihoods after retirement.

*Need for Labor Reduction Financing.* Because MWSS was a government corporation, it had sufficient funds to carry out a generous employee retirement program in preparation for privatization. Other government agencies would have more difficulty if they have to depend on public funds to pay-off similar benefits. Thus, alternative financial sources would have to be found if privatization is contemplated for such agencies.

*Salary Increases Alone May Not Be Sufficient Incentives for Productivity Improvements.* In the case of MWSS, the salaries and the benefit structure at the time of privatization was better than those in the private sector. This meant that simple monetary incentives would not work after privatization since Concessionaires would not be able to offer salary increases and promotions as incentives for increased productivity. Emphasis therefore needs to be placed on designing and implementing a broad-based employee morale and productivity improvement program. This appears to have worked significantly in the Eastern Concession, where productivity circles and employee morale have improved substantially in response to Management's HR support programs.

## List of Sources

### Interviews and Main Issues Discussed:

12/4/2000

Mark Dumol, Chief of Staff, DPWH

- The scope of the paper would focus on the privatization and the transition period, until early 1998.
- Various individuals to be included in the interviews were discussed, including former MWSS officials, labor leaders, and legal consultants.

12/5/2000

Filemon Berba, Chairman of Manila Water Company Board, former CEO of Manila Water Company

- Was the first CEO of Manila Water Company (East Zone). During the transition period, his focus was how to instill in work force the special perspective on service of the Ayala group of companies.
- Emphasized the need for corporate “values” and promoted good working relationships. Considered the approach of foreign counterparts to be too “task-oriented” when the challenge in the early part of privatization was building employee morale and teamwork.
- Introduced simple housekeeping and company practices, such as morning flag ceremonies and cleaning of individual work areas.
- In terms of service improvements, focused on customer response and improvement of practices of leak repair teams.
- In terms of choice of employees at the start of concession, Manila Water did not have the first pick of employees since many had initially indicated preference for MWSI.

Antonio Aquino, current CEO, Manila Water Company

- The privatization process has worked out well for Manila Water Company. However, due to extraordinary changes in the economic environment, it is important for the MWSS regulatory office to properly consider concessionaires’ request for changes in tariffs.

12/6/2000

Ramon de Leon, Group Director for HR, Manila Water Company

- As early as March 1997 the Manila Water Company group was already working on its HR plan. It was clearly recognized that the main concerns would be the anti-privatization campaign being led by some labor leaders. At the root of the ordinary workers' concerns is the question of job security. Thus, it was important for the transition group to have a good orientation program and to focus on building employee morale.
- Thus, the first actions of the transition group emphasized assistance to employees. They made sure that all employees received a formal letter of employment offer, clearly stating what options they had in joining the new company. They facilitated the creation of individual payroll bank accounts and made the services of the Bank of Philippine Islands easily accessible to employees. (This bank is part of the Ayala group, and the transition team wanted to emphasize the value of being part of a big corporate "family" that takes care of its employees.) The team also facilitated the transfer of employee retirement accounts from the government program to the private social security system.
- There was a major emphasis on cleaning up the dirty offices of MWSS and fixing up the facilities. This was based on the team's belief that employee morale required being proud of his company and keeping company environment as clean and as functional as possible.
- Because there was a foreign partner in the new company, the team also organized "cross cultural" seminars, to make sure that employees appreciate and understand the different working style of their foreign partners. This was considered very important since lack of understanding could lead to conflicts and increasing reluctance against suggestions that would come from foreigners.
- The team was also very open about the options and the criteria for not accepting some employees at the end of the probationary period. They organized seminars to introduce additional livelihood opportunities for workers and their families. They assisted in the projects and activities of the employee cooperative, and provided maintenance contracts to the cooperative. This cooperative included many workers who had taken the early retirement program. They also gave priority to retirees who had utility vehicles that the company could rent for leak repair and other service activities. Lastly, they kept an active program of employee referrals, to link potential retirees with other businesses or partners of the Ayala group of companies.

12/7/2000

Cristina David, Senior Fellow, Philippine Institute for Development Studies

- While there has been progress due to privatization, it is important for the government to continue monitoring the socio-economic impact of the privatized companies.

12/8/2000

Angel Lazaro, Consultant, former Administrator, MWSS

- The employment issue is of concern for privatization, but the problems are not insurmountable. This is one of the key lessons of the Argentina experience, where there

was a major reduction in labor force; however this was managed effectively. When the MWSS-KKMK group visited Buenos Aires three years after their privatization experience, the group was impressed with the progress and strength of the labor organization.

- The main key to success is to be as generous as possible to employees to promote early work force reduction. This may seem to require a lot of money initially but in the bigger picture it will be money well spent. First of all, it will significantly reduce the most vocal potential critics of privatization, which will be the employees themselves. Secondly, it will facilitate and reduce the over-all cost and delays in the privatization process.
- The goal of the early retirement process should be to try to double what employees would get if they were to retire on the standard government plan. This is possible for government corporations like MWSS because it had its own revenues, but it would be difficult to do for agencies that are not income generating.
- On the lessons of the June 15, 1997, illegal strike: whatever preparation is made by the privatization team, there will always be the possibility that disruptive actions will occur since it is so easy to mislead poorly informed workers. In this case, even if the action is disruptive and illegal it is very important for management to try to be as flexible and conciliatory as possible. Indeed even after the strike was officially declared illegal by the courts, the management did not implement punitive actions. They tried to be as flexible as possible in allowing striking workers to return to work.
- It is also very important that the process be planned very well. In the case of MWSS, the management made sure that legal consultants were part of the planning process. They also launched a media campaign to control possible public complaints against privatization.
- Because privatization case studies are very few and fewer still are the successful ones, it is very important to produce a good record of the MWSS experience.

David Howarth, Manila Resident Mission

- Beyond the labor force transition issues, the long-term concern for the privatized companies will be the improvement in the basic water supply and sewerage infrastructure. By focusing on the water tariff during the bidding process, both MWSS and the concessionaires did not effectively address the long-term needs for basic infrastructure improvements.

Rina David, Columnist, Philippine Daily Inquirer

- MWSS engaged the services of a media consultant, Manila News Features, to help popularize the benefits of privatization.
- At the time of privatization, the main concern of most was the decrease in water tariff. There was hardly any concern with the employment changes due to privatization.

Bing Veroy, Consultant, Maynilad Water Services, former Deputy Administrator, MWSS

- Labor problems will inevitably be a major constraint in any privatization program. The most important factor for the privatization team is to promote transparency in all stages of the process.
- While the early retirement package was beneficial, it could have been better. This is a key lesson: to make sure that there is no basis for employees to complain about the retirement packages being offered.
- It is also important to distinguish between the real labor organization and the most vocal. In the case of MWSS, it was clear that the most vocal organization involved in MWSS was not the main labor association.

Carlos Salonga, Vice President, HR, Maynilad Water Services

- One of the shortcomings of the privatization process was that the transition period was only planned for 6 months after turnover to the concessionaires. It would need at least a year of training and negotiations to reduce the friction that is necessarily entailed in a work force reduction or training effort.
- Even up to the present there are still various issues that workers are bringing up, indicating that it is very difficult to tie up all the loose strings associated with privatization. For example, there is still a pending complaint by workers that the “Amelioration Allowance” that were to be given to all government employees (about 10 percent of salary) prior to privatization was not disbursed by MWSS.

12/11/2000

Eusebio Tan, Senior Partner, ACCRA Law Offices, Consultant to MWSS for Labor Issues and  
 Rico de Guzman, Partner, ACCRA Law Office, Consultant to MWSS for Labor Issues  
 (joint interview)

- The labor concerns associated with privatization was at the center of government discussions. It was crucial that all legal issues be addressed early in the process, and in the case of MWSS much was resolved by the successful passage of the Water Crisis Act.
- Even among the workers of MWSS, there were disputes and at least two labor leaders associated with the main labor association were in disagreement regarding what the strategy that the association should adopt.
- The organization COURAGE was not a labor union or association in terms of its main issues. Its focus was more political than the other organization, and it was associated with the left-leaning KMU, which, in turn, was associated with the Communist Party of the Philippines. By contrast the KKMK was associated with the traditional labor unions in the country.

Lani Azarcon, Director, Strategic Planning Group, Ayala Corporation

- The key objective of the Ayala group in the bidding process was to ensure that they would have the lowest bid.
- Labor issues were not a major concern at the time of bidding because the company believed that the initial early retirement programs were already contributing to work force reduction in a significant way. Thus, this was very important as a component of preparing the privatization process.
- Also, labor transition issues were not considered that important since the Ayala group was most concerned with long-term improvements in water service. They were confident that the labor transition could be effectively managed.

Ed Borja, President, MWC Labor Union

- The two main concerns that were present throughout the privatization process were that MWSS would not pay all the required benefits (specifically the amelioration allowance) and the separation benefits in the ERPs were not enough. With respect to the latter, it was cited that the Philippine National Bank early retirement program had benefits that were three times what MWSS was offering.
- COURAGE was able to infiltrate labor ranks because of employee dissatisfaction with the package. This was especially true for those with less than 20 years of service, since their benefits were viewed to be much less than those of employees with longer service. Almost all employees also were against having a probationary period since they wanted to keep whatever security they already had at MWSS when they transferred to the new organization.

Ruben Diaz, President, MWSI Labor Union

- In addition to job security, a main concern of workers was the increased workload that was expected from a private company. Also, in the private sector it was expected that increases in benefits would not be as frequent as in the government sector.
- For those who retired or were terminated, the feedback is that they are generally worse off than before. The lump sum benefits that they received were quickly spent, and they have difficulty in finding new work.

Edgardo Fernando, former official, KKMK (MWSS) employees association

- Most workers were really against privatization, including the membership of the KKMK. Now that there are two separate concessionaires, it is important to have a confederation of workers, so that the two labor groups will be able to assist each other.
- During the transition process, the most important challenge for management is to earn the trust of the workers. In this sense, there appears to be better progress in the East vs. the West Zone.



5/30/2001

Estrellito Poloso, OIC, Administrative and Finance Department, MWSS

- Salary levels: for rank and file (Level 16 and below), government salaries are greater to or equal to private sector salaries. For section chiefs and above (Level 17 and above), they are less than in the private sector.
- After privatization, higher-level staff (Level 17 and above) kept about the same salary levels, while their counterparts in the concessions who had come from the private sector had significantly larger salaries.
- Comparing Manila Water and Maynilad, Manila Water revamped the entire management structure for the East Zone while Maynilad retained the same structure and introduced only upper management, at the Department level. Thus, the new managers were drawing salaries of P60,000/month or more while their counterparts who came from MWSS had the government rate of about P18,000. This was a key source of low morale and was a constraint for integration of staff. By contrast, Manila Water introduced only a very small core team and used the old staff to fill up their new organization structure. Also, Manila Water employees have been enjoying annual 10% salary increases, and this has contributed to improved worker morale.
- Another managerial concern regarding Maynilad was the frequent change of top management since 1998. The current CEO, R. Alunan, is now the third since privatization. Previous CEOs were L. Mirasol and J. Olives.
- The current difference between labor and management relations is apparent, with Manila Water employees and management having better working relationships.
- Another issue that has been raised by employees has to do with the relationship between the ERP packages and the standard GSIS retirement program. Under the law, RA 1616 workers would have been eligible for the same retirement package of ERP if they had 20 years of service. Thus, the only additional benefits given by the ERP were (a) to allow workers with less than 20 years of service to take the retirement plan and (b) to increase the base for salary computation by 30% (since ERP used adjusted salary instead of basic salary).
- On meeting service targets, before privatization, NRW was up to about 53%. By May 2001, Manila Water's NRW was down to 47%; however, for Maynilad it has increased to 67%.
- On the initial allocation of MWSS employees to join Manila Water or Maynilad: most employees initially wanted to join Maynilad, for the following reasons –
  - (a) Eugenio Lopez (head of Benpres) had personally visited MWSS and his speeches indicated strong support for labor;
  - (b) The Lopez companies had a long history of involvement with public utilities;
  - (c) The concession terms of Benpres appeared much more favorable than the Ayala group's, especially with their much higher water tariff.
- On the workers who were retained by the "residual" MWSS. Initially only 4 employees officially remained with MWSS – the administrator, deputy administrator, and 2 department heads. However, the rest of the current staff returned to MWSS from the concessionaires. These employees have had to return the ERP benefits that they were

given; thus although they have substantially more security as government employees, many now have difficulty paying back the ERP benefits.

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Annex 1. Estimated Cost of the Two Early Retirement Packages

**ERP 1**

	1	2	3	4	5	6	7
Level	Salary Grade	Average Salary	Adjusted Salary	Proportion of Retirees	No. of Retirees	Average Benefit	Total Benefit
Rank and File	1-17 (9)	7,979	10373	0.8	1626	414908	674,806,371
Supervisory	18-22(20)	16,660	21658	0.15	305	866320	264,184,284
Managerial	23+ (25)	20,270	26351	0.05	102	1054040	107,143,166
All Levels							1,046,133,821

**ERP 2**

Level	Salary Grade	Average Salary	Adjusted Salary	Proportion of Retirees	No. of Retirees	Average Benefit	Total Benefit
Rank and File	1-17 (9)	7,979	10373	0.8	152	414908	63,066,016
Supervisory	18-22(20)	16,660	21658	0.15	29	866320	24,690,120
Managerial	23+ (25)	20,270	26351	0.05	10	1054040	10,013,380
All Levels							97,769,516

Both ERPs 1,143,903,337

Notes on Column Items:

1. Salary Grade is based on Government Salary tables.
2. Average salary is based on estimates made by E. Polloso.
3. Adjusted Salary includes benefits, and is 1.3\*Average Salary, based on estimates of A. Lazaro.
4. Proportion of types of retirees was based on estimates of E. Polloso.
5. No. of Retirees refers to the total number of retirees (2033 and 190 in ERP I and II, respectively) multiplied by the proportion in Column 4.
6. Average Benefit is 2 months of Adjusted Salary multiplied by 20 years of service; number of years of service is based on estimates of E. Polloso.
7. Total Benefit is Average Benefit multiplied by No. of Retirees.

Sources: Interviews with A. Lazaro and E. Polloso, and ERP data.



MAYNILAD WATER SERVICES INC.

## WATER SUPPLY IN LOW-INCOME AREAS

### WEST ZONE METRO MANILA

#### **EXECUTIVE SUMMARY**

Since the beginning of the concession in August 1997, 105,630 new water connections have been done (today, it represents some 5,000 new connections per month), and 51,820 or 49% of this increase are connections in the low-income areas, under the so-called “bayan tubig” scheme. As part of the existing or planned projects, the estimated number of potential connections in the “bayan tubig” projects is 38,420.

These bayan tubig projects are spread all over the concession area and represent 391 projects in the different business areas:

<b>BUSINESS AREA</b>	<b>Nb of projects</b>	<b>HSC Installed</b>	<b>HSC Potential</b>
Central	18	24,234	5,370
Northeast	223	16,836	8,738
Northwest	96	5,612	9,878
South	54	5,138	14,436
<b>TOTAL</b>	<b>391</b>	<b>51,820</b>	<b>38,422</b>

The price of water in Metro Manila in 1999 was:

- Residential connection to MWSI’s network: 6.4 PhP/cu.m.(average residential tariff)
- Private network: 12.3 PhP/cu.m. (average over the concession area)
- Non-connected: 50 PhP/cu.m. (average over the concession area).

More specifically, for 20% of the population considered as the poorest, we have:

	Consumption (cu.m./month)	Amount devoted to water (PhP/month)	% of their income	PhP/cu.m.
When connected to Maynilad network	27	141.80	1.8%	5.35
When not connected (average)	8	329.70	4.5%	39.60
When not connected (as in F. Carlos)	13.5	1,195		83.00

These figures show that, when they are connected to the network, they consume more, but they pay less for a better quality of service (no need to spend time to get the water) and for a better quality of water.

Source: Maynilad Water Services, Inc., April 2001.

## Endnotes

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- <sup>1</sup> Bates, Gupta, and Fiodor (1997); Warford, Munasinghe, and Cruz (1997).
- <sup>2</sup> Lazaro (2000), David (1998).
- <sup>3</sup> David (1998).
- <sup>4</sup> David (1998).
- <sup>5</sup> This section is based on the description of the institutional structure of the water system in Manila, in David, pp. 2-3.
- <sup>6</sup> Dumol (2000).
- <sup>7</sup> Lazaro (2000).
- <sup>8</sup> Lazaro (Interview).
- <sup>9</sup> David (1998).
- <sup>10</sup> David (1998).
- <sup>11</sup> David (1998).
- <sup>12</sup> Dumol (2000).
- <sup>13</sup> Dumol (2000).
- <sup>14</sup> Dumol (2000, p.16).
- <sup>15</sup> Dumol (2000), Lazaro (Interview).
- <sup>16</sup> Dumol (2000).
- <sup>17</sup> Dumol (2000).
- <sup>18</sup> Dumol (2000).
- <sup>19</sup> Lazaro (Interview).
- <sup>20</sup> Dumol (2000).
- <sup>21</sup> Lazaro (Interview), Dumol (2000).
- <sup>22</sup> Dumol (2000).
- <sup>23</sup> Lazaro (1999).
- <sup>24</sup> David (1998)
- <sup>25</sup> David (1998).
- <sup>26</sup> Lazaro (Interview).
- <sup>27</sup> Lazaro (Interview).
- <sup>28</sup> De Leon (Interview).
- <sup>29</sup> MWSS Regulatory Office (2000).
- <sup>30</sup> Veroy (Interview).
- <sup>31</sup> Lazaro (Interview).
- <sup>32</sup> Lazaro (interview).
- <sup>33</sup> (Fernando (Interview)
- <sup>34</sup> Lazaro (Interview).
- <sup>35</sup> Lazaro (Interview).
- <sup>36</sup> Veroy (Interview).
- <sup>37</sup> De Guzman (Interview).
- <sup>38</sup> Lazaro (Interview).
- <sup>39</sup> De Leon (Interview).
- <sup>40</sup> Lazaro (Interview).

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