PRIVATE FINANCE FOR PUBLIC PROJECTS

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I. INTRODUCTION

This paper pertains to the private financing of public infrastructure projects traditionally implemented by the government, e.g., expressways, bridges, tunnels, railways, seaports, airports, and other similar facilities. It applies to all economies where the government undertakes and finances through taxation, the construction and operation of such infrastructure facilities. Considering however that by common knowledge the developing economies are where infrastructure facilities are more wanting, this paper will naturally bear more relevance to them.

To lay the premises, let us consider the following simplified process of developmental operations undertaken by the government of a given state in implementing a national infrastructure program. Firstly, the government formulates an integrated public infrastructure plan, considering the various social and economic factors, identifying the priority projects, and preparing the corresponding budget. Secondly, the government raises the funds necessary to implement the identified priority projects, through taxation. Thirdly, the government allocates the funds raised among the identified priority projects. Fourthly, the government undertakes the construction of the funded infrastructure projects. Fifthly, the government operates the facilities, as may be appropriate. While the realities of undertaking and financing such infrastructure projects are so much more complex, involving the various legislative and executive agencies, in a combination of financial transactions such as the issuance of treasury notes, municipal bonds, contracting of loans from international government organizations, for purposes of this paper, the foregoing abbreviated process will be assumed, to allow an orderly and systematic presentation of the private financing proposition.

Under the taxation mode of financing the construction and operation of public infrastructure facilities, common experience shows this approach spawns at least two problems of taxpayer fatigue and tax evasion. These problems, when taken in context with other unfavorable financial factors, e.g., inflation, currency depreciation, rise in interest rates, among others, perceptively threaten the very core feasibility of financing the infrastructure projects.

In view of these problems, this paper proposes the adoption of the private corporate mode of financing the construction and operation of public infrastructure facilities. This alternative approach treats as a tax credit all the private investments made by taxpayers in eligible equity securities issued by private corporations that undertake to construct and operate selected public infrastructure facilities under a build-operate-transfer scheme.

Under the private corporate mode of financing therefore, the implementation of the government formulated national infrastructure plan is privatized. The proposition effectively institutes the adoption of private corporate finance in lieu of public finance. In the process, the taxation problems of taxpayer fatigue and tax evasion are addressed, and the financial feasibility of funding the capital intensive infrastructure projects enhanced.

II. PRIVATIZATION CONCEPT

The concept of privatization for purposes of this paper, pertains to the furnishing of private services in lieu of government services in certain infrastructure facilities.[1] Specifically, it refers to the active engagement by private enterprise in the financing, construction and operation of infrastructure facilities as public utilities.[2] The concept therefore involves the imposition of proper charges for use of the infrastructure facilities,[3] where traditionally there had been none.

Among the advantages of privatized operations are the flexibility of private agencies by reason of their nonbureaucratic nature,[4] and the availability of special expertise not otherwise obtainable by government.[5]

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1 David M. Lawrence, Private Exercise of Governmental Power, 61 Ind. L. J. 647 (1986).

2 73B C.J.S. Public Utilities Sec. 2 (1983).

3 Id., Sec. 15.

4 Lawrence, supra note 1, at 654-655.

5 Id. at 656-657.

These operational advantages result in greater efficiencies and lower costs in the provision of services to the public.[6]

Public and private goods

To illustrate the concept of privatization, let us consider the proprietary structure of a simple community. Under this setting, we may classify goods and services available in the community into two types: private goods and public goods.[7] Private goods are those which are available only to specified persons in the community.[8] Public goods are those which, once provided, are available to all.[9] Merchandise for sale at a private entrepreneur's store would clearly be a private good. This is so because the merchandise is not available to everybody, but rather only to those who are willing and able to pay for the purchase price of the merchandise. On the other hand, a public road opened for use would be a typical example of a public good. This is so because the public road is available for use by any and all in the community. Everybody may travel through the road, e.g., resident, transient, citizen, alien, men, women, children, taxpayer and tax evader alike, without any restriction or discrimination whatsoever, except of course reasonable regulations for road safety.

[6] Robert W. McGee, Principles of Taxation for Emerging Economies: Lessons from the U.S. Experience, 12 Dick. J. Int'l L. 29, 87-88 (1993).

[7] Frank A. Cowell, Cheating the Government: The Economics of Evasion 32-33 (1990).

[8] Id.

[9] Id.

Under the concept of privatization employed in this paper, goods traditionally furnished by the government to the public consumers in the form of public goods, will now be furnished by private enterprise in the form of private goods. Pursuant to this approach, all those in the community who may desire to avail of the goods will necessarily be required to pay for their corresponding purchase price. No one may now avail of them for free. On the other hand, all the others who have no desire whatsoever to avail of the goods, will naturally not be required to pay anything for them.

A. PUBLIC PROJECT

To determine the type of infrastructure facilities which may be appropriately covered by the concept of privatization, we may note that the basic economic infrastructure of a given state generally covers a wide range of facilities, from expressways, bridges, tunnels, railways, seaports, and airports, to waterworks, power generation and distribution systems, and telecommunications. Some of these facilities may be furnished by the government in the form of public goods, e.g. expressways, so that once offered they become available for use by everybody. Other facilities may be operated either by government or private enterprise as public utilities and offered as private goods, e.g. power generation and distribution systems, so that only those who are willing and able to pay for the corresponding electrical charges may avail of the services.

Inasmuch as the thrust of this paper is to promote the venture of private enterprise into economic undertakings which otherwise have been exclusive domain of government, only the infrastructure facilities which traditionally have been offered by the government as public goods may be appropriately covered. It would not serve the purpose of the private financing proposition to include those facilities already operated as profitable public utilities, either by the government or by private enterprise, since with respect to these utilities, there may already be a relevant industry record of viability, in the given state itself or in other states in a comparable level of economic development. In other words, there would no longer be any reason to extend to these profitable undertakings the extraordinary investment incentives of the private financing proposition, insofar as the relevant industry record of business viability may already speak for itself.

While recognizing that no fixed delineation of covered facilities can be practicable since government practice vary from state to state, we may nonetheless note for purposes of reference that such infrastructure facilities may generally include expressways, bridges, tunnels, railways, seaports, airports, and other similar infrastructure facilities. On the other hand, the excluded facilities may cover power generation and distribution systems and telecommunications which from common experience already have known industrial records of profitability.

Waterworks may be more difficult to classify. This is because they involve not only the use of physical facilities, e.g. water pumps and pipes, but also entail the actual delivery of consumable goods, e.g. water. They are therefore similar in nature to power generation and distribution systems and telecommunications, which require not only the use of physical facilities, but also the rendition of some form of service, e.g., transmission of electrical power and electronic messages. Notwithstanding the operational nature of waterworks however, it would seem from common experience that these infrastructure facilities had generally been constructed and operated exclusively by government, not as profit earning ventures, but rather as subsidized public services. In this sense, they are similar to railways, seaports and airports which commonly have been operated as subsidized public services. In other words, by reason of the nature of their heavily subsidized operations, they are more appropriately classified as public goods rather than private goods. Waterworks just like railways, seaports and airports, generally do not have any relevant industry record of viability where operated as profit earning public utilities by private enterprise. Accordingly, it would seem that there are reasonable grounds to classify waterworks as a covered facility.

To restate, in view of the wide divergence in government practice and experience among the developed and developing economies, the determination of what facilities may or may not be appropriately covered will have to depend on the social and economic factors prevailing in a given state. The crucial factor is that the classification of infrastructure facilities should serve the purpose of the private financing proposition, which is to encourage of venture of private enterprise into the business of constructing and operating said facilities as public utilities, despite the lack of any relevant business experience in such economic activities.

Regarding the viability of the private financing proposition itself, it may be conceded that the contemplated infrastructure projects truly pose relatively high business risks in view of the lack of relevant business experience in their operation as public utilities. Nonetheless, considering the very nature of these infrastructure facilities, providing basic economic support services and catering directly to the public consumers, it could only be reasonable to presume that these facilities, also present the enormous potential of capturing a ready and reliable market, should the facilities be operated as a private enterprise.

B. BUILD-OPERATE-TRANSFER SCHEME

At the core of the privatization concept is the build-operate-transfer (BOT) scheme for financing, constructing and operating the subject infrastructure facilities.[10] As the term BOT itself indicates, private enterprise undertakes not only to build the infrastructure facilities, but

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[10] An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes, Republic Act No. 6957, Sec. 2(b) (1988) (Phil.), amended by An Act Amending Certain Sections of Republic Act No. 6957, Entitled "An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes," Republic Act No. 7718, Sec. 2 (1994) (Phil.). Implementing Rules and Regulations of Republic Act No. 6957 "An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes," as amended by Republic Act No. 7718, Sec. 1.3(c)(iii) (1994) (Phil.).

also to operate them as public utilities for a reasonable length of time.[11] The idea being to allow the operation of such facilities in the same manner as any other business where the enterprise owners are given the opportunity to recover their principal investments and earn reasonable returns.[12]

The scheme is consistent with the proposition that the goods which otherwise had been offered as pubic goods will now be offered as private goods. Of course, when the BOT scheme terminates, after the enterprise owners have recovered their investments and earned reasonable profits, the public utility facilities will be transferred to the government. At which point, the public utility services may then be offered by the government as public goods and no longer as private goods. In effect, under the BOT arrangement, the privatization of public goods is limited as to time.

Among the states and entities which currently employ the BOT scheme in infrastructure development are the Philippines,[13] Malaysia,[14] Vietnam,[15] Hong

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[11] Id.

[12] Id.

[13] An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes, Republic Act No. 6957 (1988) (Phil.), amended by An Act Amending Certain Sections of Republic Act No. 6957, Entitled "An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes," Republic Act No. 7718 (1994) (Phil.). Implementing Rules and Regulations of Republic Act No. 6957 "An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes," as amended by Republic Act No. 7718 (1994) (Phil.).

[14] Terence P. Stewart and Margaret L. H. Png, The Growth Triangle of Singapore, Malaysia, and Indonesia, 23 Ga. J. Int'l & Comp. L. 1, 25 (1993).

[15] F. Gale Connor, Vietnam: Trading with the Enemy or Investing in the Future, 25 Law & Pol'y

Kong,[16] Mexico,[17] Turkey[18] and Hungary.[19] The type of project implemented vary. For instance, the Hong Kong project involves a solid waste disposal system,[20] the Mexico project a potable water system,[21] the Turkey project a coal fired power plant,[22] and the Hungary project a toll road.[23]

It should be noted however that his paper does not cover the mechanics of the BOT scheme. It merely adopts the transactional arrangement as it has evolved through practice.

C. PRIVATE CORPORATION

Consistent with the concept of privatization is the employment of the private corporate form as the standard vehicle for the implementation of the BOT scheme. Inasmuch as the contemplated BOT companies are intended to be

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Int'l Bus. 481, 484 (1994).

16 Ferheen Mahomed, A Foreign Investor's Guide to the Environmental Legal Regime of Hong Kong, 28 San Diego L. Rev. 787, 817 (1991).

17 Francisco Ceron, Water Pollution Control Equipment, 4 No. 9 Mex. Trade & L. Rep. 19, 20 (1994).

18 Eric Schneider and Alev Bilgen, Foreign Investment Laws in the Republic of Turkey: A Model for Reform, 5 Transnat'l Law. 99, 127 (1992).

19 Andre Newburg, Eastern Europe and the European Bank for Reconstruction and Development: New Policies and Programs for Business Development, 28 Int'l Law. 433, 436 (1994).

20 Mahomed, supra note 12.

21 Ceron, supra note 13.

22 Schneider, supra note 14.

23 Newburg, supra note 15.

publicly held companies, counting among all the individual and corporate taxpayers as its potential investors, the use of the private corporate form to bring together the numerous and diverse investor interests, would appear to be not only convenient but in fact warranted by the circumstances.[24]

A private corporation is an artificial person or legal entity created under the authority of the general incorporation laws of a state, founded by and composed of private individuals, for private purposes.[25] Among the operational advantages of using the private corporate form are as follows: (1) separate personality, (2) limited liability, (3) unlimited continuity, (4) free transferability, and (5) centralized management.

The first and foremost advantage of the corporate form is that it allows the several if not numerous owners of the enterprise to assume a single personality for the transaction of business.[26] This corporate personality is for all legitimate business purposes, distinct and separate from the individual personalities of the enterprise owners. Absent this artificial entity created by legal fiction, we could only imagine the resulting complexities that would arise from the need to deal with all the individual owners, hampering the flow of business. The simplicity and convenience that the corporate form lends to the conduct of business transactions are therefore fairly evident and undoubted.

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[24] Jesse H. Choper et al., Cases and Materials on Corporations 3 (3rd ed. 1989).

[25] Henry Campbell Black, M.A. et al., Black's Law Dictionary 340 (6th ed. 1990).

[26] Alfred F. Conrad et al., Corporations: Cases, Statutes and Analysis 40 (2nd ed. 1982).

The second advantage of the corporate form is that it imposes limited business liabilities on the part of the enterprise owners.[27] The corporate shareholders are liable only to the extent of their capital contributions and nothing more. This incident of the corporate form flows from the basic principle that corporate personality is separate and distinct from the individual personalities of the individual shareholders. Accordingly, the debts of the corporation are all its own and not of the shareholders.

The third advantage of the corporate form is that it assumes an unlimited continuity.[28] Again this incident of the corporate form follows from the principle of separate personality. Inasmuch as the corporation is a separate entity on its own, its continued existence does not at all depend on the withdrawal, insolvency or death of any of it individual shareholders. This continuity of existence provides the requisite stability in business transactions.

The fourth advantage of the corporate form is that it provides a convenient mechanism for the free transfer ownership interests in the enterprise.[29] This facilitates the flow of capital investments and lends flexibility to enterprise owners concerning their investment decisions.

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[27] Choper, supra note 24, at 1-2.

[28] Id. at 2.

[29] Id.

The fifth advantage of the corporate form is that it provides for centralized management.[30] Most of the authority to manage the corporation is generally delegated to the board of directors. This arrangement lends a systematic organization to what otherwise may be an aggrupation of diverse investment interests. It becomes more critical as more investors share ownership in the enterprise.

III. TAX CREDIT CONCEPT

The concept of a tax credit for purposes of this paper, refers to the treatment of private investments made by taxpayers in equity securities issued by private corporations that undertake qualified BOT projects, as the equivalent of a tax payment. Accordingly, under the tax credit scheme, instead of requiring the taxpayers to pay taxes to finance the construction and operation by the government of infrastructure facilities which are then offered to the public consumers in the form of public goods, the taxpayers are given the option to invest their funds in private corporations that undertake to construct and operate the same facilities as public utilities and offer their services to the public consumers in the form of private goods. Of course, in view of the limited term of a BOT scheme, when the infrastructure facilities are eventually transferred to the government, such facilities may then be offered to the public consumers in the form of public goods.

[30] Id. at 2-3.

Percentage amount of investments creditable

Under the contemplated tax arrangement, full credit to the extent of 100% is proposed for the equivalent amount of private investments made in eligible equity securities. This is to ensure that the proposed measure may maximize its impact in pursuit of the privatization objective. If only partial credit were allowed, such as 25% or 50% or 75%, taxpayer psychological enthusiasm would be dampened in reasonable proportion to the reduction, thereby hampering the privatization effort. We may note that the BOT projects proposed to qualify for tax credit treatment involve only those infrastructure facilities traditionally offered to the public consumers in the form of public goods, where there is no relevant industrial record of profitability had such facilities been operated as public utilities and offered to the public consumers as private goods. Accordingly, the projects involved may be reasonably assessed as high risk projects. Furthermore, the grant of a mere partial credit likewise dilutes the tax relief effect of the measure, in the same reasonable proportion to the reduction. Besides, the allowance of a tax credit at a ratio other than a 1:1 ratio, poses administrative complications in monitoring and enforcement.

On the other hand, no credit should be allowed in excess of the full amount of private investments made, such as a 125% credit. Otherwise, the government will lose those essential tax revenues required for purposes other than the identified priority infrastructure projects. The scheme, contemplated merely as a tax relief among other purposes, would be transformed into an unwarranted tax shelter for tax avoidance. If a 100% tax credit is not sufficient to effect the whole scale privatization of the identified infrastructure facilities, then perhaps no such amount will ever be sufficient, and we may have to rethink the fundamental tax credit approach altogether.

This paper notes the contention that the imposition of a uniform tax credit rate benefits the high income taxpayer and prejudices the low income taxpayer. To remedy the situation, it is suggested that graduated rates should instead be imposed where high income taxpayers are allowed less tax credits while low income taxpayers are allowed more. This would be akin to progressive taxation[31] in inverse order.

In this light, let us consider the two basic and diametrically opposed views of taxation: the ability to pay approach and the cost-benefit approach.[32] The ability to pay approach exacts tributes from wealth producers and redistributes them to wealth consumers.[33] In this sense, it involves some form of exploitation.[34] The cost-benefit approach matches costs

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[31] Joseph Bankman and Thomas Griffith, Social Welfare and the Rate Structure: A taxNew Look at Progressive Taxation, 75 Calif. L. Rev. 1905 (1987). Jay M. Howard, When Two Tax Theories Collide: A Look at the History and Future of Progressive and Proportionate Personal Income Taxation, 32 Washburn L.J. 43, 45 (1992).

[32] McGee, supra note 6, at 41-42.

[33] Id.

[34] Id.

with benefits.[35] Those using government services pay for them, and those not using services do not pay.[36] In this sense, it is based on principles of equity.[37]

A uniform rate system is based on the cost-benefit principle since it does not discriminate against wealth producers in terms of tax rates.[38] On the other hand, a graduated rate system is based on the ability to pay principle since it discriminates against those who earn more.[39] Accordingly, the uniform rate system is preferred because it is more equitable.[40]

Corollarily, a uniform rate system does not penalize the wealth producers to the same extent as the graduated system.[41] While the high income taxpayer still ends up paying more than the low income taxpayer in absolute terms, everybody is subject to the same tax rates.[42] On the other hand, a graduated system by its nature destroys the incentive of the high income earners by penalizing them for being productive, forcing them to pay higher

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[35] Id.

[36] Id.

[37] Id.

[38] Id. at 42-44.

[39] Id.

[40] Id.

[41] Id. at 42-43.

[42] Id.

tax rates as their income increases.[43]

Finally, a uniform rate system presents a more simplified system while a graduated system involves a more complex scheme.[44] Accordingly, for purposes of administrative efficiency, the uniform rate system is preferred.[45]

In sum, for reasons of equity, productivity and efficiency, this paper recommends the adoption of a uniform tax credit rate system.

Percentage amount of taxes subject to credit

Regarding the percentage amount of taxes which the tax credit scheme proposes to be treated as deemed paid with an equivalent amount of private investments made in eligible equity securities, we again note that the contemplated privatization proposition intends to cover only those infrastructure facilities presently offered by the government as public goods, without any relevant industry record of profitability as a fee charging public utility. Accordingly, in relation to the over-all national budget, the scheme proposes to take out of the budget only the amount allocated for the identified priority infrastructure projects. Whatever proportion that amount may be in relation to the national budget, it would be the same proportion that the amount of taxes covered by the tax credit

[43] Id.

[44] Id. at 43.

[45] Id.

scheme assumes in relation to the total tax budget. This is based on the assumption of a simplified national budget where the projected total public expenditures are fully covered by the corresponding projected total tax revenues. Otherwise, appropriate adjustments will have to be made. In any case, the crucial factor is that the specific portion of total taxes that may be covered by the tax credit scheme must not exceed the amount necessary to finance the identified priority infrastructure projects.

Accordingly, where a given infrastructure project is for some legitimate reason excluded from the budget, then by necessary implication the project is also excluded from the tax credit scheme. One reason why a qualified infrastructure project may be excluded from the national budget is a determination by government that the public simply cannot afford it at a given point in time. Another reason may be that government has already transacted with a private investor group able and willing to undertake the infrastructure project under an ordinary BOT arrangement, even without the benefit of any tax credit scheme. This may be true with respect to infrastructure projects where there is a relevant industry record of profitability, such as power generation and distribution and telecommunications. In any case, such projects would have no bearing to the tax credit scheme since they are automatically excluded. In other words, any and all securities they issue would necessarily be ineligible for tax credit treatment.

To illustrate the scheme, let us consider a state with a national budget of $10 billion in projected expenditures and revenues. Of the total budget amount, $9 billion has been earmarked for health, education, defense and other public services. The remaining $1 billion is allocated for the construction and operation of identified priority infrastructure facilities traditionally offered by the government as public goods, without any relevant industry record of business profitability. For purposes of this illustration, let us assume them to be public works for expressways, bridges, tunnels, railways, seaports and airports.

Pursuant to the privatization and tax credit scheme, the projects covered by this $1 billion portion of the national budget are now sought for implementation and operation under the qualified BOT arrangement. Accordingly, this reduces the projected level of public expenditures by the same amount of $1 billion from $10 billion to $9 billion. Correspondingly, the need to raise tax revenues is also reduced by the said amount of $1 billion from $10 billion to $9 billion. While the balance of $1 is still needed to finance the construction and operation of the public infrastructure projects, the funds to be raised will no longer be in the form of taxes, but rather in the form of private investments in the qualified BOT projects.

Under this setting, it is the $1 billion portion of the national budget for tax revenues that may be allowed to be deemed paid by private investments in the BOT projects. Insofar as the $1 billion portion constitutes 10% of the total tax revenue budget of $10 billion, then correspondingly only 10% of the total taxes due should be covered by the tax credit scheme.

Accordingly, where a taxpayer has tax liabilities in the amount of $10,000, he will be required to pay only the amount of $9,000 in cash representing 90% of his tax obligations. Regarding the remaining $1,000 representing 10% of his tax liabilities, he is given the option of satisfying them by purchasing eligible equity securities issued by private corporations undertaking qualified BOT projects in the equivalent amount of $1,000.

To restate, this paper assumes a flexible position in relation to the exact numerical percentage of total taxes due that may be covered by the tax credit scheme. This is based on the recognition that the appropriate percentage may vary from state to state depending on the prevailing economic factors. Furthermore, even in a given state, the said percentage may actually change over time. Accordingly, to ensure that the closest appropriate percentage that promises to maximize the utility of the tax credit scheme may be set, this paper proposes that such a percentage be fixed by administrative regulation and not by specific legislative provision, subject only to the general standard that the percentage fixed corresponds to the amount necessary to finance the qualified BOT projects.

Taxpayers covered

Regarding the coverage of the tax credit scheme, this paper proposes that all taxpayers, including both individual and corporate taxpayers, be allowed to avail of the privilege. This is to ensure that the full impact of the privatization and tax credit measure may be realized. Of course, with respect to corporate taxpayers which are themselves qualified BOT project implementors, their purchases of their own equity securities cannot be allowed as a tax credit. The reason being that such purchases do not actually bring any real additional value to the project. To avail of the tax credit scheme, such BOT corporations will have to purchase equity securities issued by the other qualified BOT corporations not affiliated with them.

By definition, affiliate corporations refer to those corporations controlling, under control, or under common control with the BOT corporation.[46] As to what exact amount of shareholdings should be deemed as control, this paper deems it prudent not to endorse any specific numerical shareholder percentage, realizing that the optimal numerical figure will have to depend on the peculiar economic and social conditions prevailing in a given state. Nonetheless, for purposes of reference, we may note the various percentages used by law in defining control as follows: more than 50% of voting shares,[47] and also 25% or more of voting shares[48] under the Federal Reserve Act, and 25% or more of voting shares[49] under the Bank Holding Company Act.

Furthermore, to avoid complications in the application of the tax

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46 17 C.F.R. 230.405 (1994).

47 12 U.S.C. 221a(b)(1) and (4) (1988).

48 12 U.S.C. 371c(b)(3)(A)(i) (1988).

49 12 U.S.C. 1841(a)(2)(A) (1988).

credit scheme, this paper recommends that only the direct investor duly registered in the books of the BOT corporation, be qualified to claim the tax credit. This obviates the situation where the government is swamped by claims of shareholders of investment companies or participants of pooled funds, which may invest in the BOT corporations, for indirect tax credit benefits to the extent of their shareholdings or participation in the investment companies or pooled funds. While this paper sees nothing inherently wrong in such a claim for indirect benefits, the need for a simplified administration of the tax credit scheme is more compelling. Besides, the qualification as to the form of investments, that they be direct rather than indirect investments, does not appear to be unduly oppressive to investors. Whether the investments are made directly with the BOT corporation or indirectly with investment companies that invest in BOT corporations, both investments involve essentially the same private transaction of purchasing shares of a private corporation.

Investments covered

Regarding the nature of the purchases of eligible investment securities that may be covered by the tax credit scheme, this paper proposes that there should be no distinction whether the purchases were made in a private offering or in a public offering. A private offering is a transaction by the issuer not involving a public offering.[50] A public offering is the offer for

[50] 15 U.S.C. 77d(2) (1988).

sale of securities to the public.[51] The rationale being that in both instances, real value is invested in the BOT project. For the same reason, the initial subscription by the original incorporators should also be covered.

Securities covered

Regarding the type of investment securities that may be eligible for tax credit treatment, this paper recommends that only equity shares in the form of common stocks with full voting rights[52] should be covered. This is consistent with the idea of diffusing the ownership and consequently the power to control the corporation, among the widest base of taxpayers-investors as may be possible. The purpose of the voting share structure being to institutionalize a mechanism that may be readily employed whenever the need the arises, to check possible misbehavior by control groups that may exist within the corporation. Accordingly, under the contemplated scheme, preferred shares and much less debt securities, e.g. notes and debentures, would not be deemed eligible securities.

Taxes covered

Regarding the type of taxes, e.g. income taxes, value added taxes, customs duties, etc. , that may be subject to a tax credit, this paper is not

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[51] H.R. Rep. No. 85, 73d Cong., 1st Sess. 16 (1933).

[52] Delaware General Corporation Law Sec. 151(a) (Supp. 1994). New York Business Corporation Law Sec. 501(a) (1986).

inclined to take any firm position on the matter. Provided only that an administrative mechanism is in place to effectively monitor and control the amount of tax credit availments, and prevent the unexpected destabilization of the over-all national budget, the determination of the covered taxes are best left to the appropriate tax authorities of the state. Nonetheless, to the end that no unforeseeable disruptions may occur in the finances of the state, this paper would suggest that in the initial stage of implementing the tax credit scheme, the coverage should be limited to only one type of tax such as the national income tax. This should simplify the administrative process and allow the tax authorities a greater measure of control over the state's finances.

Period of creditability

Regarding the applicable period during which private investments made in eligible BOT corporate securities may be allowed as tax credits, this paper proposes that only those investments fully paid-in within the appropriate tax accounting year of the taxpayer should be allowed as tax credits for taxes due in the said year. Excess purchases of investment securities beyond the allowable tax credit limit, should not be carried over to the succeeding tax accounting year. This precludes the heavy deluge of investments in the qualified BOT projects, which projects might otherwise be limited in number and amount, in anticipation of their beneficial use as tax credits way into the future, distorting the systematic and orderly implementation of the national infrastructure plan. It also serves as a disincentive to large taxpayers who may be inclined to corner the market for eligible BOT securities, to the detriment of small taxpayers. Finally, the limitation in creditability should facilitate the monitoring and enforcement of compliance with the tax credit rules.

IV. PUBLIC OFFERING CONCEPT

Consistent with the concepts of privatization and tax credit, this paper recommends that the BOT corporations should be publicly held corporations. The reason being that by the nature of the projects involved, basic infrastructure facilities and public utilities forming integral parts of the national infrastructure program and underlying the larger national economic program, it is to the common good of all the people that the ownership of such facilities be diffused as widely as possible among the public. We may note that ownership of equity stock issued by the BOT corporations undertaking priority infrastructure projects, effectively translates to a direct stake in the over-all economic progress of the state.

Accordingly, to ensure that the qualified BOT corporations may be publicly held corporations, this paper proposes that a minimum amount of the shares of the corporation must be offered to the public by way of a public offering. This should allow the numerous members of the general public a fair and equitable opportunity to place their investments in the qualified BOT corporations vis-a-vis the institutional investors and the consortium of project developers.

The large institutional investors generally include commercial banks, investment companies, insurance companies, and pension funds, to the extent allowed by law.[53] We may note however that under the National Bank Act, national commercial banks are prohibited from purchasing any equity securities for investment.[54] Nonetheless, under the Bank Holding Company Act, bank holding companies are authorized to purchase equity securities of any company, provided only that the shares do not exceed 5% of the outstanding voting shares of the issuer company.[55]

Regarding the amount of shares that must be offered to the public, this paper does not recommend any specific minimum amount in numerical terms, nor even the method of calculating such minimum amount. This is because the appropriate amount or method of calculation may differ from state to state depending on the prevailing economic and social conditions.

Nonetheless, this paper would suggest at least two alternative methods of calculating the minimum amount of public offering. First, it may be a fixed percentage of the total authorized shares of the BOT corporation. Second, it may be a ratio, such as a 1:1 ratio, in relation to the aggregate of the amount of shares originally subscribed by the incorporators and those shares purchased by existing shareholders in a private offering. To

[53] Richard W. Jennings et al., Securities Regulation: Cases and Materials 16-25 (7th ed. 1992).

[54] 12 U.S.C. 24 (1988 & Supp. 1993).

[55] 12 U.S.C. 1843(c)(6) (1988).

illustrate the second alternative, assuming that a 1:1 ratio is employed, where the amount of original subscriptions and private offering purchases amount to a total of say $100,000,000, then shares with an equivalent amount of $100,000,000 must also be offered to the public. The first alternative has the merit of simplicity, while the second alternative has the merit of flexibility.

While again emphasizing that this paper does not purport to assume a definitive position on this matter, it would nonetheless express its inclination to favor the second alternative inasmuch as it promises to provide the flexibility needed to cope with changes in the ownership structure of the corporation. We may note that this attribute of flexibility is more attuned to the primary purpose of the public offering proposition which is to diffuse the ownership of the BOT corporation. Of course, institutional investors may frustrate the aim of the public offering by placing their own bids in the public distribution. Such a situation may however be remedied by providing implementing rules giving preference to bids of smaller denominations, and aggregating for this purpose simultaneous bids made by a single investor through different broker-dealers or requiring bids by any one investor to be coursed through only one broker-dealer at any given time during the distribution period, among other appropriate measures.

Regarding the actual conduct of the public offering, we may note that the issuer BOT corporation generally has the option of either a direct offering or a distribution through a securities underwriter. A direct offering is where the issuer handles the securities distribution by itself using its own resources.[56] A securities underwriting is where an independent securities underwriter conducts the public offering, either by purchasing for its own account the securities of the issuer with a view to its distribution among the investing public, or selling the securities of the issuer for the latter's account in connection with its distribution.[57]

While this paper recognizes the legitimacy and propriety of leaving to the business judgment of the BOT corporation the matter concerning the manner of the public offering, it would nonetheless express its preference for the securities underwriting mode. We may note that underwriters do not only have the special skill and experience in this specific type of securities undertaking,[58] they also have the access to the organizational network of broker-dealers who are at the forefront of the over-the-counter market.[59] Accordingly, it would seem that the employment of a securities underwriter or more practicably a syndicate of underwriters would more likely facilitate the distribution of the equity securities among the widest base of taxpayers-investors.

V. SAFEGUARDS IN PRIVATE FINANCING FOR PUBLIC PROJECTS

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[56] Jennings, supra note 53, at 85-88.

[57] Id. at 88.

[58] Id. at 85.

[59] Id. at 92.

To ensure that the BOT corporations are competently managed and operated, adequately capitalized with reasonable prospects for profitability, this paper proposes that the covered corporations should be required to list and maintain such listing of the covered shares,with a securities exchange[60] or securities association[61] operating in the state.

On the other hand, to safeguard against any untoward disruption of public finance, and control the process and extent of privatization of public infrastructure facilities, the BOT corporations should also be required to secure the accreditation of the appropriate finance and economic planning agencies of the government.

Of course, in the interest of the public consumers, the BOT corporations then operating as public utilities, would necessarily be subject to the regulation of the appropriate public utility agencies, specially with respect to their rate-fixing functions.[62]

A. LISTING REQUIREMENT

We may note that the listing of securities with a securities exchange or securities association requires compliance with minimum standards on distribution of shares, market value of shares, income, capital, assets,

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[60] 15 U.S.C. 78f (1988 & Supp. 1993).

[61] 15 U.S.C. 78o-3 (1988 & Supp. 1993).

[62] Public Utilities, supra note 2, Sec. 17.

scope of operations, among others.[63] The listing of securities therefore indicates a reasonable measure of corporate viability. To the extent that the continuation of listed status requires a continuing compliance with the minimum standards of the exchange or association rules,[64] it likewise indicates continued corporate operational feasibility.

Furthermore, under the Securities Exchange Act of 1934, the listing of securities with a securities exchange also triggers the application of reportorial provisions requiring the filing of periodic reports and other information.[65] This compels the public disclosure of pertinent business information regarding the issuer.

Considering these incidents of listing, we can see that the proposed measure triggers the continued active monitoring, by outside agencies both private and government, of the business operations of the issuer. In this sense, listing applies external pressure on the issuer to measure up to efficient standards of management and operations. Moreover, we may note that the first and more important tier of monitoring is performed by a private self-regulatory organization for its own account and without any cost to the government.

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[63] NYSE Rules of Board - Listing and Delisting, Par. 2499, Rule 499 (1993). NASD Manual - Schedules to the By-Laws, Par. 1803, Sec. 1 (1994).

[64] NYSE Rules of Board - Listing and Delisting, Par. 2499, Rule 499 (1993). NASD Manual - Schedules to the By-Laws, Par. 1805, Sec.3 (1994).

[65] 15 U.S.C. 78l(a) (1988).

Accordingly, this paper recommends that in order for a BOT corporation to qualify for coverage under the tax credit scheme, it must list its securities with a securities exchange or securities association operating in the state, within a reasonable time from the public offering. This should provide for an effective mechanism for the monitoring of corporate performance and protection of the interests of the investing public.

B. ACCREDITATION REQUIREMENT

In the implementation of the private financing proposition, we should never lose sight of the need to institute an effective mechanism to control the availment of the tax credit privilege. Otherwise, government might be left with an empty bag, paralyzed by a huge budget deficit caused by declining tax revenues.

In this light, this paper proposes that in order for a BOT corporation to qualify for inclusion in the private financing scheme, it must secure the accreditation of both the economic planning and finance agencies of the government. The economic planning agency confirms that the project undertaken forms part of the national infrastructure program, while the finance agency verifies that the funding for the project falls within the limits of the over-all tax credit measure. The accreditation requirement should lend the government a reasonable measure of control over the process and extent of implementation of the privatization scheme.

VI. BENEFITS OF PRIVATE FINANCING FOR PUBLIC PROJECTS

We may observe that the proposition on the private corporate financing for public infrastructure projects encompasses in a single measure a wide range of economic and legal concerns. It affects significant aspects of government planning, public finance, taxation, corporate finance, securities regulation, investment banking and public utilities. Consistent with the multifaceted nature of the proposition, we may discern its multifarious purposes or intended benefits.

A. TAX RELIEF

Among the various benefits of the proposition, the effective grant of a tax relief is the most readily apparent. This follows directly from the grant of a tax credit to the full extent of allowable private investments made by the taxpayer in eligible equity securities. The taxpayer's funds intended for tax payment is effectively re-channeled into long-term common stock investments with reasonable financial prospects for a fair return.

Furthermore, insofar as the covered securities are required to be listed with a securities exchange or self-regulatory organization, the creation of a reliable secondary market for the securities is facilitated. Accordingly, given favorable market conditions, should the taxpayer desire to cash in his securities just as soon as he has purchased them in the public offering and availed of the corresponding tax credit, he may do so by the expedient of selling his securities through the stock exchange or the over-the-counter market.

There is of course nothing inherently wrong with such a sale by the taxpayer. For economic purposes, the objective of raising the funds required to finance the BOT project has already been attained with the taxpayer's purchase of the equity securities during the public offering in the primary market. In other words, the purchase price has now been locked in with the financial coffers of the BOT corporation. The only change that transpires during the sale is the transfer of ownership over the covered securities. The financial resources of the BOT corporation remain unchanged.

B. DISINCENTIVE TO TAX EVASION

The classical economic theory of tax evasion depicts man as a rational amoral being, whose aim is simply to maximize utility, regardless of how it is attained.[66] Applied to the tax situation, it views man as a taxpayer who will to resort to any act or omission, legal and illegal, to reduce his tax payments and be financially better off.[67] It assumes that the behavior of the taxpayer is influenced by factors such as the tax rate (which directly relates to the benefits of evasion), penalties for fraud and probability of detection (which determines the corresponding costs).[68]

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[66] Paul Webley et al., Tax Evasion: An Experimental Approach 9 (1991).

[67] Id.

[68] Id.

We may note, this model is extremely simplistic.[69] Firstly, it fails to consider other social and perhaps political reasons why a taxpayer may deliberately evade taxes.[70] Secondly, it disregards the true personal interest of the taxpayer, in the broadest sense, that his payment of taxes may eventually redound to his benefit.[71]

Nonetheless, for purposes of this paper, we may consider the model sufficient to allow us to discern the economic implications of the private financing proposition. To the extent that the taxpayer may have economic incentives for evading taxes, the grant of a tax credit equivalent to the amount of purchases made by the taxpayer of eligible common stocks issued by a qualified BOT corporation and listed in a securities exchange or securities association, minimizes such incentives for fraud. This is because investments in equity securities unlike tax payments, promises financial benefits to the rational amoral taxpayer.

Stated otherwise, the allowance of a tax credit for the purchase of eligible equity securities lowers the effective tax rate. This is because the payments re-channeled for investments in qualified BOT corporations no longer represent tax contributions but rather ownership interests. In the sense that the tax credit scheme lowers the effective tax rate, it also

69 Frank A. Cowell, Cheating the Government: The Economics of Evasion 32 (1990).

70 Id.

71 Id.

provides disincentives to tax evasion, since taxpayers are generally more willing to pay lower taxes rather than high taxes.[72]

Of course, inasmuch as the contemplated tax credit scheme does not apply to the entire amount of taxes due but only to a part of the same, it may argued under the rational amoral being theory that the taxpayer still retains some incentive for evasion with the respect to that part of the taxes that needs to be paid in cash. To answer this contention, it need only be stressed that the private financing proposition does not at all purport to be a panacea for all tax evasion ills. To the same extent that the tax credit allowance is applied only to a portion of the total taxes due, then it is only fair and reasonable to expect that the intended benefit of providing disincentives to tax evasion addresses also a mere portion of the larger phenomenon of the tax evasion problem.

C. INFRASTRUCTURE FINANCING

We may start from the premise that the construction of infrastructure facilities, as in the undertaking of any project, requires funding. Under the traditional approach to infrastructure development, the government ordinarily undertakes the construction of these facilities, raising the requisite funding from the public through the collection of taxes. Under the present alternative approach, private enterprise in lieu of the government assumes the role of prime developer of the infrastructure facilities. While the

[72] McGee, supra note 6, at 46.

public will still be the ultimate source of the requisite funding, the pooled funds will no longer be in the form of taxes but rather as equity investments in BOT corporations.

To restate the discussion on tax evasion, the employment of the private financing approach to infrastructure development provides disincentives to fraud to the extent that the available alternative of equity investments promises financial benefits to the taxpayer. In other words, that portion of the taxes which might have been lost through tax evasion, may now be recovered in the form of equity investments in BOT corporations. Accordingly, the amount of funds earmarked for the financing of infrastructure projects is increased. In this sense, we can see that the private financing proposition improves the prospects for adequate infrastructure financing.

D. ELIMINATION OF FREE RIDERS

Let us revisit our model community with the basic proprietary structure of private goods and public goods. We now assume that there are just two persons in the community, namely John and Jane. To recall, public goods are those which once provided are available to all. Public goods of course have to be paid for by contributions of one or both of them.[73] Therefore, when one does not have to pay for them, he or she would prefer more public goods to

[73] Cowell, supra note 53, at 32-33.

less.[74]

Further assuming that each person's contribution is a whole sum barring fractional contributions, we can see three scenarios.[75] First, is when both John and Jane contribute, so that there are plenty of public goods.[76] Second, is when only one contributes, either John or Jane.[77] Third, is when neither John nor Jane contributes, so no public goods are provided at all.[78]

From the viewpoint of purely personal interest, the scenario where both persons contribute is inferior to the one where only the other person contributes while the person in perspective does not.[79] On the other hand, from the viewpoint of the community, the scenario where both persons contribute is superior to the one where only one person contributes.[80]

Looking at our model community, we can see a clash of personal and communal interests.[81] While the mutual cooperation of both John and Jane may be ideally suited for optimal community welfare, there will always be the

[74] Id.

[75] See Id. at 33.

[76] See Id.

[77] See Id.

[78] See Id.

[79] Id. at 34.

[80] Id. at 35.

[81] Id. at 37.

temptation for either or both of them to give primacy to his or her purely personal interests and renege on the contributions, in the hope that the other one will pay up.[82]

In this light, we may now examine the complex relationships of the real world, specifically the relationships between and among the taxpayer, tax evader and the state. Let us consider those persons who evade their tax obligations to the state, in the hope that someone else will pay up, as economic free riders.[83] These are the persons who seek to augment their well being by taking undue advantage of the contributions of others.[84]

Under the private financing proposition, we recall that public infrastructure facilities traditionally offered by the government as public goods will now be furnished by private enterprise as private goods. They will no longer be open to all for free. Those who desire to avail of the facilities will have to pay the requisite charges for usage. The contemplated scheme therefore works through a mechanism that by its nature caters only to willing payors and shuts out free riders. In the process, it works out a more equitable distribution of the cost of financing the construction and maintenance of infrastructure facilities. Those who use more will have to pay more, while those who use less will also pay less. This

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[82] Id.

[83] Lawrence, supra note 1, at 655.

[84] Id.

is akin to the cost-benefit principle of taxation based on equity.[85]

We may note of course that eventually, when the private investments made in the infrastructure facilities have been recovered and reasonable profits earned by the enterprise owners, the facilities will be transferred to the government. At which point, the government may then offer the facilities as public goods open to all for free. While conceivably, the prospective arrangement may again open the door to free riders, the possibility of an inequitous result would not be significant, since the original private investments in the infrastructure project have already earned their worth, and the ultimate cost of financing the facilities passed on to its actual users. Under the premises, free use for all may then redound to the common good.

It may be argued that the proposition to furnish infrastructure facilities as private goods rather than public goods, favors high income taxpayers as against low income taxpayers. This is because all the taxpayers regardless of income level are charged by the BOT corporation operating as a public utility a uniform rate on a per use basis.

While the argument prima facie seems perplexing, a closer examination and comparison of the consumption behavior by high income and low income taxpayers reveals the fallacy of the contention. As we can see, the consumption patterns of the two groups of taxpayers are dictated by the

[85] McGee, supra note 6, at 41-42.

availability of their economic resources and therefore necessarily divergent.

To illustrate, let us consider the users of the expressway. The high income taxpayer would usually travel through the expressway by driving a private car. Accordingly, he is required to pay the full toll fee all by himself. In contrast, the low income taxpayer would ordinarily travel through the expressway riding a public utility bus. In this sense, he is allowed to divide the cost of the toll fee with all the other public commuters. Clearly, in view of their divergent consumption behavior, the high income and low income taxpayers do not end up paying the same amount of charges. Without doubt, it is the high income taxpayer who is effectively required to pay more.

In the case of airports where the bulk of the transport business generally pertains to the carriage of passengers,[86] the same uneven payment of terminal fees results. This is because the high income taxpayers tend to be more frequent fliers compared to the low income taxpayers. Accordingly, when measured in absolute terms, the high income taxpayers end up paying more terminal fees.

Regarding seaports where the bulk of the transport business generally pertains to commercial cargo shipment,[87] there also results an uneven payment

[86] In 1992, the U.S. air transportation industry earned $59.8 billion from scheduled passenger services, $2.8 billion from charter passenger services, and $7.2 billion from cargo services. Search of LEXIS, Market Library, US Industrial Outlook File (March 21, 1995).

[87] In 1987, the U.S. water transportation industry earned $9.9 billion from freight transport

of terminal fees. Firstly, it is the merchants appropriately classified as high income taxpayers, who routinely avail of carriage services to ship mercantile goods in the ordinary course of their business. Secondly, with respect to the non-merchants, it is the high income individuals who tend to be more frequent shippers compared to the low income individuals. In this light, we can see that it is the high income taxpayers who end up paying more charges and dues.

We can therefore discern that the mere imposition of a uniform rate on all users of infrastructure facilities without regard to income level, does not at all result in the imposition of an equal amount of financial burden in absolute terms on all the users. By assuming a more realistic perspective, assessing the privatization scheme in a given period, we can see that the disparity in the consumption behavior of high income and low income users, caused by differences in manner of use (whether individually or jointly) and frequency of usage, effectively results in a progressive distribution of the financial burden, where the high income users pay more and the low income users pay less.

In this light, we can fairly say that the privatization scheme addresses the free rider problem, without necessarily favoring high income users to the prejudice of low income users, while charging a uniform rate on all facility users without regard to income level.

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services and $2.3 billion from passenger transport services. Search of LEXIS, Market Library, US Industrial Outlook File (March 21, 1995).

E. DEVELOPMENT OF CAPITAL MARKET

A developed capital market is "one which has a relatively high level of activity and frequency, and for which trading information (e.g., price and volume) is widely available. It is principally a secondary market in outstanding securities. It usually, but not necessarily, has continuity and liquidity (the ability to absorb a reasonable amount of trading with relatively small price changes)."[88] On the other hand, an open market is "one in which anyone, or at least a large number of persons, can buy or sell."[89] While the market qualities may differ conceptually, in their cumulative sense, "a developed market will almost always be an open one."[90]

From these definitions, we gather that a developed capital market may invariably involve a large amount of securities and a large number of participants, among other qualities (such as a high volume of trading, wide availability of market information, accessibility to traders).

In this light, let us now consider the incidents and implications of the private financing scheme. To restate, the financing proposition calls for the privatization of a significant segment of economic undertakings which erstwhile had been dominated by the government. Specifically, it aims to

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[88] Freeman v. Laventhol & Howarth, 915 F.2d 193, 198 (6th Cir. 1990).

[89] Id.

[90] Id. at 199.

cover the capital intensive field of infrastructure facilities. By re-channeling the flow of a substantial portion of the taxpayers' funds from tax payments into equity investments, the scheme promises to effect a major restructuring of the capital markets by adding entirely new industries into its fold. By remolding the roles played by a large number of the people from taxpayers into equity investors, the measure draws droves of new capital market participants.

We can therefore see that the private financing scheme nurtures the growth of the capital markets by generating large amounts of new equity securities issues, and transforming the numerous taxpayers into equity investors. When taken in relation to the listing requirement stated above, which requirement effectively provides for an institutionalized mechanism for active trading in the new securities by the new investors, we can discern that the proposition promotes the large scale development of the capital market.

F. ECONOMIC WEALTH

We may note that a distinct feature of the private financing scheme is the transformation of ordinary taxpayers into equity investors. Without requiring them to come up with additional funds, but rather availing only of their existing funds which otherwise were earmarked for tax payments, the proposition practically hands them new sources of financial revenues.

Stated otherwise, the scheme which grants a tax credit for purchases of eligible equity securities, lowers the effective tax rate. This in turn allows the taxpayers to augment their savings, investments or consumption.[91]

We can therefore see that the financing proposition enhances the private economic wealth of the taxpayers. Considering the strategic nature of the business activities of the issuing BOT corporations in the general economic development of the state, we can discern that the investment opportunity presents tremendous potential for growth directly interlinked with the larger economy itself.

G. REDUCED AGENCY COSTS

In corporate finance theory, an agency relationship is a contract where a principal engages an agent to perform some service for him.[92] It involves the delegation by the principal of some decision-making authority to the agent.[93] On the assumption that both parties are utility maximizers, there is reasonable ground to believe that the agent will not always act in the best interests of the principal.[94] To limit divergences from his interest, the principal can establish appropriate incentives for the agent, incur

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[91] McGee, supra note 6, at 38.

[92] Michael C. Jensen and William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 Journal of Financial Economics 305, 308 (1976).

[93] Id.

[94] Id.

monitoring costs designed to limit aberrant activities of the agent, and pay the agent to expend resources for bonding costs to guarantee that he will not take certain actions which harm the principal or to ensure that the principal will be compensated if he does take such actions.[95] Monitoring costs include more than mere measuring the behavior of the agent and covers the efforts by the principal to control such behavior through budget restrictions, compensation policies, operating rules, among others.[96] Despite these actions, where divergence between the agent's decisions and those decisions that would maximize the welfare of the principal still occurs, the principal suffers a residual loss.[97] All these costs of divergence in the interests, decisions and actions between the principal and agent, which cause a reduction in the welfare of the principal, are considered as agency costs.[98] In sum, agency costs are comprised of: (1) the monitoring expenditures by the principal, (2) the bonding expenditures by the agent, and (3) the residual loss.[99]

In analyzing the effect of outside equity on agency costs, we compare the behavior of a manager when he owns all of the residual claims on a firm and when he sells a portion of such claims to outsiders.[100] Where a wholly

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[95] Id.

[96] Id.

[97] Id.

[98] Id.

[99] Id.

[100] Id. at 312.

owned firm is managed by the owner, he will make decisions to maximize his utility, to the extent that the marginal utility he derives from each additional unit of expenditure on a given item, equals the marginal utility of an additional unit of general purchasing power (which is his full participation in the wealth reduction).[101] This is because he bears the entire cost of the benefits he takes out in maximizing his own utility.[102] Where the owner-manager sells equity claims on the corporation, he will expend resources to the point where the marginal utility he derives from each additional unit of expenditure of the firm's resources on a given item, equals the marginal utility of a proportionate fraction of an additional unit of general purchasing power (which is his proportionate share in the wealth reduction).[103] This is because he will bear only a fraction of the cost of the benefits he takes out in maximizing his utility.[104]

As the owner-manager's share of the equity falls, his proportionate claim on the outcomes falls and this will encourage him to appropriate larger amounts of the corporate resources in the form of perquisites.[105] Moreover, his incentive to devote significant efforts to creative activities falls, and he may in fact avoid such activities because they require too much trouble or

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101 Id.

102 Id.

103 Id. at 312-313.

104 Id.

105 Id, at 313.

effort to manage or learn.[106]

Since the relationship between the people and the government in a republican system fits the concept of an agency relationship, we may now analyze the people-government relationship using the corporate finance theory of agency costs.[107]

1. TAX COLLECTION

Tax collection, just like any other fiscal operation, entails innumerable possibilities for divergent behavior by government officials. They may take the various forms of laxity, carelessness, recklessness and outright fraud. Since the flow of tax revenues constitutes the lifeblood of government, aberrant behavior by government officers involved in the process, may actually cause severe repercussions affecting not only the tax collection agencies but the entire range of government operations as well. Notably, infrastructure projects present themselves to be convenient casualties in any disruption of public finance because of their capital intensive quality.

The tax credit proposition addresses the problem of agency costs in tax collection, to the extent that it treats investments in eligible equity securities as tax credits. By scrapping that portion of the tax collection process intended to raise revenues for infrastructure projects, the scheme correspondingly avoids the agency costs the affected portion entails. By

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106 Id.

107 Steven G. Calabresi, Political Parties as Mediating Institutions, 61 U. Chi. L. Rev. 1479, 1523-1526 (1994).

instituting the process of issuing private corporate securities in lieu of tax collection, to raise the requisite funds for infrastructure development, the proposition conceivably employs a financing mechanism where the incentives for divergent behavior are minimized. This is because in a tax collection setting, aberrant behavior by the tax collector may be encouraged by the taxpayer himself who may financially benefit from lower tax payments. In contrast, in a securities issuance setting, divergent behavior by the corporate officer in charge of distributing the securities will be discouraged by the taxpayer turned investor who has everything to gain in making the investment in lieu of tax payment.

2. BUDGET LEGISLATION

The legislation of the national budget has always been a highly political exercise. Since it involves the expenditure of financial resources from the country's purse, it has invariably served as the focal point of political contests by conflicting interest groups. The legislative aspect of infrastructure development is no exception. On the contrary, in view of the large amounts of funds involved in these capital intensive projects, it would not at all be surprising if these projects should turn out to be political powder kegs. Under these circumstances, we can see the tremendous potential for divergent behavior by government officers to the detriment of the taxpayers.

The privatization scheme promises to reduce agency costs related to the legislation of budget funding for infrastructure projects by taking out such projects from the year to year budget process altogether. By allowing tax credits to equity investments in qualified BOT corporations, the proposition effectively institutes a mechanism where taxpayers can channel their funds directly to infrastructure projects, conveniently bypassing the budgetary process. To a certain extent, the proposition serves to isolate infrastructure development from the political contests and concessions that may characterize legislative proceedings. In this sense, the possibilities of divergent behavior by government officers are minimized.

3. RESOURCE ALLOCATION

A common problem encountered in developing economies is the skewed pattern of growth and development among its geographical regions. Ordinarily, the national capital region and its adjacent regions benefit most from the government's economic development program, while the outlying regions lag behind. This biased trend of development usually lasts for long periods of time, despite howls of protests by taxpayers based in the outlying regions, for apparent political reasons, among others. Firstly, most of the influential government officers have strong economic ties to the national capital region. Secondly, large numbers of constituents have concentrated themselves in this area, forming a potent political block. As the people in the outlying regions recognize the disparity in economic development, more flock to the national capital causing more problems of overcrowding, unemployment, deterioration of living conditions, crime, among others. This demographic movement also adds political pressure on government officers to divert economic resources erstwhile earmarked for the outlying regions to the national capital. In this light, we can see that enormous agency costs are generated by the divergence of interests between the government officers based in the national capital region and the taxpayers based in the outlying regions, with respect to decisions made by the former concerning the funds derived from tax payments of the latter.

Inasmuch as the private financing scheme grants the taxpayers an option of satisfying their tax obligations by making equity investments in qualified BOT corporations, the problem of inequitable resource allocation may be remedied to the extent that taxpayers in the outlying regions may be allowed to invest their funds in eligible equity securities issued by BOT corporations that operate in their regions. In other words, the financing proposition empowers the taxpayers to bypass aberrant government officers and make the crucial investment decisions on their own. In the sense that the scheme effectively reverts to the taxpayers the decision-making authority to determine where to channel the development funds, it also limits the possibilities of divergent behavior and accompanying agency costs.

4. PROJECT IMPLEMENTATION

By reason of the application of civil service laws,[108] the option of adopting a flexible incentive compensation scheme in the effort to control

[108] 5 U.S.C. 2101, 5301-5349 (1988).

aberrant agent behavior,[109] is held unavailable. While other options are open, such as the imposition of a disciplinary sanctions, the unavailability of a compensation policy appears to be significant. This is because a disciplinary sanction takes a negative approach to control by threatening punishment, while a compensation policy takes a positive approach by promising reward. As a matter of social psychology, a positive approach is naturally preferred.

Under the privatization proposition where the construction and operation of infrastructure facilities are undertaken by private corporations, the applicable compensation regime holds itself to be much more liberal, allowing the adoption of an appropriate compensation policy. Accordingly, we can see more possibilities for controlling any divergent behavior by the agents involved in the implementation of the infrastructure projects. To the extent that the divergence in the interests between the corporate officers and the outside shareholders is minimized through the positive process of an appropriate compensation scheme, agency costs are correspondingly reduced.[110]

VII. CONCLUSION

In sum, this paper proposes the adoption of the private financing method, in place of the public financing method, for the construction and

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[109] Jensen, supra note 92, at 323.

[110] Id. at 308.

operation of certain public infrastructure projects traditionally implemented by the government, e.g., expressways, bridges, tunnels, railways, seaports, airports, and other similar facilities. Generally, the proposition aims to effect the temporary privatization of government engagement in the area of public infrastructure facility operations, by instituting an operational mechanism that furnishes private goods for reasonable costs at the expense of facility users, in lieu of the system that furnishes public goods at virtually no cost or at heavily subsidized costs to the facility users but where the underlying costs are passed on to the taxpayers. Specifically, it calls for the grant of limited tax credits to private investments made by taxpayers in eligible equity securities issued by qualified public utility corporations undertaking the construction and operation of identified priority infrastructure facilities on a build-operate-transfer basis.

Being a multifaceted measure, the proposition aims to provide the multifarious benefits: (1) grant a tax relief, (2) provision of disincentives to tax evasion, (3) enhancement of infrastructure financing, (4) elimination of free riders, (5) development of the capital market, (6) enhancement of economic wealth, and (7) reduction of agency costs in (a) tax collection, (b) budget legislation, (c) resource allocation, and (d) project implementation.

To implement the proposition, this paper recommends the enactment of a private financing law which basically amends the tax laws by granting tax credits for eligible equity investments. Among the salient features of the law are as follows:

1. That only public infrastructure projects traditionally implemented by the government, where there is no relevant industry record of business viability, may be covered, as determined by the economic planning and finance agencies of the government;

2. That the public infrastructure project is implemented by a private entity in lieu of the government under the build-operate-transfer scheme;

3. That the private entity implementing the project is a stock corporation;

4. That a tax credit at the uniform rate of 100% is allowed for limited private investments made by taxpayers in eligible equity securities;

5. That only a limited amount of taxes due from the taxpayers may be subject to the tax credit scheme, the limitation corresponding to the percentage amount otherwise earmarked for public infrastructure projects set for privatization, as determined by the economic planning and finance agencies of the government;

6. That the exact numerical percentage amount, such as 10%, of taxes that may be subject to the tax credit treatment scheme is fixed by administrative regulation;

7. That all taxpayers, including both individual and corporate taxpayers, are allowed to avail of the tax credit privilege;

8. That purchases by an implementing corporation of its own equity securities or other equity securities issued by its affiliates, are not allowed any tax credit;

9. That only the direct investor duly registered in the books of the

implementing corporation may be qualified to claim the tax credit privilege;

10. That only common stock with full voting rights may be eligible for tax credit coverage;

11. That only one type of tax, such as the national income tax, is covered in the initial stage of implementation of the tax credit scheme;

12. That only investments in eligible equity securities fully paid-in within the appropriate tax accounting year of the taxpayer are allowed as tax credits for taxes due in the said year;

13. That a minimum amount of the equity securities is offered to the public by way of a public offering;

14. That in the public offering, preference is given to bids of smaller denominations, as implemented by administrative regulation;

15. That the equity securities are listed with a securities exchange or securities association before, upon or within a reasonable time from their public offering;

16. That the implementing corporation is accredited by the economic planning and finance agencies of the government.

While this paper does not cover the mechanics of a BOT arrangement, it cites for purposes of reference the current BOT laws of the Philippines entitled An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes, Republic Act No. 6957 (1988), amended by An Act Amending Certain Sections of Republic Act No. 6957, Entitled "An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes," Republic Act No. 7718 (1994), and the Implementing Rules and Regulations of R.A. No. 6957 "An Act Authorizing the Financing, Construction, Operation and Maintenance of Infrastructure Projects by the Private Sector, and for Other Purposes," as amended by R.A. No. 7718 (1994). (Annexes "A" - "C")

Considering the nature, incidents, and purposes of the proposition, this paper concludes that the stage is now set for the private financing of public infrastructure projects.