Issues in Competition Policy and Elements of a Rational Competition Policy for the Philippines: An Overview Paper

Erlinda M. Medalla

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August 2000

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Abstract

This paper provides the overview of the current PASCN studies on competition policies. The concepts set forth are not meant to be novel, as indeed, the economic grounds for competition policies and the major factors affecting barriers to entry have long been well established. Rather, this paper merely aims to clarify the issues in competition policy and identify the elements of a rational competition policy for the Philippines. As such, the paper suggests four major elements. First, there should be an effective anti-trust law of general application that would prevent restrictive business practices that results in abuse of dominant position, but at the same time allow for limitation in competition on grounds of efficiency (arising from market failures discussed in the paper) or clear public interests. It should also have adequate provisions for due process. The second element is the review of government regulations and policies with significant impact on competition. Third is advocacy for competition policy to facilitate and implement the necessary reforms. And the fourth element is information and education campaign. With such a comprehensive competition policy framework, the major issue is whether or not to create a central competition body, especially considering the severe lack of capable manpower and institutions. Nonetheless, given the huge benefits that could be derived from a working competition policy, the government should actively seek ways to bring about its development. The paper suggests that its judicial application could perhaps focus on a specific provision or action at a time. For example, it could concentrate its initial efforts on one particular industry well known for anti-competitive practices. This would provide valuable demonstration effects as well as a much needed experience and jurisprudence.
Executive Summary

This paper provides the overview of the current PASCN studies on competition policies. The ideas and concepts set forth are not meant to be novel, as indeed, the economic basis for competition policies and the major factors affecting barriers to entry have long been well established. Rather, this paper merely aims to clarify the issues in competition policy and identify the elements which would lead to a more rational competition policy for the Philippines.

Competition is "a situation in a market in which firms or sellers independently strive for the patronage of buyers in order to achieve a particular business objective, e.g., profits, sales and/or market share. Competition in this context is often equated with rivalry. Competitive rivalry between firms can occur when there are two firms or many firms. This rivalry may take place in terms of price, quality, service or combinations of these and other factors which customers may value." (World Bank and OECD, 1999)

Such a competitive situation may also be effected by "market contestability." That is, competition comes not only from actual firms or sellers already in the market but also from firms or sellers that could enter the market. In other words, the threat of entry is enough to provide competition and to make the market contestable. Monopolists and oligopolists would behave like "perfect" competitors when faced with the threat of new entrants into the market. (Baumol and Willig, 1981)

In the process, competition thus disciplines and regulates the market. In general, it is an efficient regulator, helping to allocate resources efficiently and maximize consumer welfare. Desirable though its effects may be, the presence of competition is not always assured. There may be inherent structural factors and tendencies in firm behavior which would cause deviations from competition. At the same time, neither is it an end in itself, as there are times when the market could fail and competition would not lead to efficient resource allocation. Thus, ideally, the government should promote competition when it fulfills its role as an effective regulator, and step in when it does not.

This, in essence, is what competition policy is about. The primary objective is efficiency. That is, competition policy should promote competition as long as it encourages efficiency and growth. At the same time, it should allow for seemingly anti-competitive set-ups and economic regulation where the market fails. In addition, if possible, competition policy should also be made consistent with social objectives. And ultimately, the goal is to increase welfare.

This paper identifies four major factors affecting the state of competition namely

1 barriers to trade
2 barriers to entry
3. other market failures and rigidities, and
4. government policies.

These factors suggest three layers of the policy environment affecting the state of competition. The first is trade policy, which has had a significant impact on the general state of competition in the country. The second layer of the policy environment covers the other government policy measures and regulations which, in themselves, wittingly or unwittingly, tend to distort prices and hinder competition (and consequently a well-functioning market). The third layer of policy environment is the anti-trust legislation intended to prevent anti-competitive conduct of firms that could result from such structural or behavioral factors. The last is what is usually considered the core of competition policy.

This suggests four major elements of an ideal competition policy for the Philippines.

1 Creation and enforcement of an effective anti-trust legislation

Provisions in the anti-trust legislation should prevent restrictive business practices that result in abuse of dominant position, but should allow for limitation in competition on grounds of efficiency (arising from market failures discussed earlier) or clear public interests. Considering the encompassing nature of competition and the interrelationships and linkages between sectors, it should also be general in application—i.e., applicable to all sectors, regardless of ownership. It should contain rules governing monopolies and cartels, restrictive agreements, mergers and acquisitions, and outright prohibitions of clearly unfair competition practices. These rules, where possible, should identify per se prohibition to simplify some of the tasks.

2 Review of government regulations and policies with respect to its impact on competition and competition policy objectives.

A major thrust in competition policy would include reviewing government regulations and regulatory bodies with respect to its real impact on competition and overall welfare. Most importantly, the major tasks would entail the review of the following:
- regulations on public monopolies,
- the regulatory framework covering natural monopolies and access to essential facilities,
- and competitive neutrality in other government businesses.
In addition, competition policy should ideally also be able to review and re-examine major government policies in the light of competition policy objectives.

3 Advocacy for competition policy to facilitate and implement the required reforms in government policy with welfare reducing anticompetitive effects.

If the required policy reforms made consistent with competition policy objective are to be implemented, vigorous advocacy is required.
Finally, education and information campaign on competition policy and laws should be an integral part of the process. After more than three decades of trade protection before trade reforms were implemented, and having been under two decades of martial rule, it is not surprising that there is a lack of public awareness about what competition really means and what it entails.

In all these elements, the role of competition policy and the relevant competition policy authority should be both reactive and proactive.

The elements of competition policy outlined above require a lot of technical expertise. The competition authority should have very competent and knowledgeable manpower to define markets, identify anticompetitive actions, and judiciously construct and administer "competition tests" on issues of concentration, agreements, mergers and acquisitions. Being new in the area of implementing competition policy, there would be expected a lack in expertise and a need for institution and capability building. The question is what would be the best way of developing such expertise and institutions?

Whatever the approach, initial efforts should focus on the development of physical and human capital, training of judges, education of consumers, business community and government officials on the rationale for and content of antitrust statute. We should allow the institutional foundations for the competition policy system to be established first and the enforcement of comprehensive set of commands to be introduced and this could take some time. The drafting of the law and creation of such a commission should follow efforts to study the major sources of market failure and to identify distinctive institutional conditions that affect the choice of strategies for correcting such failures.

A major issue is whether or not to create a central body responsible for competition policy, especially considering the severe lack of capable manpower and institutions. Nonetheless, given the huge benefits that could be derived from a working competition policy, the government should actively seek ways to bring about its development. And a prerequisite to this would be the drafting of a carefully crafted anti-trust law which would form the legal basis for its development while including provisions that would assure due process.

The paper suggests that its judicial application could perhaps be focused on specific provision or action at a time. For example, it could focus its initial efforts on one particular industry well known for anti-competitive practices. This would provide valuable demonstration effects as well as the much needed experience and jurisprudence.
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ISSUES IN COMPETITION POLICIES AND ELEMENTS OF A RATIONAL COMPETITION POLICY FOR THE PHILIPPINES: AN OVERVIEW PAPER

Erlinda M. Medalla*

1 Introduction

During the past decade, increasing attention has been focused on competition policies in the economic literature and policy discussions around the globe. It is not that radically new concepts are being formulated. Rather, a growing need for new approaches in competition policies is being felt because of its linkages with international trade which have become highlighted with trade barriers being brought down worldwide.

Although justification for competition policies are well founded in the economic literature, there is a need to understand their implications more fully, brought about not just by what is happening in the global arena but even more importantly by various comprehensive policy reforms that have been undertaken by the government during the past decade or so.

This set of competition policy studies being undertaken under PASCN is a recognition of this need for a new perspective, a new way of understanding the issues, and hopefully a better approach to reforming economic policies.

This paper, in particular, aims to provide the overview and setting of the present studies on competition policies being undertaken. The ideas and concepts set forth in this paper are not meant to be novel, as indeed, the economic basis for competition policies have long been well established. Rather, this paper merely aims to clarify the issues in competition policy and identify the elements which would lead to a more rational competition policy for the Philippines, more applicable considering its stage of development.

The paper is organized as follows. To set the stage for discussion, the next section of the paper deals with the benefits from competition and the objectives of competition policy. Section 3 deals with the factors affecting the state of competition. To do this, it starts by attempting to clarify what is meant by competition, especially in today's more open and globalized setting. Specifically, what constitutes competition? This is done to more easily identify the major factors that affect the state of competition. What market conditions encourage or discourage competition? Towards this end, factors related to barriers to trade and barriers to entry are examined, as well as other market conditions that affect the state of competition. Do these factors lead to abuse of market power? Understanding these factors, the paper then proposes in Section 4 what would be

*The author gratefully acknowledges the research assistance patiently and ably provided by Ms. Melalyn Cruzado and Ms. Susan Pizarro. Thanks is also due to the Philippine APEC Study Center Network (PASCN) for its financial support.
the important elements of competition policy for the Philippines. Then, Section 5 aims to address the issues that confront competition policy (including formulation and administration). Finally, Section 6 of the paper concludes by describing briefly the different studies in competition policy being undertaken under PASCN, which would, hopefully help shed some light on these issues.

2. Benefits from Competition and the Objectives of Competition Policy

Competition, as a concept, seems easy enough to understand. When one thinks of competition, one envisions a number of sellers/producers competing among each other to sell the most products to the most number of consumers. If there is indeed competition, to be able to do this, the seller or firm must make sure that he produces the best quality of products at least cost. Otherwise, he loses his clientele and his market share to some other seller or firms who could do better. Hence, the benefits from competition are also not difficult to comprehend. In simplest terms, it promotes efficiency.

Indeed, the benefits from competition are well known. Competition promotes efficiency not only in terms of producing more with less (technical efficiency) but also in terms of inducing better resource allocation (allocative efficiency). Allocative efficiency in a competitive setting is encouraged because producers and investors receive the correct market price signals which induce them to invest where there are highest returns. Indeed, the presence of competition is almost synonymous with an efficient functioning of markets. The end result is increased overall welfare reflected in wider consumer choices, lower prices and better quality of products. But perhaps even more important are the dynamic gains from innovation that competition fosters and the flexibility that it develops, on the whole enabling the economy to cope better with the ever changing environment. (See Box)

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**Box 1. What are the benefits of competition?**

- Competition ensures that markets produce goods and services:
  - at the lower cost possible;
  - that best satisfy consumers' demand; and
  - at fair price to consumers

- Competition provides other benefits such as:
  - improved product quality and services to consumers;
  - consumers have more and better information about products and product quality; and
  - a spur to the development of new products and production methods.

- Competition increases domestic productivity and efficiency in order:
  - to compete in the global market;
  - to increase employment opportunities; and
  - to raise standards of living through income growth

Source: Cabalu et al. 1999
The problem is that a firm, if it could, would rather avoid competition. In other words, consistent with its profit-maximizing objective, firms have an incentive to try to gain some market power and exercise some control on how much and at what price to sell. Given enough latitude, it can do so by somehow erecting barriers to entry, colluding with other firms by entering into some form of agreement, or engaging in other anti-competitive activities. Aside from such incentive a firm has to skirt competition, there are other factors which could limit competition, particularly structural barriers to entry of firms. (This will be discussed more fully in the next section of the study). The point is, with all its potential benefits to the economy, the presence of competition is not a given.

This suggests the primary role of competition policy. That is to safeguard, protect and promote competition and the competitive process and ensure that the market is able to function effectively and bring about economic efficiency.

Of course, promoting competition may not always be enough to guarantee the market's role of allocating resources efficiently (and thereby optimizing welfare). There are instances of genuine market failures, which may require some limitation in competition-- when more competition, could even cause inefficiencies. To illustrate, these cases of market failures include, for example, the presence of economies of scale, especially in the form of a natural monopoly. In such a case, the market may be too small for more than one firm to viably service the entire market.\footnote{This, of course, does not mean that the firm involved should be allowed to freely exercise and abuse the resulting market power.} There are also cases when seemingly anticompetitive set ups have pro-competitive effects, e.g. where there are economies of scope.

In short, competition is not the end in itself. Instead, competition policy should be one which promotes competition as long as it encourages efficiency and growth. In addition, if possible, competition policy should also be made consistent with social objectives. Ultimately, the goal is to increase welfare. These principles are, of course, easier said than actually applied in practice. There appears to be multiple objectives involved which could lead to conflicts and difficult trade offs.

There are even questions about whether competition policy should advance other socio-political objectives (World Bank and OECD, 1999) as well. It could be true in some cases that competition policy could not only lead to increased efficiency but contribute to other social objective as well (e. g. equity). Thus, no trade-offs or conflicts arise. There is thus even magnification of benefits from competition and this is well and good. However, such a deliberate strategy of trying to achieve multiple objectives using one policy handle like competition policy which is mainly suited for efficiency enhancement purposes may be extremely difficult to manage. This is especially true for a less developed country like the Philippines.

In sum, the primary objective of competition policy is increased efficiency. Where increased competition could, in certain cases, lead to decreased efficiency (as in
the cases of genuine market failure described above), exceptions should clearly be made
and limitation in competition allowed. Also, there could be instances where competition
could give way to more urgent social objective if necessary. For example, certain public
goods could be provided to disadvantaged groups at less than competitive prices. In
other words, competition policy should give allowance for seemingly anti-competitive
actions if there are clear public welfare grounds. Hence, although competition policies
may not be explicitly aimed at promoting other social objectives, the overriding and
underlying goal remains to be national welfare. And to avoid some of the complications
involved, what constitutes "public interests" should be made clear beforehand.

3. Factors Affecting the State of Competition

To identify more clearly the important elements of competition policy for the
Philippines, it would help to outline and understand what are the major factors affecting
the state of competition in the first place. What are the threats to competition? But before
this is done, this section steps back to clarify what competition really means, especially
for a developing country like the Philippines in a relatively open, globalized setting.

Quoting from the World Bank/OECD glossary, competition is defined as:

"a situation in a market in which firms or sellers independently strive for the
patronage of buyers in order to achieve a particular business objective, e. g., profits, sales
and/or market share. Competition in this context is often equated with rivalry. Competitive rivalry between firms can occur when there are two firms or many firms. This rivalry may take place in terms of price, quality, service or combinations of these and other factors which customers may value."

"the process by which economic agents, acting independently in a market, limit
each other's ability to control the conditions prevailing in the market."

More recent literature broadens the definition of competition to include "market
contestability." That is, competition comes not only from actual firms or sellers already
in the market but also from firms or sellers that could enter the market. In other word, the
threat of entry is enough to provide competition and the market is contestable.
Monopolists and oligopolists would behave like "perfect" competitors when faced with
threat of new entrants into the market. (Baumol and Willig, 1981)

Bearing this in mind, what then are the factors that could affect the state of
competition? What does competition imply for a small country like the Philippines
which has a fairly open trade regime? This paper identifies four major factors affecting
the state of competition, namely:

1. barriers to trade
2. barriers to entry
3. other market failures and rigidities, and
4. government policies.
Barriers to Trade

In such a fairly open setting, the large world market is a major source (potential or realized) of competition for demand or supply. This suggests barriers to trade as a major factor affecting the state of competition.

If there are barriers to trade, firms or sellers competing for business are limited to the local economic agents. In other words, the total geographic market becomes smaller, being limited to domestic suppliers, whose market shares are then larger without the share that would have been taken up by imports in the absence of the trade barrier. Thus, the capability of these agents to limit each other’s control of the prevailing conditions of the market is accordingly so much less. The result is increased potential market power, especially for the dominant firm. Where sufficient domestic competition exists, the effect of the trade barrier is minimal.

In general, there are two sources of barriers to trade. The first comprises natural barriers arising from large transport costs relative to the value of the product making it uneconomical for trading. Or transport time could be too long for perishable products (and cutting transport time would be too expensive). The second major source of barriers to trade is government policy itself, in particular the prevailing trade policy. This refers to the use of tariff and other non-tariff measures to control trade.

Where there are no natural barriers to trade and the good is tradable, trade liberalization would clearly enhance competition, at least by making the market more contestable. The world market is a potential source of supply, so that even a monopolistic or an oligopolistic domestic producer, faced with threats of entry of competing imported goods, would act like perfect (or something less perfect but close) competitors.

Trade reforms during the past 15 years have removed or reduced tariffs and other traditional import controls (mainly import license requirements). However, more recently, anti-dumping measures are becoming more important (where mere threats to file a case could actually prove to be an effective barrier to trade). Also, even if trade were liberalized by removing or lowering both tariff and non-tariff barriers, there are still other factors to consider to assess how much competition results. The World Bank/OECD study identifies the following factors:

- The existence of cross-border distribution systems,
- The amount of information that domestic buyers have about foreign firms,
- Whether foreign suppliers have been placed on approved sourcing lists,
- The existence of significant excess capacity held by foreign firms,
- The similarity between the needs of domestic buyers and needs of foreign firms,
- Exchange rate trends,
- The existence of technology licensing agreements, strategic alliances, or other affiliations between domestic buyers and foreign firms.
However, advances in information technology and declining transport costs across borders (especially relative to domestic transport costs) diminish the impact of these factors, with the exception perhaps of the third and the last factors. Indeed, if these concerns would have some impact on the ability of foreign products to compete with local supply, they may even enhance, not diminish, the competitive edge of foreign products over domestic supply because of some perceived (real or not) superiority of imported goods (i.e., like it or not, the presence of so-called colonial mentality of many local buyers).

What is more important to examine is the structure of the local distribution channels (the third and the last factors cited above are related to this). If the local distribution channels are somehow tied up with local producers (e.g., through vertical integration or some vertical agreement like exclusive dealing), then the impact of trade liberalization may be limited (especially if substantial sunk costs are involved in putting up another distribution channel).

Perhaps another consideration is that local firms could (and most likely do) resort to product differentiation. However, this would only offer minimal market power as foreign competition could potentially offer so much more. And if product differentiation leads to overall increased supply of goods, the impact is pro-competitive, resulting in a wider range of products and higher consumer welfare.

With these considerations in mind, the conclusion is that in general, where the good is tradable, and a close import substitute can freely come in, the market generally becomes contestable. The Philippines, being a small country is a price taker with respect to tradable goods. Hence, barriers to trade represent a significant factor in the state of competition in the market for the affected products.

**Barriers to Entry**

Not all goods, however, are tradable. For these goods, the geographic market (e.g., due to huge transport costs) is limited to within local borders. (In this sense, barriers to trade are in effect barriers to entry. However, a distinction is made between barriers to trade and barriers to entry in this paper to highlight its unique significance and importance for a small developing country like the Philippines.) A prime example of a

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2This is a problem, for example, in the case of the downstream oil industry. This is discussed in greater detail in a separate paper by Peter Lee U in this PASCN series of studies on competition policy.

3This was manifested even during the era of high tariffs when domestic firms would strongly oppose tariff cuts because they feel they would suffer significant reduction in market share. (Power, Bautista and Associates 1979)

4And even for some tradables, there still remains some barriers to trade. As previously noted,
nontraded product is the output of the services sectors. On the whole, the nontraded sectors actually represent a much larger portion of the economy. With insurmountable barriers to trade, barriers to entry of firms could significantly affect the state of competition in the affected sectors. The fewer the economic agents in the market, the larger could be the potential power of the incumbent firms.

Thus the next question is what factors affect barriers to entry?

Bains (1968) was among the first to analyze barriers to entry as factors allowing incumbent firms to raise and maintain prices above costs without fear that new firms would enter the market to contest it. Stigler (1968) incorporated into the analysis the asymmetries between incumbent firms and new entrants arising from costs which the latter must incur and the former would not. Barriers to entry could either be structural or behavioral. Various studies (World Bank/OECD, 1999; Lamberte et al, 1992, studies culling from earlier works of Bains, 1968; Stigler, 1968 and Porter, 1979) include the following as main sources of structural barriers to entry:

1. Sunk costs
   These are investments into the market which would not have any use or value if withdrawn from it. Thus new firms would think twice before entering the market if such costs are high relative to the expected returns (which is dependent on its perceived success rate\(^5\) and amount of profit). Sunk costs could come from large fixed costs, start up losses, physical and human investments which are specific to the market, "soft" assets such as huge advertising costs to establish brand names and others. Stigler argues that barriers to entry arising from economies of scale are really due to sunk costs.

2. Absolute cost advantage
   Incumbent firms could have absolute cost advantage, e. g. arising from steep learning curb, prior access to a natural resource, some government policy like direct subsidies, etc.

3. Large capital requirements
   This could also be due to sunk costs or imperfection in the capital market which limits the ability of new entrants to come up with the required capital at similar costs to the incumbent (thereby also endowing incumbent with absolute cost advantage).

4. Network industries
   These are where competing firms share the same critical facilities. New entrants may be denied access to the common facility by incumbents.

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\(^5\)The perceived success rate is dependent on the amount of sunk costs in that the new entrant is more likely to believe that the incumbent would act more aggressively against its attempt to enter the market. Similar argument applies in the case of the incumbent maintaining excess capacity (that it adds credibility to incumbent to behave aggressively against potential entrants).
The second type of barriers to entry includes barriers which are erected by incumbent firms in response to potential entrants. These behavioral barriers include, among others:

1. Predatory pricing
   This is where the incumbent firm sells temporarily at a price below cost to drive out new entrants. There is some debate about how effective this is in discouraging new entrants since it may be unsustainable and not a very rational behavior. (McGee 1958). There are certain conditions, however, when it could be a rational behavior. This could, for example, be the case for a firm which is vertically integrated who might use it to demonstrate toughness in other markets and is willing to suffer losses. Another possibility is where an imperfect capital market would allow an incumbent with huge credit line to adopt a predatory manner over new entrants who might not have the same financial resources, and the potential entrants believe it would do so.

2. Excess capacity
   This is an attempt to demonstrate that the incumbent can maintain the pre-entry level of output.

3. Product differentiation and advertising
   This is when "first-mover" advantage is perceived. This is possible with established brand loyalty and some "inertia" in consumer tastes. (The result, however, could be pro-competitive when demand actually expands. The incumbent might try itself to fill in the differentiated products and maintain it even if it is unprofitable to hold on to some market power, but as in predatory and limit pricing, this could be unsustainable.)

4. Horizontal restraints
   Horizontal relationships, whether through mergers and acquisitions or some horizontal agreements would increase the market share and market power of the firm/s involved. Some horizontal restraints or agreements could benefit the firms because of efficiency gains from the arrangement and would therefore have pro-competitive effects. However, they could also be exploitative aside from being exclusionary. Such horizontal agreements with anti-competitive effects include
   a. Cartel agreements to fix prices above competitive levels and/or to limit levels of outputs
   b. Bid rigging or collusion setting prices at auctions
   c. Arrangements to divide the market (by territory, size, customer, etc.).

5. Vertical restraints

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6Porter (1979) view behavioral barriers to entry in a dynamic sense, in those new entrants would attempt to overcome the barrier even as incumbents try to enforce it.
Vertical relationship between firms maybe able to discourage entry into one or some stage of production. This could take the following forms:

   a. Foreclosure and exclusion
   b. Raising rival's costs
   c. Contracts such as exclusive dealing, tie-ins (sale of one product on condition of purchase of another), etc.

The presence of these barriers would endow incumbent firms market power which could be abused. Basically this abuse is in terms of raising prices above competitive levels and limiting output (exploitative abuse), thereby reducing welfare. In some cases, the exclusionary action would in itself be the abusive action (exclusionary abuse, e.g. predatory pricing) with no efficiency gains to be realized. These are the anti-competitive conduct of firms which an effective competition policy would try to prevent.

Other Market Failures and Rigidities Affecting the State of Competition

When the presence of monopolistic elements brought about by the barriers to entry induces market failure and anti-competitive effects, the role of competition policy and law is more or less straightforward: to prevent the anti-competitive practice. There are, however, instances of market failures where more competition could lead to greater inefficiency because the usual price-allocation function of the market becomes irrelevant or simply ineffective. Or there could be market rigidities such that cooperative (and thus seemingly anti-competitive) set-ups are needed to realize efficiency gains. In other words, the policy implications are for allowing limitations in competition, or exemptions to the rule (e.g. allow exclusionary arrangements). These instances introduce complications to the implementation of a rational competition policy. These cases include, among others the following.

1 Economies of Scale

Economies of scale can arise from efficiencies in production which could only be realized upon the attainment of a certain plant size. Economies could also come from other stages or areas such as purchasing, marketing, and R&D activities. Such gain in efficiency from economies of scale, however, is not by itself an argument for limiting the number of firms in the market. If the good is tradable (specifically, a potential export), economies of scale need not be derived from serving the domestic market alone. If there are private initiatives to enter the market, they could have very well realized the potential gains and should not be restricted. This clearly reflects that the market is contestable. Indeed, the more logical action to counter undesirable anti-competitive effects that could arise from the existence of economies of scale would be to make the market as contestable as possible.

7The proceeding discussion, especially for the last three cases, draws from the analysis in World Bank/OECD 1999.

8Indeed, where sunk costs are involved which could erect barriers to entry, competition laws should try to prevent anti-competitive conduct of excessive pricing or limiting output.
A problem arises, however, when the good is nontradable and the size of the market is too small for more than one producer to achieve economies of scale. The same arguments above could hold. There could result a duplication of investment which could be a waste of resources if entry is not restricted. Nonetheless, wasteful as duplication of investments may be, the cost of duplication may still not be large enough to outweigh the cost of foregoing the competitive process.

The problem is when the production of the non-tradable good (or service) requires very large fixed capital. There may not even be increasing returns to scale but huge capital required for production even for a minimum volume. In addition, it may also involve an essential facility, that is, a facility which is a necessary input to another but is much too costly to be integrated into the production process. Then, duplication may indeed be socially and economically unviable and some regulation would be needed and justified. This is the case of the so-called natural monopolies. Examples are in electricity (transmission) and telecommunications. (These are discussed in more details in separate papers respectively by Abrenica and Serafica in this PASCN series of studies on competition.) Such cases lead government to create regulatory bodies to address the problem. In the case of the Philippines, these are the Energy Regulatory Board (ERB) for electricity and the National Telecommunications Commission (NTC) for the telecommunications industry.

2. Economies of scope
   These refer to cases when joint production of two or more products (goods or services) is more efficient and less costly than producing them separately. A notable example is in the financial sector where efficiency gains are derived when a single financial entity provides deposit taking, insurance and brokerage services rather than separate entities. (This is discussed further in a separate paper by Milo in this PASCN series.)

3. Synergies
   This is similar to efficiencies derived from economies of scope. Efficiency gains are made possible if there are excess capacities in different functions or activities (including intangible assets like good reputation of the firm) of two (or more) firms which could be more fully utilized with the merging of the firms. This could provide solid arguments for mergers and acquisition.

4. Transactions cost economies
   There could be economies in transactions costs involved in mergers and agreements, vertical or horizontal. These could arise for example in the case of vertical mergers or agreements by reducing the transactions costs between stages of production, as a result, for example, of more efficient information flows and better coordination.
Some other genuine market failures (unrelated to efficiency gains from economies in operation) could directly affect the competitive condition itself. For one, there could be imperfect information among buyers and sellers which could lead to market failure. Specifically, there could be asymmetries in the information available to different sellers and buyers which could provide one set of sellers or buyers undue advantage over others. In other words, the advantage has actually bestowed the firm some market power thereby most possibly resulting in reduced welfare. Another case of market failure is where externalities are involved in production or consumption. Certain costs and benefits may accrue to society but are external to firms, or consumers, such as in the case of many environmental concerns (pollution). If these costs and benefits are not internalized, goods and resources would not be appropriately priced (e.g., according to its relative scarcity) and the market would not be able to function effectively. Consequently, wasteful use of resources would be incurred, again leading to reduce welfare. Both these market failures, however, do not necessarily call for curtailment in competition or a need for enforcing competitive conduct rules. In the first case, all that may be required to increase competition could be a more efficient information system. In the case of externalities, some appropriate fiscal and other policies which would induce internalization of these "external" costs and benefits (through taxation and market-based-instruments) might offer the first best solution.

At this point, several important conclusions need to be highlighted and reiterated from the above discussion. First, for certain products, there could be structural barriers to entry which would naturally lead to a monopolistic market structure (or concentration). Second, there are tendencies for exclusionary behavior of firms. Third, such monopolistic elements could allow firms to undertake exploitative and exclusionary abuses. Fourth, ideally, the anti-trust law should be focused on preventing these exploitative and exclusionary abuses. And fifth, there could be efficiency gains for certain exclusionary practices (i.e., not all exclusionary actions are indications of abuse). The possibility of the fifth point is what makes anti-trust law very difficult to implement.

**Government Policy-Induced Factors Affecting Competition**

Finally, we come to the last major factor affecting the state of competition. This refers to government policies themselves. Government policies themselves (aside from trade policy discussed above) appear to wittingly or unwittingly erect barriers to entry or affect the state of competition when government intervenes in the market through these policies. To organize the discussion, these government policies are grouped into two general headings.

**a. Government policies and regulations with direct impact on competition**

The first group includes those government policies and regulations which would have more direct impact on competition. They are direct government interventions which control either entry into the market or some aspects of the operation of the market itself or both. In general these include:
1 Government regulation of an industry, or a section of it,
2 Direct government equity participation, and
3 Other regulatory restrictions.

No government measure and action could have a more direct impact on competition that attempts of the government to regulate an industry. Such strong involvement, however, would also require a strong rationale. In general, the government would have reason to intervene in case of market failure. Among the most important and most recognized of these is the presence of economies of scale, specifically in the case of natural monopolies.

The first type of government regulations is mainly concerned with those governing natural monopolies especially with respect to access to public goods, e.g. in the telecommunications industry and the power sector (transmission). The intent of these regulations are, of course, supposed to actually be pro-competitive -- as the market, in such cases of natural monopolies, would fail in achieving efficiency if left to itself. And where these also involve essential facilities, the objective of the regulation could also be to achieve certain social objectives, e.g. ensuring a minimal provision of a public good at an affordable price to disadvantaged group or area (mainly through cross-subsidization). A regulatory framework is needed.

One problem, however, which is common to all regulations, is that the regulator could be subject to "capture." (Stigler 1968) The regulator becomes beholden to the incumbent firm and would serve to protect the "competitor" rather than the competitive process. Another obvious problem is when the task of regulation is directly given to the monopolist. The monopolist is also the regulator. Here, by law or stated policy, the "competitor" and not the competitive process is protected. (This has happened before, especially during the time of Marcos, as in the case of the National Power Corporation then, the public monopoly, who has the sole authority to approve or disapprove electricity projects. Lamberte et al, 1992) Another problem, also common to all regulations, is the tendency to use complicated and cumbersome procedures which could negate whatever pro-competitive effects there could be.

This implies a need for a careful and regular review of the regulatory framework and its implementation.

With regards to the second, what is more important to consider is how it impacts on competition. The public enterprise may be enjoying undeserved, unnecessary and unfair advantages, e. g., in terms of tax privileges, access to credit and loan guarantees. This could drive the more efficient private firms out of the market. Privatization has been part of the major reforms being implemented since the Aquino administration. For some years, asset privatization has been a source of badly needed revenues. Nonetheless, privatization is also viewed as a tool to encourage competition. However, transfer of ownership alone would not ensure (may only transfer rents) increased efficiency if the necessary conditions for a competitive market is not set forth beforehand. Indeed, the problem may not be whether or not to transfer ownership but rather how the competition
process and discipline could be introduced. If there would be transfer of ownership, all unnecessary advantages previously enjoyed by the firm should be removed and competitive neutrality should be ensured. These issues need to be examined further in the reforms of public enterprises.

With respect to the third, the other regulatory restrictions could range from explicit restraints to entry requiring firms to obtain permit or license to operate in a particular market to stringent procedural and other requirements making entry to a market difficult. These include among others:

a. Local Government Code provisions on licensing and zoning,
b. Lengthy and cumbersome bankruptcy and insolvency laws forming exit barriers,
c. Labor Code provisions which restrict flexibility of firms to downsize or shut down also forming exit barriers,
d. Intellectual property rights protection,
e. Government procurement policy, and
f. Business registration requirements.

The rationale for the restriction would vary from public safety to monitoring and other reasons. In the first, the local government is given leeway in its efforts to pursue its own strategy for development. While some autonomy should exercised by the Local Government, they should be made aware if their actions could have serious detrimental impact on competition and efficiency, even if in the end they have the final decision. In the second, these exit provisions could form entry barriers as well.

The government policy on intellectual property rights (IPR) is intended to encourage innovation, a necessary condition for dynamic efficiency. Though it could grant temporary monopoly rights to the holder of the of the IPR, this should be balanced against this future dynamic gains from innovation.

Finally the cumbersome process of registration procedures itself could be an important source of barriers to entry. This is especially true for small and medium scale industry. The checklists of requirements doing business in the Philippines and business registration in Tables 5 and 6 illustrate the long process and numerous requirements a prospective business needs to hurdle just to be registered. This could more especially prove difficult for small and medium enterprises. Regular review of these procedures should be done to simplify and modernize the process.

To summarize, these regulations are supposed to serve some objectives, even pro-competitive objectives. Nonetheless, there is a clear need to re-evaluate these policies and review whether such policies and regulations could pass a "competition" test or, if not, if they could be justified on grounds of public welfare in general or the objectives they are supposed to achieve in particular.
b. Other government policies affecting competition

The second group would include government policies aimed at achieving various other objectives that are not overtly related to competition but would nonetheless have significant, though less direct impact on the state of competition. The list in this second group could be long but the major policies would include among others the following:

- Industrial policies: investment policy, export promotion, foreign investment, and regional development policies,
- Agricultural policies, and
- Environmental policy and regulations.

The last could have direct impact on barriers to entry as well but is included here because of other social objective that is paramount to it. Also, there is no doubt that there are other major policies not included which would have a significant interface with competition policy objectives. This, however, hopefully illustrates the importance of examining this interface and lessons that could be obtained from it for the others.

These policies are supposedly intended to serve other explicit objectives -- the basically development of the sector, ultimately benefiting the economy as a whole. The question is how much should competition policy also be considered.

For the investment policy as a whole, the objective is to aid in industrial growth and development. The thinking behind this is that there are market failures which prevent the industrial sector from developing naturally. Indeed, there is greater conscious consideration of this rationale for role of investment policy. This is reflected in the shortening of the list of industries in the Investment Priorities Plan (IPP), and moving towards a more promotional body. The "measured capacity" concept in the Omnibus Investment Code which limits granting of incentives when a certain capacity (some optimum scale) is reached, clearly anti-competition in nature, is not followed in practice. There is a move towards the "greening" of incentives, realizing externalities involved. Export promotion remains in the list of priority. As noted above, regional dispersal of industries and promotion of regional investment have been among the stated goals of the Philippine government.

These are arguably desirable objectives. Nonetheless, the industrial strategy chosen has probably been too preoccupied with simply trying to overcome the failures of the market (real or merely perceived). An obvious strategy which has been overlooked is to proactively support competition policy for industry, since their objectives in a large part actually merge. Their objective of industrial development policy is to enhance efficiency coincide with competition policy objective. Indeed, could competition policy actually serve as one of policy tool for industrial development (together with trade, fiscal and monetary policies)? Was it even deliberately considered? Or, on the contrary, are

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9 In particular, there are the policies on deregulation and privatization. However, these policies address directly the problems in government regulations and are thus discussed in conjunction with these regulations.
there anti-competition effects which unintentionally go against the competition policy objective (serving to defeat their purpose)? One that comes to mind is the inherent bias of an incentive granting system against the entry of small and medium scale industries.

Of particular importance is the policy on foreign direct investment. Restrictions on foreign equity have a direct impact on entry of firms. Specifically, they represent (policy-induced) structural barriers to entry. Substantial liberalization was effected by the 1991 Foreign Investment Act which changed the regime from a highly regulatory system of positive list where foreign equity is fully or partially allowed, to a more liberal system of negative lists where only those in the list are not allowed 100 percent foreign equity participation. Recently, some liberalization was implemented in retail trade with the passing of the Retail Trade Act. Foreign equity participation is still limited for many sectors and this is supposedly for some other social objectives (national security, sovereignty, and others). Clearly, there is a need to re-examine the issues to evaluate whether the restriction in fact serves the stated objectives, and assess the benefits and costs of limiting competition with such restrictions.

With respect to agricultural policy, a basic rule should also be for government to intervene only when market fails. However, for agricultural policies, there appears to be the additional, equally important (possibly more so in some cases), equity objective. This is where it could run counter to competition policy objectives. Nonetheless, if such trade offs exist, are they justified? That is, would benefits (from equity considerations for example) outweigh costs (e.g. efficiency losses from foregoing competition objectives).

In particular, agricultural policy still relies on tariff policy tools and other trade controls (anti-competition). Agricultural policies also employ government regulations with direct impact on competition. This include for example, the regulations implemented by the National Food Authority (NFA) and Sugar Regulatory Administration (SRA). These policies supposedly to protect income of farmers (equity objective). Are the costs of protection and regulation commensurate to the benefits of increased income for the farmer? These are important questions to ask.

With respect to environmental policies, environmental concerns are usually characterized by externalities. This means that environmental policy and management would need measures to internalize these external costs and benefits. Where market-based instruments could be used, uniformly and fairly applied, no serious impediments to competition are expected. However, in many cases, regulatory (command and control measures) are usually the more expedient tools -- from standard setting to permitting requirements. Examples are the environmental impact assessment (EIA), environmental clearance certificate (ECC) required for a number of industries even before they can begin to operate. Some industries also complain about the impact on competitiveness of such legislations as the Clean Air Act. They could restrict entry and/or entail prohibitions, most especially affecting small and medium scale industries. Again, there are trade-offs. And the question is would benefit (from environmental regulation) outweigh the costs?
In sum, what all these indicate is the important interface between these policies and competition policy. And what is implied is a need to closely re-examine these government policies in the light of competition objectives. Again, competition is not the end in itself. Rather, the objective is to clarify what kind of trade-offs exist and make them transparent so that judicious decisions could be made and reforms implemented if called for.

4. Elements of a Rational Competition Policy for the Philippines

With such factors affecting competition in mind, the next question is what should be the elements of a rational competition policy for the Philippines.

These factors suggest three layers of the policy environment affecting the state of competition. The first is trade policy, which determines the general terms of trade, especially as far as a small country is concerned. Or in more concrete terms, how much barriers to trade are erected, whether through the imposition of tariffs or non-tariff trade restrictions on imports. The second layer of the policy environment includes the other government policy measures and regulations which, in themselves, wittingly or unwittingly, tend to distort prices and hinder competition (and consequently a well-functioning market). The third layer of policy environment involves measures and regulations intended to govern the conduct of firms themselves to limit if not prevent any abuse of market power that these firms might possess, the anti-trust policy. The last is what is usually considered the core of competition policy.

The discussion points to two major requirements for an effective competition policy. First, there is a need for an effective anti-trust law. And second, there is a serious need to re-examine and re-evaluate government policies themselves which impact on competition. This suggests four major elements of an ideal competition policy for the Philippines.

1. Creation and enforcement of anti-trust legislation aimed at preventing restrictive business practices that significantly lessen competition and result in abuse of dominant position, inefficiency and reduction in welfare,

2. Review of government regulations and policies with respect to its impact on competition and competition policy objectives,

3. Advocacy for competition policy to facilitate and implement the required reforms in government policy with welfare reducing anticompetitive effects, and

4. Information and education campaign

In all these elements, the role of competition policy and the relevant competition policy authority should be both reactive and proactive.
Creation and enforcement of anti-trust law

With regards to the first element, provisions in the anti-trust legislation should prevent restrictive business practices that result in abuse of dominant position, but should allow for limitation in competition on grounds of efficiency (arising from market failures discussed earlier) or clear public interests. Considering the encompassing nature of competition and the interrelationships and linkages between sectors, it should also be general in application— that is, applicable to all sectors, regardless of ownership. Thus, even firms under certain regulatory boards should be subject to the discipline of the anti-trust law. The objectives of the regulatory board would not be violated, as the law would have enough allowances for efficiency and public interest justification. Indeed it should benefit from the discipline it enforces.

The anti-trust policy should contain rules governing monopolies and cartels, restrictive agreements, mergers and acquisitions, and outright prohibitions of clearly unfair competition practices. These rules, where possible, should identify per se prohibition to simplify some of the tasks. For other cases, rule of reason, e.g. by applying judiciously crafted "competition tests" should allow for limitation in competition where found to be so justified. The anti-trust law should endow investigative powers to whichever agency is tasked to implement it. There should, however, be transparency in the procedures, ideally with some guidelines published. Finally, there should be clear possible course of actions, in terms of remedies and/or penalties for those found to be in violation of the anti-trust law. To elaborate a little further, as suggested in the World Bank/OECD Framework for the Design and Implementation of Competition Law and Policy, these cover the following provisions:

➢ Rules governing monopolies and cartels and abuse of dominant position

  o Establish if firm has dominant position
  o Examine entry barrier condition
  o Identify anticompetitive actions (creating obstacles to entry, e.g. predatory pricing)
  o Set guidelines for rule of reason regarding what anticompetitive, exclusionary actions could be allowed. There should be a competition test to determine if the obstacle to entry is solely created by increasing efficiency of the firm. This competition test allows for limiting competition on efficiency grounds
  o Burden of proof -- firm
  o Provide for possible remedies (e.g. reorganize, divest)

➢ Rules governing restrictive agreements. The premise is that not all agreements are cartel agreements. Similar considerations apply as in the case for rules governing concentrations (below)

  o Identify per se prohibitions. These would include clear cartel agreements (naked restraints of trade) such as:
- Price fixing or setting
- Output fixing or setting
- Bid rigging
- Division of markets
  - Examine entry barrier conditions
  - Identify other forms of anticompetitive (exclusionary) conduct where rule of reason could apply
  - Set competition test guidelines
  - Burden of proof--firm

➢ Rules governing mergers and acquisitions
  - Examine entry barrier conditions
  - Set and define threshold for what is small enough mergers where prior notification is not required.
  - Set rule of reason guidelines for permitted mergers and acquisition even for those above the threshold. For these there should be competition test which show that there would on balance be efficiency gains.
  - Burden of proof--firm

➢ Provisions for prohibited unfair competition practices:

List specific actions which should be prohibited unfair competition practices. Examples of such practices of unfair competition which should be prohibited could include:

- Distribution of false or misleading information-- which could harm competing firm
- Distribution of false or misleading information (including information lacking basis) to consumer's e.g. related to price, quality, characteristics, etc.
- Unauthorized use, receipt, or dissemination of confidential scientific, technical, production, business, or trade information

The review of the anti-trust legislation is dealt with in more detail in a separate paper by Commissioner Antonio Abad. It examines why, in the first place, the present legislations are inadequate and why there is a need for a new anti-trust law.

**Review of government regulations and policies**

With regards to the second element, as follows from the discussion in the previous section, a major thrust in competition policy would include reviewing government regulations and regulatory bodies with respect to its real impact on competition and overall welfare. Most importantly, the major tasks would entail the review of the following:
- regulations on public monopolies,
- the regulatory framework covering natural monopolies and access to essential facilities,
- and competitive neutrality in other government businesses.

In addition, competition policy should ideally also be able to review and re-examine major government policies in the light of competition policy objectives.

**Competition policy advocacy**

If the required policy reforms made consistent with competition policy objective are to be implemented, vigorous advocacy is required. This cannot be done without a rigorous and careful review of these policies. Review should cover identifying gainers and losers. They should be able to identify problems, trade-offs and possibly weigh benefits and costs of policy. In particular, studies on the impact of competition policy reforms which could support its advocacy would be needed.

Ways and means to mobilize consumer and other advocacy groups should be institutionalized. This is related to the next element discussed below.

**Education and information campaign**

Finally, education and information campaign on competition policy and laws should be an integral part of the process. After more than three decades of trade protection before trade reforms were implemented, and having been under two decades of martial rule, it is not surprising that there is a lack of public awareness about what competition really means and what it entails. What could be cartel behavior such as collusion and other anti-competitive actions are viewed as part of the ordinary course of doing business and benign firm behavior. On the other hand, there is some paranoia about big businesses involved in the production of politically sensitive commodities (e.g., oil). The fact that certain businesses are big is enough to draw conclusions of "unfair" competition. These perceptions are well ingrained and would be difficult to change. A lot of education and information campaign is needed for competition policy to be successfully implemented. And this should be a clear and major function of the competition policy body.

To perform this task, it would be necessary to mobilize the relevant groups in the community, particularly those who understand and support competition in the various sectors—consumers, politicians and in the business community itself. Enlisting the help and mobilizing consumer groups, in particular, would help build awareness about competition and build constituency for needed reforms.
5. Issues in Competition Policy

The elements of competition policy outlined above require a lot of technical expertise. The competition authority should have very competent and knowledgeable manpower to define markets, identify anticompetitive actions, and judiciously construct and administer "competition tests" on issues of concentration, agreements, mergers and acquisitions. Being new in the area of implementing competition policy, there would be expected a lack in expertise and a need for institution and capability building. The question is what would be the best way of developing such expertise and institutions?

Should a central body be created?

Herein lies the first major issue in competition policy for the Philippines: whether or not to create a central body responsible for competition policy. Given the formidable tasks implied by the comprehensive nature of the elements of a rational competition policy outlined above, a central body is indeed necessary. It need not perform all the tasks at all levels but may only require very close coordination with other government agencies, especially the regulatory boards which continue to exist.\textsuperscript{10} But the requirements in terms of capable manpower and institution building could be daunting.\textsuperscript{11}

Successful implementation of competition policy requires not only the careful design of substantive prohibitions and the construction of an effective competition body, but would also entail improvements in other institutions such as courts and the judicial system. Sadly, the institutional ingredients that make ambitious competition system feasible in developed countries rarely exist in developing settings and which will take long years (decades) to build.

Again, the question is: what is the best way to develop the competent body to implement competition policy. One approach is to do this gradually, possibly on a piecemeal basis. We can begin with the creation of a coordinating body, and an austere law, which can be augmented over time and emphasize the establishment of implementing institutions and promotion of competition advocacy. Another approach is to transform an existing body which is performing some of the functions of competition policy. A third approach would be to create a new central body (such as the Fair Trade Commission) which could be designed to develop and evolve into what it should ideally become.

It is difficult to decide at the moment which is the most effective approach. The problem with first approach is that coordinating bodies are usually not very effective as they lack the necessary mandate, budgetary requirements and power. The problem with the latter two approaches is that the requisite foundation may not be there. The

\textsuperscript{10} Indeed, it should leave the more technical aspects to the particular agency specializing in the particular industry in question.

\textsuperscript{11} Related to this, for the PASCN series, a study is done by Tabbada on administrative and capability issues in implementing the anti-trust law.
bureaucracy may not be ready to perform such a function, even with enough mandate, budget and power, and might even cause more harm than good at its current state of development.

Whatever the approach, initial efforts should focus on the development of physical and human capital, training of judges, education of consumers, business community and government officials on the rationale for and content of antitrust statute. We should allow the institutional foundations for the competition policy system to be established first and the enforcement of comprehensive set of commands to be introduced and this could take some time. The drafting of the law and creation of such a commission should follow efforts to study the major sources of market failure and to identify distinctive institutional conditions that affect the choice of strategies for correcting such failures.

In the long run, the government should work towards creating such a commission. Ideally this commission would be responsible not just for the prevention of anticompetitive behaviour of firms, or simply anti-trust legislation, but rather for the broader area of competition policy and law including competition advocacy and information and education campaign.

What should be the priority and focus in the short-medium run?

The second issue is related to the priority and focus of competition policy in the short-to-medium run. While competition issues regarding the conduct of firms are important, perhaps the more crucial and urgent concern is the second layer of the policy environment-- the government policies with anti-competition effects, especially the first group of policies, i.e., those with direct impact on the state of competition. Specifically, this means reviewing the performance of the regulatory boards. This is due to several reasons. One, a lot has already been done in terms of implementing reforms with regards to trade policy (first layer), and perhaps it is timely to shift some of the focus on the other government policy-induced anti-competitive elements. Second, there is a clear need to re-evaluate policies and review whether such policies and regulations could pass a "competition" test or, if not, if they could be justified on public welfare grounds. And finally, this could be where the greatest impact of implementing competition policy could be felt.

While priority and focus should be given reforms of government regulations, it does not imply that creation and/or implementation of a more effective anti-trust policy should be neglected. Efforts should begin to be made towards making it operational and workable. Indeed, perhaps it is one of the requirements for reforms that are needed in instilling market discipline in industries covered by the regulation. However, due to the comprehensive scope of the anti-trust law, its implementation or application could be focused on one provision of the law to gain experience, jurisprudence, expertise and capability upon which to build on. Focus and priority could, for example, be placed on anti-trust rules on mergers and acquisition. This is probably a good way to start, as the burden of proof lies on the part of the firm and hence, data and information gathering
demands for analysis would be greatly reduced. It could also focus its initial efforts on one particular industry well known for anti-competitive practices.

**Lack of appreciation of the problem by the private sector**

This brings us to the third issue. How great is the need for competition policy and law? Rightly or wrongly, the private sector does not seem thoroughly convinced of the need for competition policy in general. Benefits from deregulations in the transport and telecommunication sectors and need for competition policies in these sectors are well understood. However, there appears to be a lack of appreciation about the gravity of the problem -- specifically with regards to limited competition in many industries in the manufacturing sector and its adverse effects.12

Possibly one of the reasons for this lack of appreciation of the problem with respect to the manufacturing sector is the relative novelty of the idea after three decades of protectionism and two decades under martial law. Another is that trade reforms have been a relatively recent experience -- only during the past decade or so. The Philippines is a small country, where the average size of firms is relatively small. Even the larger establishments are small compared to medium sized firms in the developed countries. There are doubts that existing firms have enough resources to erect barriers to entry, except possibly for large or capital intensive industries.

Another question is if trade is relatively free, isn't foreign competition enough? Many would probably agree that increased competition in nontradable sectors like services, not subject to the same contestability of markets made possible by the open trade regime, would benefit society. However, there is apprehension about a more general application of competition policy -- that it could lead to indiscriminate use of power of competition authority. More education and information campaign is needed about the state of competition, the anti-competition elements present and benefits from competition policy that would also apply to the already open manufacturing sector. Some demonstration of these benefits is necessary.

We are thus back to the original question: should a central body be created? Its potentials as an effective means of reviewing and reforming policies are great. What a boon it could be. What possibilities there could be in reforming even recalcitrant government policies? Given the huge benefits that could be derived from a working competition policy, the government should actively seek ways to bring it about. And a prerequisite to this would be the drafting of a carefully crafted anti-trust law which would form the legal basis for its development while including provisions that would assure due process.

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12 A separate study is done for the PASCN series by Aldaba on competition policy in the manufacturing sector, dealing, among other things, with this issue.
Box 2. DUE PROCESS: A CHECKLIST

- Do competition authorities operate independently from outside pressures from public or private parties?
- Are competition officials chosen on the basis of professional criteria?
- Are competition officials protected from the possibility of arbitrary removal from office?
- Do competition authorities enjoy relative financial independence and autonomy regarding staffing policies?
- Are there strict legal provisions against conflicts of interest?
- Do competition legislation and authorities have clear, unconflicting objectives, such as achieving economic efficiency?
- Is the decision-making process transparent?
- Do concerned parties have a right to be notified that formal action under competition provisions has been initiated?
- Are there clear, procedural rules setting deadlines for decisions and requiring detailed justifications?
- Is it the case that no fact, no forecast (in competition cases that require forecasting market developments) no technical argument nor any issue of liability, is conclusively presumed against any party?
- Has all information considered by administrative authorities been lawfully obtained?
- Do competition authorities possess the necessary tools for legally gathering sufficient information and conducting appropriate investigations?
- Are competition authorities required to construct a record of evidence and to render a decision based on the record?
- Are competition authorities required to make every effort to preserve the confidentiality of the information supplied to them as part of an investigation?
- Are staffs subject to strict legal provisions designed to protect confidentiality?
- Are sanctions commensurate with gravity of violation committed?
- Is impartial review of decisions available?


6. On-going PASCN Studies on Competition Policy

By way of conclusion, this section of the paper describes briefly the different studies in competition policy being undertaken under PASCN, which would, hopefully help shed some light on these issues.

1. Recommendations for Philippine Anti-trust Policy and Regulation – Atty. Anthony Abad

This study has been commissioned as a means of developing specific recommendations for new anti-trust policies and regulations. The scope of work and objectives of this study are as follows:

- To review existing anti-trust laws and regulations, especially with respect to how appropriate the provisions are in providing competitive conduct rules and balancing exclusionary with efficiency effects;
- To examine the effectiveness and adequacy of these laws and regulations;
- To examine how well these laws conform with international rules; and
- To suggest recommendations for reform.
There have already been quite a number of studies conducted dealing with anti-trust and/or competition issues from an economic analysis point of view, but also some on an industry or sectoral basis. In contrast, this study will be focusing on anti-trust issues from a legal and regulatory structure point of view and in a comprehensive manner rather than a sector-specific approach. This study will also be analyzing the proper administrative structures for effective enforcement of policy, and necessarily including some insights on existing political economy conditions.

2. **Political Economy and Administrative Capability Aspect of Competition Policy – Prof. Jose Tabbada**

This study will assess the capability of the Philippine bureaucracy or administrative system (hence “administrative capability”) to implement competition policy. It is a part of a larger study entitled “Towards a National Competition Policy for the Philippines” which seeks to define the elements of a national competition policy for the country.

To date, however, a framework for a competition policy remains to be formulated. It is therefore the task of this study to contribute to the elaboration of such a framework.

3. **Analysis of the State of Competition and Market Structure of the Manufacturing Industry – Ms. Rafaelita M. Aldaba**

This study would focus on government policies and regulations, structural elements and other factors affecting competition in the manufacturing industry. The major objective of the study is to examine the effects of these factors on competition in the manufacturing sector. It would determine the restrictive government policies and regulations affecting the sector as well as assess the regulatory capability of the government agencies involved in implementing these. It would examine the market structure of the sector including the effects of structural elements on competition in the sector. Structural elements would have to be considered as industries have specific structures defined by the nature of the product and the environment in which they operate. The study would also identify issues and problems that need to be studied more closely. Policy recommendations dealing with these issues would be formulated with a view to modifying policy measures that are judged to have adverse affects on competition.

The study is important as it serves as an input to the formulation of a framework for the country’s competition policy. Moreover, to sustain the trade policy reforms carried out since the 1980s, there is a need to ensure a competitive environment that will allow firms to compete according to fair rules and will, at the same time, take care of the interests of consumers. The present study is a step towards this direction.
4. **Analysis of the State of Competition and Market Structure of the Services Sector – Dr. Myrna Austria**

This study is part of the broader research project on developing a national competition policy for the country. It will focus on analyzing the state of competition and market structure of the services sector particularly finance (banking and insurance), transportation (land, water and air), and the distribution sector (wholesale and retail). Specifically, the analysis will focus on three areas, namely, regulatory regime, market structure, and regulatory capability. The study will analyze how these three areas have affected competition and efficiency in the sectors. Inefficiency in the services sectors weakens the competitiveness of the manufacturing sector since services are considered a vital input to industries. Inefficiency in the services sectors could be policy-induced, especially those that inhibit the entry of new players in the market. Government policies and the government’s capability to implement regulations and laws will therefore be analyzed on how they have affected the structure of the services sector and hence, competition in the sector.

5. **Analysis of the State of Competition and Market Structure of the Banking and Insurance Sectors – Dr. Melanie Milo**

The last two decades have seen a significant change in the regulation of the Philippine financial services sector, particularly the banking industry. On the one hand, there has been a substantial relaxation in certain regulations such as direct controls on interest rates, as well as restrictions on lines of business, ownership and portfolios. The overall objective of such deregulatory reforms was to promote competitive conditions to foster greater efficiency in the financial sector. On the other hand, there has also been a strengthening of prudential regulation, which focused particularly on controls on the capital or “own funds” of banks. The latter is justified as necessary to correct a “market failure”, which arises from the difficulty for banks to credibly demonstrate their level of risk to depositors and other lenders.

The present study proposes to analyze how competition and efficiency in the financial services sector, particularly the banking and insurance industries, have been affected by the regulatory regime and market structure. This study is part of the broader research project on developing a national competition policy for the Philippines. As border barriers decline, the behavior of firms plays an increasingly central role in global outcomes. This is especially true for the financial services sector.


The proposed research is an examination of the planned restructuring of the power sector, anticipating problems of competition and regulation that attends to the transformation of industrial structure. The study is also an inquiry into the nature and performance of energy regulatory institutions in selected countries (viz.,
U.K., U.S., Chile and New Zealand) for the purpose of drawing insights and policies that may apply to the Philippine power sector. The anticipated passage of the "Omnibus Power Industry Act" will facilitate greater participation of the private sector in power generation, transmission and distribution. Consequently, a well-defined competition policy framework that will ensure a smooth transition from a highly integrated and regulated industry structure to be a liberalized market regime is required.


This study will provide an assessment of the current state of competition in the telecommunications sector and identify policy and regulatory gaps in order to strengthen contestability in the market. The experience of select communities will be examined to determine if liberalization policies and programs need to be re-examined (i.e., service area scheme) and if threats to a multi-player environment remain (i.e., inadequate interconnection). Other external forces (e.g., WTO, worldwide trend towards cost-based termination or the collapse of the accounting rate regime, etc.) will also be considered as they impact on the competitive environment. Finally, we will probe into consolidation movements in the industry and the relevance of an anti-trust legislation.

8. **Competition Policy for the Philippine Downstream Oil Industry – Dr. Peter Lee U**

This study will examine the current competition policies, specifically as embodied in the Supreme Court decision, Republic Act 8479. The study will also consider, to the extent feasible, other legislation pertinent to this industry, that may arise in the course of data-gathering and interviews with government and industry officials.

The study will also examine the current industry structure and practices, to identify potential or actual anti-competitive behavior.

Lastly, the study will examine the role that economic theory played, in the crafting by the Supreme Court of its decision. It will also endeavor to understand the process by which the Supreme Court acquires such information.

Research objectives:

a. To assess the appropriateness and consistency of government competition policy as embodied in the current oil deregulation act and the Supreme Court decision;

b. To examine current industry structure and practices to identify possible areas of anti-competitive behaviour and make necessary recommendations on how to remedy such situations; and

c. Examine the role that economic theory played in the Supreme Court decision and the process by which this knowledge is required

The paper aims to examine the major government policies in terms of how they relate to the objectives of competition policy. Towards this end, three sets of government policies are considered. The first is trade policy. The second group includes government regulations and restrictions directly affecting competition. The third group includes other major government policies with other development objectives. The objective is to clarify what important trade-offs may exist and how and possibly when conflicts between government policies and competition policy objectives arise.
REFERENCES


