

**Policy Forum on Competition Policy Issues in the Philippines:
Framework for Strengthening Corporate and Economic Governance¹**

14 July 2000

NEDA Makati Bldg. Legaspi Village
Makati City

FORUM HIGHLIGHTS²

*(Note: Opening activities started at 9:00 a.m. DDG Raphael P.M. Lotilla of NEDA gave the welcome remarks and introduction of opening speaker. Then Senator Loren Legarda-Leviste, Chairperson of the Senate Committee on Economic Affairs, followed and delivered her opening statement. Dr. Mario B. Lamberte, President of the PIDS, acted as the master of ceremonies and moderator during the open forum)

DDG Lotilla

In the area of competition, there is a great difference between the myth system and the operationalization of that myth system. This is evident in the weak enforcement of existing policies and legislations in the field of competition. There is therefore a need to enhance the implementation of competition laws.

Papers presented in the policy forum will lead to significant contributions in improving or refining economic legislations in Congress that will keep the Philippines competitive in the global market.

Sen. Loren Legarda-Leviste

Competition policy is among the most important issues to face in order to meet the challenges of survival and thrive in the global economy. There is need to establish a framework for competition that would create an atmosphere conducive for the Philippine economy to flourish and subsequently assure that economic growth redounds to the benefit of all. And this is where the role of the legislative branch to create laws and the executive branch to implement such laws are crucial.

PAPERS PRESENTED

There were four (4) papers presented during the policy forum, as follows:

- 1) "Issues in Competition Policy and Elements of a Rational Competition Policy for the Philippines" by Dr. Erlinda Medalla, Senior Research Fellow, Philippine Institute for Development Studies (PIDS);
- 2) "Recommendation for Philippine Anti-Trust Policy" by Atty. Anthony Abad, Commissioner, Tariff Commission (TC);
- 3) "Competition Policies in the Power Sector" by Dr. Ma. Joy Abrenica, Professor, School of Economics, University of the Philippines (UPSE);
- 4) "Competition Policy for the Philippine Downstream Oil Industry" by Dr. Peter Lee U, Professor, School of Economics, University of Asia and the Pacific (UAP)

¹ A joint undertaking of the Legislative-Executive Development Advisory Council (LEDAC), National Economic and Development Authority (NEDA), Philippine Institute for Development Studies (PIDS) and Philippine APEC Study Center Network (PASCN).

² Prepared by Ms. Melalyn D. Cruzado, Senior Research Specialist, PIDS

1) **“Issues in Competition Policy and Elements of a Rational Competition Policy for the Philippines”** by Dr. Erlinda Medalla, Senior Research Fellow, Philippine Institute for Development Studies (PIDS)

Benefits from Competition and the Objectives of Competition Policy (CP)

- ❖ *Benefits*: promotes efficiency (producing more with less, inducing better resource allocation, dynamic gains from innovation) resulting to increased overall welfare (wider consumer choices, lower prices, better quality of products)
- ❖ *Primary role of CP*: to safeguard, protect and promote competition and the competitive process and ensure that the market is able to function effectively
- ❖ *Objectives of CP*: 1) promote competition as long as it encourages efficiency and growth and 2) promote consumer welfare and should be consistent with social objectives

Factors affecting the State of Competition

- ❖ *Barriers to Trade*: where the good is tradable and a close substitute can freely come in, the market becomes contestable; source of barriers are large transportation costs relative to the product & government trade policy, i.e., use of tariff and other non-tariff measures
- ❖ *Barriers to Entry*: factors allowing incumbent firms to raise and maintain prices above costs; there could be structural or behavioral barriers which could lead to negative anti-competitive conduct of firms
- ❖ *Other Market Failures and Rigidities*: where more competition could lead to greater inefficiency or cooperative set-ups are needed to realize efficiency gains. Cases include economies of scale, economies of scope, synergies and transactions cost economies
- ❖ *Government Policy*: when government intervenes into the market through regulation of an industry, direct equity participation & other regulatory restrictions (direct impact); or when government policies are intended to serve other explicit objectives such as policies relating to industrial, agricultural & environmental regulations (indirect impact). There is a need to closely re-examine such policies in the light of competition objectives

Elements of Competition Policy

- ❖ Enforcement of an effective and rational anti-trust law that would prevent restrictive business practices that significantly lessen competition and result in abuse of dominant position
- ❖ Advocacy for Competition Policy will help implement the required reforms in government policy with welfare reducing anti-competitive effects
- ❖ Information and education campaign is necessary for the successful implementation of CP and for helping build awareness about competition and a constituency for reforms

Issues confronting Competition Policy

- ❖ *Whether or not to create a central body responsible for CP*: A central body is necessary given the formidable tasks implied by the comprehensive nature of the elements of a rational CP. It also entails improvements in other institutions such as courts and/or the judicial system
- ❖ *What is the best way to develop the competent body to implement CP?* There are three options, namely: 1) piecemeal basis with the creation of a coordinating body and an austere law which can be augmented over time and which emphasizes the establishment of implementing institutions and promotion of competition advocacy; 2) transformation of an

existing body which is performing some of the functions of competition policy; 3) creation a new central body such as a Fair Trade Commission which could be designed to develop and evolve into what it should ideally become. 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 anti-trust statute.

- ❖ *How great is the need for competition policy and law:* There are apprehensions about a more general application of competition policy-that it could lead to indiscriminate use of power by the competition authority; to alleviate fears of implementation competition policy, competition law should have enough provisions for due process. Given the huge benefits that could be derived from a working competition policy, the government can tap it as an effective means for reviewing and reforming policies.
- ❖ *What should be the priority and focus in the short term-medium run:* focus on government policies with direct impact on the state of competition by reviewing the performance of the regulatory boards; implementation of anti-trust could be focused on one provision of the law to gain experience, jurisprudence, expertise and capability or on one particular industry well known for anti-competitive practices.

2) “**Recommendation for Philippine Anti-Trust Policy**” by Atty. Anthony Abad, Commissioner, Tariff Commission (TC)

Rationale for Anti-Trust Legislation

- ❖ In pursuing a market economy approach, competition policy is central to any economic development and the success of an economic development plan depends on how competition is being harnessed.
- ❖ Competition Policy can have a political reform role. The political economy considerations that include the interaction of key sectors of the state with each other (e.g. government-business, government-civil society, etc.) determine the quality and effectiveness of anti-trust enforcement.

Existing Anti-Trust Laws and Regulations in the Philippines

- ❖ *Constitution*, Article 12 on national economy and patrimony, particularly Section 19 sets out a definite state policy on competition “The State shall regulate or prohibit monopolies when the public interest so requires, no combinations in restraint of trade or unfair competition shall be allowed.”
- ❖ *Criminal Law*, in particular the Revised Penal Code, provides punishment on anti-competitive behavior
- ❖ *Civil Law*, specifically the New Civil Code under Article 28, states that “unfair competition in agricultural, commercial and industrial enterprises or in labor through the use of force, intimidation, deceit, machination or any other unjust, oppressive or highhanded method shall give rise to a right of action by person who thereby suffers damage.” There are also treble damages for civil liability arising from anti-competitive behavior.
- ❖ *Special Laws and Regulations:* Intellectual Property Code or the IP law for ramification on fair trading and fair competition issues; Corporation Code when dealing with mergers and acquisitions, with corporate structure also having something to do with competition; Revised Securities Act deals with machination with unfair trade practices in the area of Securities dealing industry; Price Act or setting price control for primary commodities

again is a form of competition regulation or enforcement; Consumer Act is supposed to protect consumer welfare, one of the primary objectives of competition law.

- ❖ *Regulations by particular government agencies*, either general or industry-specific agencies through their mandate and regulatory process, have a significant effect on competition
- ❖ *International treaties and agreements* like the WTO agreement and the ASEAN agreements have some effects on trade policy.
- ❖ *Jurisprudence/Supreme Court Rulings*: The Tatad vs. Secretary of Energy case points out the need to enact anti-trust or competition laws and provides for a definition of monopoly and combinations in restraint of trade; the case of Tanada vs. Angara emphasizes the importance of competition and how trade liberalization plays a role in enhancing competition; the case of Gokongwei vs. SEC for actions constituting unfair competition when it bid for San Miguel part-time ownership

Assessment of the Anti-Trust Regulations

- ❖ The Constitution has its limitations because it is merely a mandate to the state and it is the Congress that will enact laws to implement the constitutional provisions
- ❖ Problems with criminal law lie on the burden of proof which is proof beyond reasonable doubt; the vagueness of the wording of the law; and lack of comprehensiveness and administrative mechanism for effective enforcement
- ❖ As regard to special laws and regulations, with so many enforcement agencies, the responsibility is too diffused and accountability for implementation is difficult to fix
- ❖ Lack of jurisprudence, meaning there is really no testing of the legal system
- ❖ Other problems are political capacity to withstand political pressure, budgetary constraints, technical capacity, management constraints, and even proper compensation package.

Recommendations

- ❖ *Come up with a comprehensive anti-trust law* that is general in application; effectively harmonized and linked with other government polices that deal with competition policy; provides a listing of anti-competitive practices, correct delineation of whether they are per se violations or whether a rule of reason, and adequate set of remedies and penalties. With regards to administrative mechanisms, there is a need for an independent commission/body that has a public accountability and there should also be separation between the investigation, prosecution and adjudication role
- ❖ *Adopt a piece meal approach*, basically referring to the amendment of existing legislations like the Revised Penal Code on the issue on the burden of proof and an adequate administrative mechanism, the Civil Code on the need for a stronger private enforcement mechanism, the Consumer Act by providing the legal mechanism for consumers to file cases for anti-competitive practices and the Tariff and Customs Code by amending the Tariff Commission charter and merely transform it into a Philippine Trade Commission or some other anti-trust body.

OPEN FORUM 1

Comments/Observations	Responses
<ul style="list-style-type: none"> ❖ How to incorporate in the anti-trust legislation the globalization aspect? 	<ul style="list-style-type: none"> ❖ Merge trade policy with competition policy ❖ Need for a healthy domestic competition in order to compete globally
<ul style="list-style-type: none"> ❖ The difference between competition policy and competitiveness policy 	<ul style="list-style-type: none"> ❖ Competition policy should lead to increased competitiveness-should be a key element of CP ❖ Different focus: Competition policy, on prevention of anti-competitive behavior of firms while competitiveness policy, on enhancing competitiveness of firms ❖ One role of competition policy is to review the consistency of competitiveness policy with competition policy
<ul style="list-style-type: none"> ❖ Criminal or penal provisions are territorial in nature, so how to penalize those violators/ corporations outside the country ❖ Penalties are more of reactionary in nature that is imprisonment or fines 	<ul style="list-style-type: none"> ❖ The role of competition authority will be to define the relevant market and conduct investigations with regards to effects or practices that takes place in the relevant market ❖ With regard to global or regional markets, there has been talk in the WTO, OECD, UNCTAD about coming up with a certain Competition Code ❖ Anti-dumping and countervailing duties are actually measures to prevent abusive behavior of firms
<ul style="list-style-type: none"> ❖ The discussion has overlooked the element of culture and its effects on Philippine competitiveness 	<ul style="list-style-type: none"> ❖ Liberalization allows competition and therefore homegrown corporations will start to produce the best qualities of products ❖ The proper behavior is to buy the best products at the lowest cost

3) **“Competition Policies in the Power Sector”** by Dr. Ma. Joy Abrenica, Professor, School of Economics, University of the Philippines (UPSE)

Key Issue

- ❖ The electricity market is seen as one of the vulnerable sectors in the exercise of market power. In order to mitigate the exercise of market power, there is a need for combinations of ways such as the unbundling of electricity market and imposition of restrictions on vertical integration.

Current Structure of the Electricity Market

- ❖ The current market structure is vertical integration, that is, from generation companies to transmission companies, distribution companies then to consumers. The financial flows coincide with actual flows of electricity.

Proposed Restructuring

- ❖ Initially, the competition would be introduced in the wholesale market and it is possible to have financial flows different from the electricity flows. Eventually, the competition will also be in the retail market, which means splitting the distribution utility into two, line companies and electric suppliers. Also an essential feature of the bill is the open access of these bottleneck facilities (transmission and distribution utilities).
- ❖ The Senate and the House are in agreement on how the electricity market will evolve. But there are still disagreements on the provision in terms of cross-ownership; provision on the caps that would be placed on installed generating capacity and provision on unbundling of business activities

Conceptual Issues

- ❖ Cross-ownership restriction provides vertical separation of generation, transmission and distribution sectors of the industry
- ❖ Limiting control on generation-installed capacity
- ❖ Limits on bilateral contracts
- ❖ Diagnosing and regulating market power

Lessons from Other Countries

- ❖ Mandatory separation of functions and clear delineation of limits of cross-ownership and vertical integration;
- ❖ Limits on the size of generators to ensure competition
- ❖ Unbundling of transmission charges and the provision of fair access to transmission
- ❖ Clearly defined, published transmission prices reflecting incremental costs
- ❖ Establishment of a centrally dispatched bulk supply market with energy priced at the systems' marginal cost
- ❖ Access by generators and marketers to at least part of the retail market

Policy Options

- ❖ Reconsider position on cross-ownership to a more prudent one to foreclose opportunities for anti-competitive practices by totally disallowing vertical integration
- ❖ With cross-ownership, mitigate market power of integrated firms through vigilant enforcement of anti-trust and sound independent system of regulation
- ❖ Consider introducing competition in transmission and distribution aspects.

OPEN FORUM 2

Comments/Observations	Responses
<ul style="list-style-type: none"> ❖ Issues over the deadlock in the Power Bill 	<ul style="list-style-type: none"> ❖ The issue on cross-ownership and timing and sequencing of reforms about the privatization of NPC, when and what price, and who will shoulder the stranded cost ❖ The Senate has two bills-restructuring and privatization bills while the House has no separate privatization bill
<ul style="list-style-type: none"> ❖ Provision that redefines Gencost being not a public utility which would mean skirting the provision of the Constitution on certain caps on foreign ownership 	<ul style="list-style-type: none"> ❖ Allowing foreigners to own the generation company fully would suggest giving them in effect leeway to exploit the natural resources ❖ Try to evaluate the resultant effect on pricing mechanisms and on consumers
<ul style="list-style-type: none"> ❖ Disagreement between the House and the Senate on the structure, allowing greater private sector on generation and distribution but the transmission still going to be a government utility 	<ul style="list-style-type: none"> ❖ The government tries to avoid the same case as the telecommunications sector wherein the bottleneck facility is owned by the private sector. In the power sector, the transmission grid is the bottleneck facility so they want to retain it under a government agency
<ul style="list-style-type: none"> ❖ In the Chile case, was there any safeguard legislations on transmission restrictions which accompanied the liberalization of the sector? 	<ul style="list-style-type: none"> ❖ No law, they just allowed it although they have this committee. But in Argentina, there was an independent body called CAMMESA where stakeholders in the power industry are represented and one of the safeguards is the budget coming from contributions of the industry players
<ul style="list-style-type: none"> ❖ How to consider the technology aspect, is it price or non-price items? 	<ul style="list-style-type: none"> ❖ This stresses the point about the need for a regulator who's not only an accountant but also knowledgeable on the technology side of the market so that it can determine the appropriate product price

4) **“Competition Policy for the Philippine Downstream Oil Industry”** by Dr. Peter Lee U, Professor, School of Economics, University of Asia and the Pacific (UAP)

Oil Industry Structure

- ❖ Crude oil dependent, relying heavily on importations while refined petroleum products come from the big three companies (Petron, Shell, Caltex)

Status of the Oil Industry after Deregulation

- ❖ It has brought in quite a number of new players and in fact, it indicates an increasing market share of around 9%, although still insignificant as compared to the 90% market share of the three big players
- ❖ At the subsector level, the retail has the lowest penetration by the new players due to high cost involved in putting up a gas station unlike in the industrial or bulk sales (sales to NPC) where it has relatively larger share. Sales of LPG are where the new players have the most advances.
- ❖ Among the new players, Flying V, Seoil, Unioil and Total have the most number of gasoline stations.

Issues on the Proposal to create the National Oil Exchange

- ❖ Whether the operation is under a government or a non-profit entity, essentially it is a monopoly because the entity will control importations, all storage facilities and terminals including those of the big 3.
- ❖ It is against the spirit of deregulation/privatization since the idea is to get the government out of the business and to leave business to private sectors and therefore leads to worries or fears in the minds of investors, whether domestic or foreign.
- ❖ Philippine consumption is very low as compared to the world consumption so it is difficult to get significant volume discounts in the world market.
- ❖ Retail gasoline is a special business that needs huge capital requirements; with the big 3 accounting for 90% of the market, they will essentially control and dictate the prices.

Fostering Competition on the Retail Subsector

- ❖ Divorcement law which is separating ownership of retail stations from the gas or oil companies
- ❖ Breaking up of the big 3, e.g., divesting some portion of their gasoline stations much like the FTC in the US before merger approvals

Price Setting: Collusion or Competition

- ❖ Gasoline is a homogenous product, one company's price cannot diverge too much from another one or else the consumers will just purchase the lower priced gasoline (Law of One Price). So, if a firm raises price, it is actually rational and profit maximizing for competitors to simply follow
- ❖ So having very similar prices and changing prices at the same time is not a conclusive proof of a cartel; other evidences are necessary to make a case that there is indeed collusion.

OPEN FORUM 3

Comments/Observations	Responses
<ul style="list-style-type: none"> ❖ Are all the retail gasoline stations owned by the big 3 or are there exclusive dealership of gas stations? 	<ul style="list-style-type: none"> ❖ The big oil companies owned around half and a few are owned by the new players ❖ There is exclusive dealership for the rest particularly in the big 3
<ul style="list-style-type: none"> ❖ How reflective is the pricing scheme right now as to the true state of market price of oil products? 	<ul style="list-style-type: none"> ❖ Need to look at the cost to know what profit they are earning and make comparisons with other industries ❖ Or look at how prices move in relation to international crude oil prices ❖ Compare prices of other countries
<ul style="list-style-type: none"> ❖ What is the status of the oil exchange? 	<ul style="list-style-type: none"> ❖ The Speaker is pre-disposed to having a National Oil Exchange as response to the oil price situation
<ul style="list-style-type: none"> ❖ If it's perceived that the margin for dealers is so narrow, how come lots of stations are still springing up? 	<ul style="list-style-type: none"> ❖ The new players wanted to be visible so they penetrate into the market
<ul style="list-style-type: none"> ❖ Issue on cross-subsidization of gasoline stations vis-à-vis other services related to dealers margin 	<ul style="list-style-type: none"> ❖ Part of the marketing strategy ❖ Economies of scope could be the reason for these bundling of products ❖ No concrete evidence if there is indeed cross-subsidization of convenient stores to the gasoline stations. As long as it does not create a barrier to entry, then it increases consumer welfare ❖ What limits the impact of oil deregulation is basically the fact that building a gasoline station requires large capitalization (entry barrier)
<ul style="list-style-type: none"> ❖ How to promote competition in the downstream oil industry when the worldwide industry is getting concentrated? 	<ul style="list-style-type: none"> ❖ Even with 3 players, the market can still be competitive for so long as there is a strong anti-trust body that can detect collusion, looking at the type of business arrangements that might disadvantage other competitors
<ul style="list-style-type: none"> ❖ Generic, unbranded gasoline 	<ul style="list-style-type: none"> ❖ Some independent gas stations buy oil from the big 3 and resell it as generic gasoline. For anti-trust perspective, the role is to make sure that the major players will not discriminate this kind of business
<ul style="list-style-type: none"> ❖ Need to develop a strong government infrastructure for generic brand to ensure that there is no adulteration and for quality control purposes 	<ul style="list-style-type: none"> ❖ DOE routinely conducts inspection, sampling and spot testing regularly on gasoline stations, whether owned by the big 3 or a nameless company. In cases where the gasoline stations failed these tests, they are subject to penalties, cease and desist orders (CDO) ❖ Imported products are also subject to routinely quality testing
<ul style="list-style-type: none"> ❖ The need for housekeeping seal to indicate the quality of products 	<ul style="list-style-type: none"> ❖ Part of the consumer advocacy element of competition policy but it takes time for a good housekeeping seal to be credible and reputable among consumers