Policy Brief

SENATE ECONOMIC PLANNING OFFICE

August 2009 PB-09-04

Regulating competition

Regulation represents a potent tool by which the state can control market outcomes. In the Philippines, the issue of how and to what extent regulation influences market behavior is subject to much debate. In light of increasing competition and the emergence of complex market arrangements, regulators are now faced with the daunting task of ensuring that markets work to achieve the efficiency and equity goals of society.

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Introduction

Economic reforms introduced in the 1980s (post-EDSA Revolution) have all been geared towards increasing competition in the domestic market. Privatization, trade liberalization, foreign investment and financial policy reforms --- all were instituted in recognition of the efficiency gains and improved consumer welfare brought by competition. What might have been overlooked, though, during these past decades is the importance of regulating the outcomes of market imperfections unleashed by these policies.

Regulation plays a significant role in advancing the welfare of the consumers by ensuring fair market prices and guaranteeing quality goods and services. While the country already has a number of anti-trust laws and regulations in place, they are inadequate and ineffective in dealing with the increasing complexity of the market. Anti-competitive behavior is observed in some industries, compromising consumer interests and resulting in lost markets. The perceived failure of government to inhibit this errant behavior has been attributed, in part, to the absence of a comprehensive competition or anti-trust legislation.

This Policy Brief discusses the need for an effective regulatory framework given the realities of present day market structures. The following section sets the basic premises of perfectly competitive markets and provides for the rationale of state intervention. The third section presents market conditions that entail regulation while the fourth gives a brief description of the existing regulatory framework, including the proposed Competition Act of 2009 (Senate Bill 3197). The last section discusses problems that must be addressed in the formulation of an effective regulatory environment. The Brief concludes with some policy implications on regulating market behavior.

I. Why regulate markets?

Competition advances the efficiency and equity objectives of society. A market is said to be *perfectly competitive* if it consists of a large number of sellers and buyers of a homogenous product and all are fully informed of the product's implications. Since it faces competition, a seller will attempt to outdo his competitor and protect his market share (and profit) by directing all his efforts in producing quality products at least cost and selling these at a price determined by the market. This implies then that no seller will be able to dictate the market quantity and (therefore) price of a product.

The constant threat of competition also compels firms to make sure that their resources are utilized efficiently. That is, resources are utilized to their full potential and reap the highest possible returns. In this light, competition is seen to foster innovation. Moreover, by restricting the market power of an individual and by ensuring the production of the best product for the best price, competition ensures the equitable distribution of income and output (Medalla, 2003).

Real markets, however, do not function according to the paradigm of perfect competition. For instance, some markets require high capital entry costs so that only a handful of firms are able to serve them (e.g., oil exploration). In other markets, it is more pragmatic for just one or two firms to serve the consumers (e.g., energy transmission). Still in other instances, a large firm can be the sole owner of a production input/technology and accordingly be the sole provider of a product/service (e.g., pharmaceuticals). Thus, one will find that more often than not, industries are dominated by a few, relatively large firms (oligopolists), or, as usually the case of public utilities, by one firm (monopolist).

The lack of competition within these industries may result in the failure of the market in bringing about the efficiency and equity goals of society. *Market failure* generally pertains to situations where unfettered markets result in inferior, unfair, and/or disruptive outcomes (Fabella, 2008). The state is thus called upon to intervene with the occurrence of such market failures. State intervention by way of regulation serves as a proxy for the competitive process that the market, by itself, fails to bring about.

BOX 1. INTRODUCING COMPETITION IN SEGMENTS OF AN INDUSTRY

Reforms such as the vertical separation of sectors have enabled competition, albeit to a limited extent. The enactment of the Electric Power Industry Reform Act (EPIRA) in 2001 caused the vertical disintegration of the generation, transmission, distribution, and electricity supply in the energy industry. This in effect opens up the generation and electricity supply sectors to competition. The transmission and distribution sectors on the other hand, remain monopolistic and are subject to regulation such that they are given congressional franchises to operate. Moreover, the Energy Regulatory Commission (ERC) was given the authority to set tariffs in the transmission and distribution sectors and the broad powers to regulate behavior of market agents in all sectors of the industry.

BOX 2. REGULATING NATURAL MONOPOLIES

Successful regulation of natural monopolies is perhaps exemplified by the case of water (and sewerage) service in Metro Manila. In 1997, the service was passed on to the hands of private concessionaires, who by themselves are virtual monopolies in their own respective zones. The private concessionaires, however, now operate under a new regulatory framework, some features of which are encapsulated in the concession contracts. In particular, dispute resolution is performed through a panel of adjudicators.*

This feature ensures a transparent, and therefore credible, settlement (on price adjustments) that protects the interests of both firms and consumers (Fabella, 2008). Moreover, a price review and a contract review are conducted every five years upon satisfactory completion of a performance evaluation (utilizing a set of pre-approved performance indicators). This feature offers the right incentive structure that rewards utility providers for operating efficiently. The new regulatory framework requires stringent contract enforcement. Foreign firms stand as partners of the local operators and to date, consumers have uninterrupted 24-hour water service and water quality meets international standards.

**Consisting of an international expert nominated by the Foreign Chamber of Commerce, one nominated by the regulator MWSS, and a third nominated by the private concessionaire.*

II. Restraint of trade in the Philippines

Since the goal is to introduce and enhance competition in markets, regulation is aimed at prohibiting and/or curtailing market behavior that are deemed anti-competitive. The following activities come under the purview of (anti-trust) regulation.

Anti-competitive agreements refer to the collusion between market players resulting in shared markets, limited supply, and inflated prices. A *cartel* is an example of such an agreement[1] between firms that are seemingly competing, yet agreeing to coordinate actions to affect market supply and thus, market price. Evidence of such behavior is found by Aldaba (2002) in the cement industry, which is divided into five groups (with cross-ownership) and is highly concentrated. Ironically, such anti-competitive behavior became apparent after pro-competitive policies -- price deregulation, removal of import restrictions, and substantial tariff reductions -- were introduced. Thus, gains from trade liberalization are nullified without an effective competition policy (Aldaba, 2008). A cartel is also believed to exist in the oil and rice industries and is perceived to be responsible for price hikes in the domestic market.

In other cases, a firm may agree to source its inputs from a 'favored supplier' and discriminate against other sellers offering the same good at lower prices.[2] For example, electricity distributor MERALCO has been accused of buying power from its affiliated independent power producers (i.e, Sta. Rita and San Lorenzo power plants) even though the National Power Corporation is selling power at lower prices. Such practice essentially subsidizes high cost (presumably inefficient) firms and consumers end up paying higher prices.

Abusive behavior may also be exhibited by a dominant firm or a monopolist. Some cases of abusive behavior can be placed within the context of the *essential facilities doctrine* wherein the natural monopoly structure that typifies public utilities may compel the owner of an essential (or bottleneck) facility to discriminate against his competitors who need access to that facility. In the telecommunications industry, for instance, PLDT, the dominant player that owns the backbone facility, also has the most number of fixed line subscribers. Patalinghug and Llanto (2004) cited cases that seem to corroborate the perception that

[1] A cartel is an example of what is called a *horizontal agreement*.

[2] This is an example of a *vertical agreement,* which is an agreement between firms operating at different levels of the supply chain.

PLDT is exploiting its dominant market position. These cases include delayed or insufficient interconnection, unequal access settlements or dispute on revenue-sharing arrangements. In addition, Abrenica (2008) reported a deluge of administrative cases filed before the National Telecommunications Commission (NTC) involving allegations of *predatory pricing*[3] by competing carriers.

Even a state-owned firm can demonstrate abusive market behavior when operating in an environment of poorly designed incentive schemes. Prior to the privatization of water distribution in Metro Manila, the state-owned MWSS acted as a monopolistic utility provider that controlled and operated water sources and pipelines. Water services at that time were characterized by intermittent water supply and long water queues. In this pre-reform setup, the MWSS was unable to offer sufficient quality services to consumers who were willing to pay for such.

Firms' participation in merger and acquisition activities is grounded on the expected efficiency gains arising from economies of scale .

Mergers, acquisition and joint ventures, on the other hand, may threaten the state of competition in markets. In merger cases, the question is whether the combination of Firm A *plus* Firm B will be able to raise prices above the level that would prevail under effective competition. For example, if a firm is allowed to acquire a rival firm or is merged with it, then it would be too easy to imagine that consumers may end up with fewer choices and higher prices.

Firms' participation in merger and acquisition activities (M&As) is grounded on the expected efficiency gains arising from *economies of scale* (or *scope*). This is often cited as the basis for the formation of conglomerates. After the Asian financial crisis, for instance, some banks engaged in M&As to conform to the more stringent capital or asset base requirements that were imposed, while others turned to asset management companies (AMCs) to rehabilitate and repackage unhealthy assets. All this may be well and good to strengthen and stabilize a failing banking industry. However, there is a downside to being 'too big' as evidenced by the recent fall of foreign banking and insurance giants such as AIG, JP Morgan Chase, Bank of America, and Wells Fargo. 'Bigness' can cause firms to believe too much in their ability to take on risks using assets that they do not own. Moreover, since they are said to be 'too big to fail,'[4] taxpayers

[3] A dominant firm can engage in *predatory pricing* wherein it sells its product at reduced prices (below cost) with the intention of eliminating its competitors, thereby enhancing its market power and eventually charging a higher price.

[4] It is argued that these firms are so huge that if they were to collapse, it would damage the economy irreparably.

end up bailing them out. In these cases, M&A activities threaten social welfare.

Broadly speaking, anti-trust regulation seeks to prohibit and/or control the aforementioned acts. The 'public interest' character of public utilities in particular, explains why these economic activities should come under substantial anti-trust scrutiny. In the case of M&As, the role of anti-trust policies becomes significant not only after the act, but more importantly, before such act has been committed. It is not the role of anti-trust authorities to limit firm size, but rather, to ensure that the market structure is reasonably competitive by restraining firms from taking undue advantage of their influence (i.e., size) in the market (Medalla, 2003).

"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."

-Sec.19, Art. XII of the 1987 Philippine Constitution

III. Regulatory framework

Cognizant of the welfare gains brought by competition, the 1987 Philippine Constitution prohibits anti-competitive practices (Section 19, Article 12) and calls for the promulgation of laws imposing criminal and civil sanctions against those exhibiting anti-competitive behavior (Section 22, Article 12). In addition, old anti-trust provisions dating back to the Spanish and American regimes have found their way into the present Criminal and Civil Codes.[5] Anti-trust enforcement is also vested in various regulatory agencies and bodies.

Given the alleged misconduct of firms, it appears that the existing regulatory framework is inadequate to curb market behavior deemed inimical to social welfare. To date, there are no clear procedures for dealing with market players involved in anti-competitive practices. Indeed, if one has to wade through Philippine jurisprudence, one will find no market player convicted and/or penalized on the grounds of anti-competitive behavior or one involved in any restraint of trade. Moreover, there is no existing criterion to justify firm behavior that might be regarded as 'unfair' and no standard framework to assess how public interest is or would be affected (Global Competition Forum n.d.).

Thus, the call for a comprehensive competition law whose objective is "to control or eliminate restrictive agreements or arrangements among enterprises, or mergers and acquisitions or abuse of dominant positions of market power, which limit access to markets or otherwise unduly restrain competition, adversely

[5] Article 186 of the Revised Penal Code (R.A. 3815), Please refer to the appended list of other laws that provide the basis for prohibiting/regulating anti-competitive behavior.

affecting domestic or international trade or economic development."[6]

Senate Bill 3197 or the proposed *Competition Act of 2009* seeks to respond to this call by strengthening the existing legislative framework concerning anti-competitive acts. Sponsored and defended on the floor by its principal author, Senate President Juan Ponce Enrile, and co-authored by Senators Miriam Defensor Santiago, Antonio Trillanes IV, Mar Roxas, and Edgardo Angara, it has already passed the third and final reading in the Senate. The Lower House has yet to pass its own version of the bill.

Existing statute provides for a limited/vague proviso on anti-competitive practices and is deemed ineffective. If it is to be a regulatory instrument, then it must clearly define what it seeks to regulate. Senate Bill 3197 offers a list of market practices pertaining to restraint of trade or unfair competition. It specifically prohibits: (1) cartelization; (2) monopolization; (3) the abuse of monopoly power or dominant position; and (4) other unfair competition practices.

Moreover, the proposed measure provides for an exhaustive and comprehensible enumeration of the elements or a detailed description of those prohibited acts. Thus, the proposed legislation and its application would be better understood in the context of their purpose. This feature should deter arbitrary interpretation of the law if it were to be enacted. For instance, Section 6 on monopolization reads:

> "It shall be unlawful for any firm to willfully or knowingly acquire and maintain its market power by excluding competitors from any part of trade, industry or commerce as distinguished from natural growth or development of a firm as a consequence of a superior product, business acumen or historic accident: *Provided,* That, a firm that has at least fifty percent (50%) of the relevant market, or firms up to three (3) in number has at least seventy percent (70%) of the relevant market, as found and certified by the Department of Trade and Industry or the concerned regulatory agency shall be deemed a monopoly or in dominant position."

Senate Bill 3197 also seeks to impose stricter penalties on parties guilty of engaging in restraint of trade. This, in effect, would

BOX 3. STATE INTERVENTION

There are two mechanisms by which the state can address the problems of imperfect markets. The *price incentive* mechanism can be exercised by the imposition of taxes on economic activities that are considered harmful to society (e.g., cigarette consumption or production processes that emit effluent charges). On the other hand, controlling the behavior of market agents is precisely the object of *anti-trust regulation.*

Valletti and Estache (1998) describe two types of regulation pertaining to infrastructure (utilities). *Regulation on structure* includes merger controls, the removal of entry barriers, restrictions on the line of business or the break up of an integrated incumbent. *Regulation on conduct* concerns the pricing behaviour of firms both in terms of their level and their structure.

[6] Draft possible elements for Article 1 of the revised version of the United Nations Conference on Trade and Development Model Law on Competition.

BOX 4. REGULATORS FACE INFORMATIONAL CONSTRAINTS

A regulator is faced with the daunting task (and cost) of acquiring the correct market information. However, he who owns that information has wide discretion over the amount and quality of information that the regulator can acquire. As Owen and Braeutigam (1978), cited in Alba (2008), put it:

The ability to control the flow of information to the regulatory agency is a crucial element in affecting decisions. Agencies can be guided in the desired direction by making available carefully selected facts. Alternatively, the withholding of information can be used to compel a lawsuit for "production" when delay is advantageous. Delay can also be achieved by over-response: flooding the agency with more information than it can absorb. Sometimes, when a specific item of information is requested and it is difficult or impossible to delay in providing it, the best tactic is to bury it in a mountain of irrelevant material. This is a familiar tactic of attorneys in anti-trust suits. It is also sometimes useful to provide the information but to deny its reliability and to commence a study to acquire more reliable data. Another option is to provide "accurate" information unofficially to selected personnel of the agency who are known to be sympathetic. If another party has supplied damaging information, it is important to supply contrary information in as technical a form as possible so that a hearing is necessary to settle the issues of "fact."

make it more costly to engage in anti-competitive practices. Section 9 on penalties stipulates:

> "Without prejudice to the violation of other laws, any firm that shall be found to have violated Sections 5, 6, 7 and 8 of this Act, or any combination thereof, shall, for each and every violation, be punished by a fine of not less Ten million pesos (PhP10,000,000.00) and not exceeding Fifty million pesos (PhP50,000,000.00) if a natural person; by a fine of not less than Two hundred fifty million pesos (PhP250,000,000.00) but not exceeding Seven hundred fifty million pesos (PhP750,000,000.00) if a firm, and by imprisonment not exceeding ten (10) years, or both, at the discretion of the court. In the alternative, a fine shall be imposed in the amount double the gross proceeds gained by the violator or double the gross loss suffered by the plaintiffs."

Furthermore, the proposed measure authorizes the Department of Justice (DOJ) as its key enforcer and bestows upon it the power to inquire on, and investigate a verified complaint (or that which is referred by a regulatory agency) without prejudice to the exercise of regulatory powers by other regulatory bodies.

IV. Factors that may work against the ideal

Regulating markets have become more challenging. Regulators face the difficult task of formulating pro-competitive policies as market structures/arrangements increasingly become more complex and schemes that perpetuate monopoly power become more devious. Some problems that undergird imperfect markets must be understood and addressed in order to come up with an effective regulatory framework.

Information asymmetry pertains to a situation wherein a regulator does not have access to information or where the courts cannot easily verify information that is made available (Alba, 2008). The problem arises given the fact that much of market information is private and often requires acquisition costs. Firms and consumers alike are not inclined to divulge information that may allude to their 'type' (i.e., good or bad, efficient or inefficient, etc.) for fear of being subjected to regulation policies that may be disadvantageous to them and/or that may compromise their market position. This makes information asymmetric.

How should a regulator determine a fair market price if it does not have complete knowledge of a firm's cost structure, operation, or demand schedule?

For instance, in 2003, party list group Social Justice System (SJS) filed a complaint against the so-called Big Three oil companies[7] for monopolization, cartelization, and predatory pricing. In May 2009, a Manila regional trial court ordered the Commission on Audit, Bureau of Internal Revenue, and Bureau of Customs to form a panel that will examine and audit the books of the Big Three. The examination would include cash receipts, cash disbursement books, purchase orders on petroleum products, delivery receipts, sales invoices, and other related documents. The Office of the Solicitor General, however, expressed the opinion that the audit results may not be legally binding since the audit itself goes beyond the mandate of the government agencies concerned.

Such constraint limits the extent to which regulators can control market behavior. How should a regulator (in this case, the court) determine a fair market price if it does not have complete knowledge of a firm's cost structure, operation, or demand schedule? Price controls cannot simply be set arbitrarily. Even more problematic, how should the regulator (dis)prove alleged market misconduct such as cartelization, overcharging, (non)price predation, or any other anti-competitive behavior?

Recognizing the importance of obtaining relevant information, Senate Bill 3197 provides for a stipulation on the disclosure of such. To wit:

> SEC. 13. *Power to Investigate and to Enforce Orders and Resolutions*. –The DOJ shall conduct preliminary inquiries by administering oaths, issuing *subpoena duces tecum* and summoning witnesses, and commisioning consultants or experts. It shall determine if any provision of this Act has been violated, enforce its orders and carry out its resolutions by making use of any available means, provisional or otherwise, under existing laws and procedures including the power to punish for contempt and to impose fines.
>
> SEC. 14. *Self Incrimination.* – Pursuant to the preceding section, a person subject of any preliminary inquiry or investigation by the DOJ shall produce the specified document or information when so required by written notice: *Provided,* That no person shall be excused from disclosing any document or information to the inquiring officer on

[7] Chevron Corporation, Pilipinas Shell Petroleum Corporation, and Petron Corporation.

the ground that the disclosure of the information or document may be incriminating: *Provided, further,* That such document or information produced by the person subject of investigation shall not be admissible as evidence against him in criminal proceedings: *Provided, finally,* That such document or information shall be admissible in evidence in civil proceedings including those arising from or in connection to the implementation of this Act.

The state can indeed compel information although it may be unlikely that the complete or correct information is given. In this case, the state would not be able to 'optimally' regulate and the results of regulation (in terms of output and prices) would be second best to those of a competitive market. Social welfare is therefore not maximized.

Government failure is often cited by those who believe that market failure constitutes a necessary but not a sufficient condition for state intervention. That is, even when market failure is correctly diagnosed and the state is called upon to intervene, the state must proceed with caution because it may not necessarily have the expertise, resources, or information to resolve market failures or to oversee the enforcement of competition laws (Fabella, 2008).[8] Particularly in developing countries, regulators may be hindered by, among others: (1) inadequate technology/technical capability that could enable effortless detection of cost padding and evaluation of real costs; and (2) socio-political complexities that inhibit the development of a well-developed incentive scheme to reward state auditors (regulators) and discourage corruption (Laffont, 2005).

In weak states, initial good intentions can easily give way to rent-seeking activities of vested interests. Such conditions make the danger of *regulatory capture* (even worse, *political capture*) inevitable. Regulatees can exert their influence on the selection of a regulator and/or on the action of an incumbent regulator.

There is also the risk of a regulator abusing market participants. Empirical evidence provides support for this observation. For instance, if it is supposed that a firm disposes over private information regarding its costs; the regulator has the time and resources to determine the true nature of said firm; and Congress has to believe in the information provided by the

BOX 5. AN INTERESTING ASIDE: SOCIAL COST OF PUBLIC FUNDS

The concept of *marginal cost* has long been used to measure economic efficiency. In public economics, the marginal cost of public funds measures the loss incurred by society in raising additional revenues to finance state spending. Raising public revenues are indeed costly given the *deadweight loss* brought by the imposition of taxes (fees) and the attendant collection/ administration inefficiencies (compounded by corruption). *Thus, marginal cost is always equal to one under an optimal tax system (i.e., the cost of collecting an additional tax dollar is one dollar).*

Estimates of the marginal cost of public funds found in the literature were found to be 0.3 for developed countries, 1.2 for Malaysia, between 1.2 and 1.5 for Thailand, and 2.5 for the Philippines (Laffont, 2005 and Jones, 1990). Alba (2008) noted that the relatively large cost of raising public funds in the Philippines implies that state-funded projects should be limited to those with the highest economic rates of return and that the state should be downsized.

[8] Joseph Stiglitz calls these *constrained Pareto situations*, where the un-intervened market is suboptimal due to information asymmetry but the government has as well no access to proper information and cannot thus improve the situation.

regulator. Laffont and Tirole (1991) explained that in such a situation, it would be possible for the regulator to hide information from Congress and extract an *information rent* by colluding with the firm (assuming that retention of such information is favorable to the firm). The authors' model shows that regulatory capture reduces social welfare. In this light, regulation not only fails to counter monopoly pricing --- it sustains it.

The recent pre-need industry debacle has been blamed, in part, on the Securities and Exchange Commission's lack of capability to regulate the industry. The Legacy Group was still able to acquire the permit to sell new investment plans even though it had yet to act on the Commission's advisory to recapitalize in 2006. The same is true for College Assurance Plan (CAP) back in 2001 when the Commission gave it the permit to sell despite a PhP2.6-billion deficit in its trust fund. One wonders whether the Commission was 'captured' or if it really was just short of the technical resources (they do not have their own actuary) to monitor and regulate such industries. The non-passage of the Pre-Need Code was also cited as a restraint on the Commission's exercise of its regulatory powers.

Empirical studies suggest that regulation may be a more viable option in countries where institutionalized checks on regulators are stronger (World Bank, 2004). Such experiences are certainly not out of the ordinary, certainly not unique to the Philippines, leading some to question whether the cost of state intervention may not exceed the costs of the market failure to be corrected in the first place.

Ambiguity in certain cases also makes it difficult to formulate a comprehensive regulatory framework. A blanket regulation policy issued by an insufficiently informed regulator or that which is poorly designed may end up penalizing not only bad regulatees, but good regulatees as well. Herein lies the danger.

The leniency with which the U.S. anti-trust authorities handle cases of partial cross ownership[9] is rooted in the courts' interpretation of the exemption provided in the Clayton Act on stock acquisitions "solely for investment." However, Gilo, et. al. (2004) found that such lenient approach towards partial cross ownership (PCOs) may be misguided since such 'passive investments' may well facilitate tacit collusion among firms.

BOX 6. TO MERGE OR NOT TO MERGE?

Austria (2003) mentioned that prior to 1998, the shipping industry was much more concentrated. The merger of shipping giants in 1996* and then again in 1998**, was initially perceived to be a threat by the other major players. However, since shipping companies operate by maintaining niche markets, the mergers neither made the industry more concentrated nor increased the market power of the merged companies. The merger in fact promoted competition. The merger was the response of the companies involved in increasing their efficiency as a result of competition (Austria 2003).

Moreover, tying and bundling may result in both pro-competitive and anti-competitive effects. Thus, in the Microsoft case, the U.S. Court of Appeals held that:[1]

> "We hold that the rule of reason, rather than *per se* analysis, should govern the legality of tying arrangements involving platform software products.... There being no close parallel in prior anti-trust cases, simplistic application of *per se* tying rules carries a serious risk of harm".

**William Lines Inc., Carlos A. Gothong Lines Inc., and Aboitiz Shipping Corp. merged to become WG&A.*
***Universal Aboitiz Inc., and Sea Angels Ferry Corporation merged to become Philippine Fast Ferry Corp.*

[9] Refers to cases wherein firms acquire their rival's stocks, giving them a share in their rival's profits but not in the rival's decision making (Gilo et. al. 2004). In 1997 for example, Microsoft acquired approximately 7 percent of the non-voting stock of Apple, its rival in the PC market.

The effectiveness of the regulatory environment is not only determined by the design of regulatory instruments but, more importantly, by the quality of regulatory institutions and their capacity.

Also, a case for predatory pricing may be tenuous. Abrenica (2008) clearly articulated the dilemma faced by a regulator:

> "Keeping in mind the motive behind state intervention/ anti-trust regulation, the question then that must be posed is this: Confronted with the charge that the dominant firm in a market sets a price below cost, should the regulator compel the firm to charge a higher price to allow other firms to survive in the market and thus preserve the competitive environment or should he allow consumers to reap the benefits of the low price but imperil market competition in the future?"

Courts handling anti-trust cases have developed tests for identifying unreasonable restraints, the so-called *per se rule* and the *rule of reason*. When an act has no beneficial effect and its 'inherent nature' is detrimental to the state of competition, then the per se rule applies. There can be no defense for such an act, the existence of which need only to be proven. Thus, Section 5 on Cartelization of Senate Bill 3197 reads:

> "….Restrictive agreements resulting from cartel-like behavior of firms, in any form, are hereby *per se*[10] deemed illegal."

The paragraph then proceeds with an enumeration of these restrictive agreements that includes, but not limited to, agreements to fix selling price of goods or other terms of sale.

Acts that do not qualify as per se offense, come under the purview of the rule of reason. This test reviews the 'inherent effect' and the 'evident purpose' of the act. For example, mergers may not necessarily be beneficial or harmful, and tying and bundling may result in both pro-competitive and anti-competitive effects. Whether such acts are judged legal or not would depend on the evidence supporting the actual intent of firms to restrain trade, their ability to act on this intent, and the ease with which market entry can reverse the effect of the act.

There is a general observation that the trend in the enforcement of competition policy is moving from the use of per se rule towards the use of the rule of reason. Rule of reason cases, however, are known to be lengthy and thus, administratively costly.

[10] Italics provided.

Conclusion and policy implications

For developing countries like the Philippines, there is general observation that 'less regulation is not necessarily better regulation.' (World Bank, 2001).

Market liberalization and deregulation imply that the production of goods and services is left to the private sector where competition is fostered and state intervention is used where market failure exists. Given the country's particular set of economic and social characteristics, however, these processes have presented their own problems and failures. For developing countries like the Philippines, there is the general observation that 'less regulation is not necessarily better regulation.' (World Bank, 2001). Thus, policy debates are now focused on regulatory reforms.

Indeed, the regulatory framework of the Philippines is in dire need of reform. In a less than perfect world, the provision of an effective regulatory framework ensures that markets function well such that social welfare is improved. The effectiveness of the regulatory environment is not only determined by the design of regulatory instruments but, more importantly, by the quality of regulatory institutions and their capacity (World Bank, 2002). That is, good regulatory governance enables efficient markets, which, in turn, determine economic growth.

Senate Bill 3197, when enacted, would serve to strengthen the existing legislative framework on regulating markets. However, much has to be done in the context of a broader institutional capacity building. In the meantime, the literature provides for some other elements that could induce good market behavior and prevent misbehavior.

First, deregulate markets that are sufficiently competitive. Again, competition would induce market outcomes that are beneficial to society on the whole. If a firm produces an inferior good, then competition would drive that firm out of the market. Too much regulation on a sufficiently competitive market puts too much strain on businesses, putting them under the discretion of public inspectors, breeding corruption, and increasing their costs.

Second, contracts need to be enforced. This might mean introducing reforms in the court system. In developing countries like the Philippines, access to (commercial) courts is limited and where available, dockets are full. In addition, small businesses cannot afford lengthy court procedures. The absence of efficient courts often results in delays and higher costs of doing business. In cases of insolvency/bankruptcy and dispute resolution, court procedures should be streamlined and simplified.

Third, the use of technology should be promoted to cut regulatory/administrative costs. For instance, credit rating bureaus reduce market failures associated with asymmetric information. Electronic business entry and re-registration also lower transaction costs. Moreover, technology reduces the need for regulatees to face regulators so that opportunities to extract bribes are diminished.

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Annex

List of some existing laws that provide the basis for prohibiting and regulating anti-competitive behavior in the Philippines

1. *The Philippine Constitution*. Under Article XII, Section 19, the state is mandated to regulate or prohibit monopolies and to disallow, without exemption, combinations in restraint of trade or unfair competition. Section 22 of the same article encourages the promulgation of legislation that would impose criminal and civil sanctions upon those violating the principle set by Section 19.

2. *The Revised Penal Code*. Punish anti-competitive behavior that is criminal in nature. Article 186 defines and penalizes monopolies and restraint of trade and Article 187 provides for the penalties. The Revised Penal Code also penalizes other frauds in commerce and industry such as falsely marking gold and silver articles, and altering trademarks.[11]

3. *The Civil Code.* Article 28 of the Code allows the collection of damages arising from unfair competition in agricultural, commercial, or industrial enterprises or in labor. Article 19 allows the collection of damages arising from abuse in the exercise of rights and in the performance of duties, i.e., abuse of dominant market position exercised by a monopolist. The Civil Code does not define unfair competition but merely enumerates means by which unfair competition can be committed:

4. force, intimidation, deceit, machination, or any other unjust, oppressive or high-handed method.

5. *Republic Act 3247, known as An Act to Prohibit Monopolies and Combinations in Restraint of Trade.* Provide for recovery of treble damages for civil liability arising from anti-competitive behavior.

6. *Republic Act 8293, otherwise known as the Intellectual Property Code of the Philippines.* Provide for the protection of patents,[12] trademarks,[13] and copyrights,[14] and the corresponding penalties for infringement.

7. *Batas Pambansa Bilang 68, otherwise known as the Corporation Code of the Philippines.* It provide for rules and procedures to approve all combinations, mergers, consolidation, and acquisition. It is noted, however, that the Corporation Code does not address the problem of probable abuse of a dominant position when horizontal or vertical mergers occur.

8. *Batas Pambansa Bilang 178, otherwise known as the Revised Securities Act.* It complements the Corporation Code. It prohibits and penalizes the manipulation of security prices and insider trading.

[11] Republic Act (RA) No. 166 (1947).
[12] Republic Act (RA) No. 8293 (1997), at Part II.
[13] *Id.*, at Part III
[14] *Id.,* at Part IV

9. *Republic Act 7581, otherwise known as The Price Act.* It Identifies and defines illegal acts of price manipulation, such as, hoarding, profiteering, and cartelization. It also seeks to stabilize prices of basic commodities and prescribe measures against abusive price increases during emergencies and other critical situations through price controls and mandated ceiling mechanisms.

10. *Republic Act 7394, otherwise known as The Consumer Act of the Philippines. It* provides for consumer product quality and safety standards. Its scope includes deceptive, unfair, and unconscionable sales acts and practices (including weight and measure, product and service warranties), consumer credit transactions, and penalties for violations of the statute.

This Policy Brief was principally prepared by **Maria Kathreena del Rosario** under the supervision of SEPO's Directors and the overall guidance of its Director General.