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Designing a Cooperation Framework for Philippine Competition and Regulatory Agencies

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Abstract

As the Philippines move toward the legislation of its comprehensive competition law, one important issue that has emerged is the interaction between the competition agency and sector regulators. Based on a review of different approaches that different countries have adopted, the paper develops a framework for the interplay between regulatory agencies and competition authority in the Philippines. Taking into account the country's stages of institutional development and market and policy reforms, the paper proposes an approach that would leave competition enforcement exclusively in the hands of the competition authority while technical and economic regulation would be performed by the sector regulator. At the same time, the sector regulator may be given competition law enforcement functions to be performed in coordination with the competition authority.

The proposed approach would be based on a cooperation mechanism with sector regulators taking the leading role in economic and technical issues while the competition authority will be the lead in competition issues like abuse of dominance, anticompetitive agreements, cartels and merger review. It is important that the two coordinate and consult with each other to ensure that the policies or remedial measures taken by one would not be against the mandate of the other. The competition functions of the authority such as assuring non-discriminatory access to essential networks and controlling other forms of anticompetitive conduct and merger review may be shared with sector regulators.

Key words: competition law and policy, regulation

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Rafaelita M. Aldaba and Geronimo S. Sy[1]

I. Introduction

During President Aquino's inaugural address in 2010, he announced competition law as one of his priority bills. In June 2011, the government issued Executive Order Number 45 designating the Department of Justice as the country's competition body. The Office for Competition Office created under the Department of Justice has been mandated to investigate all cases violating competition law and prosecute violators; enforce competition policy and competition law; and supervise competition. The young competition office is currently formulating its organizational and administrative plans along with its enforcement agenda. Apart from its advocacy work through competition trainings and capacity building activities, it is also coordinating closely with other government sector regulators as it attempts to craft a mechanism for cooperation to promote competition.

With the introduction of competition through liberalization and deregulation, sector regulators such as the National Telecommunications Commission, Electricity Regulatory Commission, as well as the Metropolitan Waterworks and Sewerage System Regulatory Office, among others, were established to control anticipated market failure and at the same time ensure fair competition in their respective sectors. Sector regulators have been mandated not only to regulate their respective industries but also to promote competition and social objectives such as universal service. It is clear that there is an overlap between the activities of the competition authority and those of the sector regulators.

Given that the competition authority and sector regulators have concurrent jurisdiction over the implementation of competition rules, great care must be taken in designing a cooperation mechanism. To avoid conflicts and confusion among stakeholders, it is important to clearly define jurisdictional boundaries between the competition authority and the regulators. Countries have adopted different approaches to ensure coordination and policy coherence between sector regulators and the competition authority. In Australia, for instance, competition related functions of sector agencies have been combined and placed within the competition authority. In Korea, the competition body has a cabinet level standing and has veto power over anticompetitive proposals from sector regulatory agencies. Mexico's competition agency has power to both terminate regulation of a sector and initiate such regulation. In Japan, while the competition body Fair Trade Commission is not a member of the cabinet, it has a right to make binding recommendations. In the UK, seven regulators share concurrent power in the area of competition with the Office of Fair Trading.

The main objective of the paper is to develop a framework for the interplay between regulatory agencies and competition authority taking into account the country's stages of institutional development and market and policy reforms. The paper is divided into six parts, after the introduction, part II describes the current state of competition legislation in the country and discusses the need for competition policy and competition law. Part III presents the economic arguments why governments regulate industries along with the different approaches in regulating monopolies. Part IV reviews the interface between competition and regulation and drawing from

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this analysis, Part V presents the proposed operational framework for the interaction between regulatory and competition agencies. Finally, part VI summarizes the major recommendations of the paper.

II. Rationale for Competition Law and Policy

A. Current State of Competition Legislation in the Philippines

In Southeast Asia, the Philippines is one of the few remaining countries without a comprehensive anti-trust legislation. Thailand, Indonesia, Singapore, and Viet Nam have while Malaysia already passed its Competition Act last year. Though the Philippines does not have a comprehensive anti-trust law, it has numerous competition legislations and regulations that deal with monopolies and combinations in restraint of trade. The Philippine Constitution prohibits and regulates monopolies, combinations in restraint of trade and other unfair competition practices. The Revised Penal Code defines and penalizes anticompetitive behavior that is criminal in nature. The Civil Code of the Philippines allows the collection of damages arising from unfair competition as well as abuse of dominant position by a monopolist. The Act to Prohibit Monopolies and Combinations in Restraint of Trade allows treble damages for civil liability arising from anticompetitive behavior (see Table 1).

Table 1: Anti Trust Legislations in the Philippines

Competition Law	Description
Article XII, Section 19 Philippine Constitution	prohibits and regulates monopolies, combinations in restraint of trade and other unfair competition practices
Act No. 3247: Act to Prohibit Monopolies and Combinations in Restraint of Trade (Dec. 1925) Republic Act No. 3815: Revised Penal Code (Dec. 1930) Art. 186 Monopolies & Combination In Restraint of Trade (Revised Penal Code)	allows treble damages for civil liability arising from anticompetitive behavior defines and penalizes anticompetitive behavior that is criminal in nature Penalty of prison correctional in its minimum period or a fine ranging from P200 to P6000 or both shall be imposed
Republic Act 386: Civil Code of the Philippines (1949) Article 28	allows the collection of damages arising from unfair competition as well as abuse of dominant position by a monopolist Unfair competition in agricultural, commercial or 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 the person who thereby suffers damage
Executive Order 45 (2011)	designates the Department of Justice as the country's competition body

There are also sectoral legislations pertaining to industry regulation and competition such as those in the downstream oil industry and electric power industry (see Table 2). In these sectors, various government agencies are tasked with both the regulation and promotion of competition; for instance, the National Telecommunications Commission for telecommunications, the Energy Regulatory Board for power, Philippine Ports Authority for ports, and the Civil Aeronautics Board for air commerce. There are also special legislations such as the Anti-dumping Act, Intellectual Property Code, Revised Securities Act, price control measures and consumer protection laws such as the Price Act and the Consumer Act (see Table 3). Note, however, that in the case of the Corporation Code of the Philippines which covers the rules on mergers, consolidations, and acquisitions; competition issues such as the possible abuse of dominant position arising from mergers and acquisitions are not taken into account in their merger analysis. There is general agreement that despite their considerable number and varied nature, these laws have been ineffective in addressing anticompetitive behavior mainly due to lack of enforcement. The laws have been hardly used or implemented as may be seen in the lack of cases litigated in court. Since the laws are penal in nature, guilt must be proven without reasonable doubt and hence, the amount of evidence required so that the case may prosper is tremendous. The fines are also insufficient to prevent would-be criminals.

Table 2: Sectoral Regulatory Agencies

Regulatory Agency	Function
Department of Trade and Industry Bureau of Trade Regulation and Consumer Protection Bureau of Food and Drugs Bureau of Product Standards	protection of consumer welfare
Intellectual Property Office	protection of intellectual property rights
Securities and Exchange Commission	stock and nonstock corporations, resolves intra-corporate disputes and regulates all forms of securities, brokers and dealers, financing companies and investment houses
Bangko Sentral ng Pilipinas	banks and financial institutions
Insurance Commission	insurance companies
Housing and Land Use Regulatory Board	land use and real estate development
National Food Authority	rice, corn, wheat and other grains and foodstuff
Sugar Regulatory Administration	sugar industry
Philippine Coconut Authority	coconut industry
National Telecommunications Commission	telecommunications companies
Land Transportation Franchising and Regulatory Board	common carriers for land
Civil Aeronautics Board	companies engaged in air commerce
Maritime Industry Authority	shipping industry
Philippine Ports Authority	port operators and arrastre services
Department of Energy Energy Regulatory Board National Power Corporation	power generation companies and oil companies
Local Water Utilities Administration	water firms outside Metro Manila

Table 3: Competition-related Legislations

Special Laws	Description
Republic Act 8752: Antidumping Act of the Philippines (1999)	Protect Filipino enterprises against unfair foreign competition & trade practices
Republic Act 8293: Intellectual Property Code of the Phil (1997)	protects patents, trademarks, and copyrights and provides for the corresponding penalties for infringement
Batas Pambansa 68: Corporation Code of the Philippines (1980)	rules on mergers, consolidations, and acquisitions. It does not, however, address competition issues such as the possible abuse of dominant position arising from mergers and acquisitions

Batas Pambansa 178: Revised Securities Act (1982)	prohibits and penalizes manipulation of security prices and insider trading
Republic Act 7581: Price Act (1991)	to stabilize prices of basic commodities through price controls and ceiling mechanisms and prescribe measures against abusive price increases during emergencies and critical situations in order to protect consumers
Republic Act 7494: Consumer Act of the Philippines (1932)	consumer product quality and safety standards and includes deceptive and unfair sales practices like weight and measures as well as product and service warranties
Republic Act 8479: Downstream Oil Industry Deregulation Act (1998)	Deregulation of the downstream oil industry to ensure competitive market to encourage fair pricing, adequate & continuous supply of environmentally clean petroleum products
Republic Act 9136: Electric Power Industry Regulation Act (2001)	Restructuring of the electric power industry & privatization of the of the assets of the National Power Corporation

There have been numerous attempts to legislate new competition laws since the 11th Congress covering the period from 1998 to 2001 (see Appendix 1). Up to the 13th Congress (2004-2007), none of the bills was acted upon, most had pending status and never went beyond first reading. Note that the lawmaking process requires three readings. This inaction seemed to indicate the lack of appreciation and political will to pass a comprehensive framework for competition law in the country by previous administrations. In his inaugural speech in July 2010, President Aquino announced that competition law would be one of the administration's priority legislations.

During the 14th Congress (2007-2010), some positive changes took place as the Senate moved for the passage of the consolidated version of the Senate Bills on competition. Senate Bill No. 3197 or Competition Act of 2009 was approved after third reading in June 2009. SB 3197 prohibits cartelization, monopolization, abuse of dominant position or monopoly power and other unfair competition practices and imposes stricter penalties on parties guilty of engaging in restraint of trade. It authorizes the Department of Justice as its key implementing body and bestows upon it power to investigate and enforce orders and resolutions. However, in the case of the House, the consolidated version of the House of Representatives bills remained pending with the House Committee on Trade and Industry as the 14th Congress ended in 2010.

In June 2011, Malacañang issued Executive Order 45 (dated June 9, 2011) designating the Department of Justice as the country's Competition Office. The Office for Competition is mandated to investigate all cases violating competition law and prosecute violators; enforce competition policy and competition law; and supervise competition, among others. Barely a year old, the young competition office is currently in the process of formulating its organizational and administrative plans along with its enforcement agenda. It has conducted advocacy and awareness-raising campaigns and organized competition trainings and capacity building activities for lawyers, judges, members of academe, journalists, and government agencies.

In the 15th Congress, the House Consolidated Bill, House Bill 4835 was approved during its second reading. It differs from the Senate Bill in terms of creating a new agency to be known as Fair Trade Commission (FTC). The FTC will exercise exclusive jurisdiction to enforce, implement and administer the law. Under the Senate version these functions will be performed by the Department of Justice. At present, Senate Bill 3098 is still up for second reading approval. The process requires three separate readings. Given that there are two separate versions of the competition bill, a bicameral conference committee would be formed to address and reconcile the differences between the House and Senate versions. Once a joint and reconciled version has been prepared by the committee, this will be presented to both houses for ratification before submission to the President for approval.

B. Why the Need for Competition Law and Policy

1. Barriers to competition

In economics, competition is seen as a process that allows a sufficient number of producers in the same market or industry to independently offer different ways to satisfy consumer demands. As competition is often equated with rivalry, it pressures firms to become efficient and offer a wider choice of products and services to consumers at lower prices. A competitive economy enables individuals to exercise economic freedom, meaning freedom for consumers to choose what they value most and for entrepreneurs to choose where they want to invest. The competition process will allow consumers and producers to exercise their freedom of choice free of any price fixing conspiracies and monopolistic bullying. This way, consumer welfare increases resulting in dynamic efficiency through innovation and technological change.

Competition can be lessened significantly by (a) government regulatory policies, (b) behavioral restraints and (c) structural characteristics of the market that can act as barriers to entry (see Box 1). Regulatory barriers include investment licensing, tariff and nontariff measures, antidumping and countervailing duties.

Box 1
Structural, Behavioral, and Regulatory Barriers to Entry

Structural: barriers due solely to conditions outside the control of market participants

- Sunk costs: costs that a firm cannot avoid by withdrawing from the market, a sort of entry fee
- Absolute cost advantage: access to natural resource or human resources
- Economies of scale: unit cost of production fall with increasing output
- Large capital requirements
- Network industries: firms that are competitors share some critical facility like transportation and telecommunications

Behavioral: represent abuse of dominant position where "relatively large" firms engage in anti-competitive conduct or restrictive business practices by preventing entry or forcing exit of competitors through various kinds of monopolistic conduct

- Excess capacity
- Product differentiation and advertising
- Horizontal restraints: cartels or collusion (price-fixing agreements, market sharing territorial arrangements, bid rigging), price discrimination
- Vertical restraints: resale price maintenance, exclusive dealing
- Foreclosure and exclusion
- Tactics to increase rivals' costs

Regulatory: barriers imposed by government policies

- Special permits, license to operate
- Regulations influencing the use of some inputs
- Tariffs, quotas, and other non-tariff barriers
- Anti-dumping and countervailing duties
- Discriminatory export practices
- Exclusionary lists
- Ownership restrictions

Economies of scale (increasing returns to scale) is an example of a structural barrier. When there are increasing returns to scale, there is a minimum size that firms have to attain if they are to have average cost as low as possible. If the minimum efficient scale is so large that only one firm of that size can serve the entire market, there will be a monopoly. This situation often occurs in public utilities such as distribution of water, electricity, and piped gas.

Behavioral barriers represent abuse of dominant position where "relatively large" firms engage in anti-competitive conduct by preventing entry or forcing exit of competitors through various kinds of monopolistic conduct including predatory pricing and market foreclosure. Behavioral restraints are often classified into two: horizontal and vertical restraints. The former refer to agreements that are often referred to as "naked" restraints of trade, cartel behavior, or collusion. Examples are price-fixing, bid rigging, and allocation of territories or customers, and output restriction agreements. Vertical restraints are contractual agreements between supplier and purchasers/retailers in both upstream and downstream markets. Examples include resale price maintenance agreements, exclusive distribution agreements, exclusive dealing agreements, tie-in sale agreements and quantity forcing[2].

Firms may gain market power by limiting competition, i.e., by erecting barriers to trade, entering into collusive arrangements to restrict prices and output, and engaging in other anticompetitive business practices. The presence of barriers to entry impedes competition and allows firms to acquire and exercise market power. Market power enables firms, unilaterally (monopoly) or in collusion with others (cartel), to profitably raise prices and maintain these over a significant period of time without competitive response by other existing or potential firms. Barriers to entry are necessary for market power. Market power can be created through mergers or agreements between competitors not to compete or through restrictive vertical arrangements and predatory pricing which is an abuse of preexisting market power. A firm's exercise of market power can harm consumers and other producers through higher prices (rather than competitive prices), reduced output, and poorer quality products. In general, market power results in inefficient allocation of resources and negatively affects industry performance and economic welfare.

Large firms may further take advantage of their market power by abusing their dominant position or monopolization. This entails the suppression of competition by restricting or foreclosing the entry of smaller rivals, for example by increasing competitors' costs of entering a market or charging predatory prices which harms the competitive process.

Collusion or cartel describes a type of conduct or form of behavior where firms agree to coordinate their actions. Instead of competing against each other in terms of price, quality, or service, firms jointly agree to set prices and quantities that would maximize total industry profits. In a competitive environment, firms act independently and rivalry is present among competing firms in the market. In a cartel, firms get together and attempt to fix prices or levels of outputs, rig bids in auctions or procurements and divide markets by allocating customers, territories, relevant products or supplies in order to maximize total industry profits.

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[2] (i) Resale price maintenance agreements: retail price is fixed by the producer or price floors or ceilings are imposed; (ii) Exclusive distribution agreements: distributors are assigned exclusivity within a geographic area or over particular types of clients, or over specific products; (iii) Exclusive dealing agreements: downstream firms are prohibited from dealing with competing producers or distributors; (iv) Tie-in sale agreements: downstream firms are required to purchase a certain range of products before being allowed to purchase a particular product; and (v) Quantity forcing: downstream firms are required to purchase a minimum quantity of a product.

Cartels and collusion are anti-competition, they create market power, and suppress rival and consumer activities. Cartels are worse than monopolies because they make it appear that there is competition in the market, when in reality there is none. They make consumers believe that what they see are independent offers while potential investors or rivals are made to believe that the market is sufficiently supplied. By raising prices and restricting supply, artificial shortages are deliberately created. As a result, goods and services become completely unavailable to some buyers and unnecessarily expensive for others. These output restrictions cause inefficiency, reduce productivity, and result in economic and social harm.

Box 2
The Case of the Alleged Cartel in the Philippine Cement Industry

Historically, the cement industry thrived under a powerful, government-sanctioned cartel. Due to the economic slump in the early 1970s which resulted in large losses and chronic oversupply situation, cement firms pushed for government regulation to prevent cutthroat competition. Immediately, the government created the Philippine Cement Industry Authority (PCIA) in 1973. The PCIA was tasked to allocate supply, control prices and regulate entry in the industry. In the absence of the necessary firm-level information, the PCIA coordinated closely with the industry association, Philcemcor, to perform its price and supply regulation function. Eventually, it delegated the setting of production quotas to Philcemcor.

Collusion in the industry took place through the firms' informal agreement to set production quotas and to assign geographic markets among themselves. Philcemcor held regular monthly meetings to set production quotas. It also collected firm level data on production, prices, capacity utilization and other relevant information on the cement industry. Philcemcor also arranged the geographical division of the markets that restricted Luzon plants to sell only in Luzon and the Visayas/Mindanao plants to confine their sales in the area [SGV Consulting, 1992]. This practice divided the country into regional markets served by a dominant player, thus, eliminating competition from taking place in the industry.

During the 1990s, deregulation and trade liberalization were implemented in the industry. PCIA was abolished, tariffs were reduced and import restrictions were removed. Prior to 1997, the industry was dominated by three big domestic Filipino groups. A wave of mergers and acquisitions took place right after 1997 Asian crisis. Currently, the industry is controlled by the world's top three major cement makers: Holcim, Lafarge, and Cemex.

After the mergers and acquisitions, cement price increases were observed to increase in a simultaneous fashion between January 1999 and 2000. In May 2000, ex plant price/bag was P110 and reached around 140-145 per bag in 2001.

These price increases occurred at a time characterized by excess supply, which ballooned from 5 million bags in 1996 to 10 million bags in 1998 and 1999. Meanwhile, sales revenues grew by 25% despite a 12% reduction in production growth and a 130% increase in import growth in 2000. Note that the price increases coincided with reduced tariffs as well as entry of imports.

Consumer groups threatened to file a criminal case against the industry which they accused of engaging in cartel activities, but this never prospered. The House Committee on Trade and Industry and the Department of Trade and Industry (DTI) immediately conducted investigations but no resolution was made. The industry, through its association, Philcemcor, filed an antidumping case against imports. The Tariff Commission (TC), however, failed to find sufficient evidence to prove that the industry suffered serious injury from imports. However, DTI reversed the decision of the Tariff Commission by granting safeguard measures to protect the industry against imports. Recently, the Supreme Court voided the safeguard duty on imported cement, thus nullifying the earlier DTI decision.

Source: Aldaba, 2005, "The Impact of Market Reforms on Competition, Structure, and Performance of the Philippine Economy".

Recent Philippine experience in the cement industry shows that even with the removal of tariffs, competition in the industry has remained weak (see Box 2). The high and rising trend of cement prices from 2000 up to the present indicate that past trade liberalization and even the more recent tariff elimination are not enough to ensure that markets perform efficiently. The industry has remained highly concentrated; entry barriers are high because of the large capital requirements. Competition against imports is limited owing to the high transport and handling costs of cement importation. Demand for cement is inelastic which also provides another source of market power to firms to control prices. All these tend to indicate that the cement firms can collectively exert market power and their price behavior shows that they are able to exercise it. As such competition has been limited to the detriment of consumers, particularly small users.

In mid-December 2009, prices in Metro Manila and nearby provinces went up to as high as P260/bag from P205/bag in early December due to an artificial shortage created as the big three decided to simultaneously close their plants for annual maintenance activities. Cemex shut down its Antipolo plant while Holcim and Cemex shut down their plants in Norzagaray, Bulacan. Even at zero tariffs, traders still consider cement importation a high risk business. It is not viable due to high logistic costs and the market power of local cement manufacturers to easily match or underprice imported cement. Traders are aware that local manufacturers will bring down their prices in areas where any shipments come in.[3] Moreover, imported cement can only compete with a small segment of the market composed of small users since local manufacturers have long-term contracts with large customers and contractors providing special discounts to bulk sales.

As earlier noted, we have existing laws for the promotion of competition, however, these laws are fragmented and are implemented by different agencies. There is no central body that coordinates and monitors these agencies and regulatory institutions. Responsibility becomes too diffused and accountability is hard to trace. Hence, there are instances when these agencies issue conflicting rules and policies (see Box 2). While the Tariff Commission disapproved the request of the cement industry for the imposition of anti-dumping duties, the Department of Trade and Industry allowed the granting of safeguard measures on cement imports. This occurred at the height of the cement cartel issue. Eventually, the Supreme Court nullified the safeguard duty on cement imports.

2. Competition policy and law

Competition policy aims to achieve economic efficiency to maximize consumer welfare as well as to preserve and promote competition through the prevention of restrictive business practices by firms and their abuses of economic power including inefficient government regulation. Competition policy is consistent with policies that enhance competition in local and international markets like liberalized trade policy, relaxed foreign direct investment and ownership requirements and economic deregulation.

Competition policy objectives include freedom of trade, freedom of choice, access to markets, and achievement of economic efficiency to maximize consumer welfare (CUTS 2003). Thus, competition policy covers both (i) policies that enhance competition in domestic and international markets and (ii) competition law (also referred as antimonopoly or antitrust law). To attain the objectives of competition policy, a competition or anti-trust law is put in place to govern the behavior of firms. Competition law is a legal tool that allows competition principles to be enforced in the governance system.

Competition laws represent a clear set of enforceable legal rules applying to commercial tactics, behavior, and transactions by commercial establishments. They prohibit firms from attaining or exercising substantial market power obtained through improper means. It is important to recognize that competition laws do not prosecute firms that have gained market power through legitimate behavior, i.e., skill, foresight, and hard work. Competition laws are concerned with the elimination of abusive monopoly conduct, price fixing and other cartels as well as with the prohibition of mergers and acquisitions that limit competition. Competition laws prevent artificial

[3] Isip, Irma. Risky business traders unwilling to import cement despite zero tariff.

barriers to entry, thus, facilitating market access. This enhances competition and ensures that its benefits flow to consumers – both to individual consumers and firms that buy intermediate goods and capital assets including governments that build infrastructures.

III. Economic Regulation

A. Why governments regulate industries

Economic regulation refers to government restrictions on prices, quantity, and entry and exit conditions for certain industries. There are two main types of regulation: regulation of structure and regulation of conduct (Valletti and Estache, 1998). The former includes merger controls, removal of entry barriers, and restrictions on the line of business or break up of an integrated incumbent. The regulation of conduct covers pricing behavior of firms in terms of level and structure. The constraint on prices can be both on the final and at the intermediate level.

The most common economic arguments for regulation are based on correcting for market failures, economies of scale, or equity conditions. Traditionally, governments have regulated the utilities sector. Compared with the rest of the economy, utilities have three distinctive characteristics (Guash and Spiller, 1998):

- They require technologies that are commonly considered to be specific, sunk investments.
- They display aspects of natural monopoly such as economies of scale and scope in the physical provision of basic services, economies of scale in planning and managing the network, network externalities, and advantages in raising capital, which are being gradually eroded by technological innovations.
- Their products are massively consumed by captive consumers with fairly inelastic demand.

These features of the utilities sector have formed the basis for raising the need for governmental regulation of utilities. In theory, if there are economies of scale or scope, average costs are decreasing. This implies that a single firm may be able to produce more efficiently than several competing firms. However, the control over price exerted by a monopolist could give rise to efficiency losses to society, hence, regulation is necessary to curtail abuses of monopoly power. When an industry is characterized by increasing returns to scale or when network externalities or significant coordination costs are present, regulation is an important approach for increasing economic efficiency. The general principle is to regulate segments of the market that exhibit natural monopoly characteristics not only to restrain abuses of monopoly power but also to protect consumers and ensure access (fair price and quality) by future competitors to essential or bottleneck facilities often controlled by incumbent firms.

Interconnection and access to networks as an intermediate service or bottleneck facility is critical to fostering competition and reducing market dominance. Regulation should ensure that access and interconnection charges promote an efficient structure of production, use and consumption; allow network operators to make a sufficient return and promote efficiency while avoiding unnecessary construction of duplicate networks. In the presence of alternative delivery systems or bypass technologies, the correct access prices become vital to ensure efficiency of the total system.

There are basically two approaches in addressing the access problem:

- Break up the vertically integrated dominant firm and to prohibit the essential facility spin-off from reentering the competitive market.
- Preserve vertically integrated firm as monopoly while regulating either final prices to consumers or access prices to competitors or both to promote competition.

The access problem becomes more serious in the presence of vertically integrated industries. By allowing the bottleneck owner to compete against other firms, there is a danger that the incumbent will set access charges, which may make further entry difficult. Policies prohibiting vertical integration across monopolistic and competitive segments of the production process are necessary to facilitate access terms and to eliminate conflict of interest. The threat of market foreclosure to upstream competitors has led to a policy of unbundling or separating the stages of utility production.

Economic regulation must ensure that the monopolists do not overcharge or cheat on the quality of service provided to customers. At the same time, economic regulation must ensure that the monopolists are getting a reasonable return on their assets, operating efficiently, and making investment decisions that are consistent with demand at unbiased prices.

The establishment and implementation of an effective regulatory system is a difficult activity; it requires a regulatory tradition and track record, expertise and strong institutional support that are often lacking in developing countries. The difficulty is exacerbated because governments face multiple objectives such as ensuring competition, high revenues from privatization for fiscal reasons, ambitious investment demands, rapid expansion of basic services, and distributional factors in the pricing of services. Governments are also tempted to use regulation to advance short-term political goals that may make the regulatory system vulnerable to capture.

Efficient regulation is hampered by the problem of asymmetric information: while firms have a good idea of their costs and demand structure, the regulator often does not have access to such information. Moreover, since regulation redistributes resources and rents, politicians can use it to secure political gains rather than correct market failures, hence, leading to inefficient economic results and undermining the effectiveness of even well-designed regulatory framework.

B. How monopolies are regulated

Regulation is seen as a principal-agent relationship in which a regulator – the principal – attempts to control the firm, a natural monopoly – the agent. The fundamental problem confronting the regulator is the asymmetry of information that can be reduced but not eliminated. The regulated firm will always know more about its economic environment, production cost, effort, demand, and quality than the regulator and will try to extract some rent from consumers as a result of information advantage.

Given the regulator's lack of information about the regulated firm, Loeb and Magat (1979) suggest that the regulator should simply transfer the consumer surplus to the firm to induce it to behave optimally. However, this leaves the equity issue or the cost of public funds unresolved because the monopolist appropriates the entire economic surplus.

Baron and Myerson (1982) indicate that there is a trade-off between efficiency and informational rents. If these rents are costly to society, the Baron and Myerson model allows the monopolist to charge a higher price and a pricing formula that accepts the cost declaration by the monopolist at face value plus some margin.

Laffont and Tirole (1986) introduce a model with a richer asymmetry of information both on the technology and unobservable cost reducing efforts of the firm. Given this setting, optimal regulation requires a menu of contracts offered to firms. The contracts should be based on the firms' information such that firms self select themselves. An inefficient firm should not be given the same contract as an efficient firm. Essentially, what Laffont and Tirole are saying is that there is no such thing as free lunch and there is a need to balance efficiency gains with higher informational rents that must be given up. One important difference of their model with the Baron and Myerson scheme is the absence of the need to distort prices to reduce informational rents.

C. Price regulation approaches

Standard monopolist

There are two main approaches to monopoly regulation: rate of return regulation and price cap regulation. The rate of return regulation is a cost-based regulation that allows firms to earn sufficient revenues to cover costs including a fair rate of return on equity. The principle is to control prices, though indirectly, by allowing the regulated firm to earn only a normal or fair rate of return on its capital investment. It is used in Canada, Japan, and the US. This price-setting method requires detailed information on costs, assets, and investments. The main problem with this method is its creation of perverse incentives. Since the firm is guaranteed a return on its investment, it tends to overinvest in capital (Averch-Johnson effect) or simply overstate the value of the assets when their correct value is difficult to assess (Estache). The larger the value of the asset, the larger the benefits allowed, and hence, the higher the prices will be. In addition, this method provides little incentive for productive efficiency because the firm can pass production costs on to the final users in the form of higher prices. The rate of return regulation penalizes efforts to reduce costs, as these would have to be passed through in the form of price cuts to customers.

Price cap regulation was introduced in the United Kingdom as an alternative to the rate of return regulation. This method is used in some states in the US as well as in Australia, Puerto Rico, Singapore, and Latin America. It is based on the control of maximum prices or the imposition of price caps. Under this scheme, the firm is free to increase its price between review periods at the rate of inflation (RPI) minus some amount (X) to reflect expected increases in productivity arising from technological improvements. The system provides incentives for cost reductions and efficiency gains. The firm retains any profits that may result from cost cutting or technological innovation at least until the end of the review period. For the next review period, the initial price and the new X will reflect the new cost structure, hence enabling consumers to benefit from the increased efficiency. Some of the problems with this pricing system are the determination of the annual adjustment factor and the length of time for which it will apply. In practice, either the cap is too high and the firm will earn enormous profits or it is too low and the firm goes bankrupt. Another problem with the price cap regime is the temptation to cut quality as a way to reduce cost which implies a higher profit for the monopoly. Under the rate of return regulation, overinvesting in quality may be a rewarding strategy for the private investor.

With the introduction of electricity sector reforms in the in 2001, the Philippines shifted towards price cap regulation for retail tariffs of all distribution utilities. In the past, the regulatory approach for distribution retail tariffs were based on the rate of return regulation principle with assets revalued on a replacement cost basis. The rate of return base could not be greater than 12 percent.

Regulation of access and interconnection

The setting of access charges is a highly difficult exercise. In practice, regulators may leave access charges to be set by private negotiation and intervene only if parties fail to reach an agreement. Interconnection and access costs can be calculated in several ways and indeed, there are complexities in apportioning costs into line-sensitive and traffic sensitive areas, peak and off-peak hours, central business district, metropolitan, provincial, and rural areas, and different areas of the network hierarchy.

In theory, the first best solution is to set access price equal to the marginal cost of production. However, with the theoretical first best, the incumbent would recover only the variable cost and would make a loss equal to the fixed cost. In the absence of government subsidies, the second best solution is to set access charge equal to the average cost of the bottleneck owner. When different services are produced with the essential input, another alternative is to allow access charge to follow an inverse elasticity rule in which the more a good is needed by a downstream user, the higher the access charge that the bottleneck owner should be allowed to levy from that specific user.

The efficient component pricing rule (ECPR) also known as the Baumol-Willig rule is one creative second best solution. When final products are homogeneous and the market is contestable, the ECPR simply sets the access charge equal to the difference between the final price and the marginal cost on the competitive segment. The basic message of the ECPR is to set the access price equal to the net benefit earned by society when that service is provided competitively. The main advantage of the ECPR is when it works it avoids inefficient entry, but it does so at the expense of maintaining the incumbent's monopoly power over final goods.

The ECPR has been criticized because of its assumption that all firms face identical cost structures and provide perfectly substitutable goods. Its opponents suggest that access charge must allow for cost and demand asymmetries between monopolist and competitors as well as allow for several competitors by introducing product differentiation. Another criticism is it abstracts from incentives so that there is no reason to have more than one firm in the competitive segment. Therefore, entrants must be more efficient than the monopolist or they would never choose to enter. In that case, however, the monopolist would cease providing the service at all because it would earn higher revenues by selling its rights without incurring any costs. Thus, it limits the development of dynamic efficiencies arising from competition.

Laffont and Tirole proposed a global price cap as an alternative to the ECPR. The global price cap includes both access charges and final goods prices. The bottleneck input is treated as a final good and included in the computation of the price cap. The approach requires that a weighted average of all these prices not exceed the cap. When the cap is properly set, the regulated firm is induced to choose optimal Ramsey price structure. It does not require the regulator to measure marginal cost or to estimate demand elasticities. One major concern that has been raised with global caps involves predatory practices that the incumbent can engage in. By increasing the access prices and reducing the final product price, the incumbent can satisfy the global cap while engaging in a price squeeze that damages competition.

In the Philippines, revenue cap regulation was adopted for transmission rates with the approval of rules on the adoption of performance-based regulation in transmission wheeling rates in May 2003. Like retail electricity rates, the regulation of transmission wheeling tariffs was used to be based on a rate of return regulation principle.

D. Franchises and concessions as alternatives to price regulation

Franchises and concessions are seen as alternatives to regulation in natural monopoly settings and are often used to compete for the market, to transfer operating rights and use of assets to the private sector, and to set the initial price of services and subsequent adjustment mechanisms.[4] Their advantage over regulation is that they impose no informational requirements on a government agency. Franchises and concessions are important schemes for introducing private sector participation in sectors where the government does not want to transfer ownership of assets to the private sector.

Franchising refers to the granting of a right or a license to operate a defined service and to receive associated revenues after a competitive bidding process is carried out. Competitive bidding for the natural monopoly dissipates all the monopoly rents. A franchise arrangement is essentially contractual and as such, it requires constant involvement of the regulator in monitoring compliance, in reconciling interpretations, and in negotiating terms. The role of the government is to set the rules for competition at the bidding stage and enforce the terms of the agreement.

The franchising of natural monopolies has the following advantages:

- reduces opportunities for regulatory capture and lessens the scope for political interference in management
- encourages cost efficiency because franchise contracts specify maximum prices for set qualities of goods and services and permit cost savings to accrue to the franchisee during the life of the contract.
- fosters productive efficiency because the competitive nature of contract bidding assures that the lowest prices are obtained and still allowing the franchisee to earn a normal return on investment.
- optimal pricing can be achieved even when sunk costs rule out contestability because competition occurs before firms commit themselves to investment programs.

The disadvantages include the following:

- complex design and monitoring systems when multiple bidding targets are present
- inability to cover every conceivable circumstance
- difficulty in enforcing contracts
- poor service quality and lack of incentives due to the fixed term nature of contracts
- inability to commit a path of price adjustments over the life of the concession which creates opportunities to use and abuse renegotiation opportunities rendering the initial price bid, on which the concession is awarded, almost meaningless

On the overall, franchising is only superior if abuses after the franchise is awarded are contained and repeated bidding is practical. Water and sanitation, solid waste collection, urban transportation, rail, airport and subway services, toll roads and cable and television are the sectors that seem most appropriate for franchise-bidding regulation.

Concessions are very similar to franchising, the only difference is that concessions involve more detailed follow-up supervision and more future obligations of the operator are built into the contract. Concessions are well suited to sectors with monopoly characteristics. The government

[4] Most of the discussions here were drawn from Guash and Spiller (1998).

delegates the right to provide a particular service but maintains some control over the sector by dictating the rights and obligations of the provider. The service must be provided under the conditions specified in the contract or license. The private sector assumes operational responsibility and some of the commercial risk of provision. In general, the concessionaire must achieve specified targets.

The approach includes build-own-operate (BOO), build-operate-transfer (BOT), and lease-and-operate contracts. Under BOO and BOT agreements, the private sector is responsible for financing and carrying out the investment specified in the contract. Under BOT, the assets revert to the state at the end of the concession terms while under BOO, the ownership of the existing assets and the responsibility for their future expansion and maintenance are transferred to the private sector. Under the lease-operate-contract, the private contractor receives a fee to provide the service including operating and maintaining the infrastructure.

Concession arrangements embody a regulatory framework and in practice should be viewed as an integral part of regulation rather than as a substitute for it. The terms of the contract need to be monitored, enforced, and occasionally revised. In practice, the number of cases where privatizations/concessions have gone sour and the contract renegotiated are quite high. The common problems are poor concession design, unclear concession/regulatory rules, ex post changes of the rules of the process, and inappropriate bending to requests to renegotiate deals.

IV. Competition and Regulation Interface

Since the late 1980s, developing countries have been privatizing their utilities sectors primarily because of fiscal constraints: the public sector was unable to fulfill the massive investments necessary to bring up these sectors to modern standards of service and coverage. Given the introduction of market reforms (liberalization of entry restrictions, prices and normal business practices; rethinking of universal service obligations) and progressive privatization of many utilities sectors, sector regulators were put in place to control anticipated market failure. Sector regulators are mandated to ensure fair competition in their respective sectors and sometimes being tasked to formulate and/or apply general or sector specific competition laws or rules. Note that one of the principal objectives behind these economic reforms has been to broaden the scope for private markets to allocate resources in order to improve overall economic efficiency.

The OECD (1998) defines the two agencies as follows:

- Competition authorities have practically economy-wide coverage, they administer framework laws intended primarily to protect consumer interests by prohibiting firms from reducing competition through collusion or merger with rival firms or seeking to eliminate competitors by means other than offering superior products to consumers.

- Regulators cover one or a small number of sectors where the government believes the public interest would not be adequately served merely by relying on private markets supervised by a competition agency, and decides therefore to empower an individual or institution to directly specify acceptable technologies, marketing methods and/or prices charged.

While both competition and sector regulators share a common goal of protecting and play complementary roles in fostering competitive markets, safeguarding consumer welfare and enhancing social and economic welfare, the two generally have different legislative mandates, employ different approaches and have different perspectives on competition matters (see Table 4)[5]. The two agencies' empowering statutes and administrative practices usually differ on the weight that must be assigned on the economic efficiency objective as well as on the number and diversity of other objectives that must be considered. For instance, many competition agencies generally concentrate on the economic efficiency objective and give it clear primacy over other objectives such as ensuring small businesses have "fair" access to markets or contributing to balanced regional development (OECD 1998). Regulatory authorities, on the other hand, are usually assigned or adopt a much wider set of concerns rooted in distributional issues or a desire to correct for various market failures apart from the existence of market power. Sometimes, due to these other concerns, regulators may be led to tolerate or encourage anticompetitive market structures as where cross-subsidies are believed necessary to ensure service obligations are fulfilled.

Table 4: Sector Regulators and Competition Authorities: Institutional Characteristics

Characteristics	Sector Regulator	Competition Authority
Mandate and overall approach	• Substitute for lack of competition • Broad range of socio-economic goals	• Protect and enhance competition process • Emphasis on efficiency objectives
Specific approaches or methods	• Attenuate effects of market power wielded by natural or network monopoly • Impose and monitor behavioral conditions • Ex-ante prescriptive approach • Frequent interventions requiring continual flow of information	• Reduce market power whenever possible • Impose structural and behavioral remedies • Ex-post enforcement (except with merger review) • Information gathered in case of investigation; more reliant on complaints

Source: UNCTAD 2004 (adapted from OECD 1999)

In terms of basic approach, competition authorities are seen as enforcing a set of economy-wide prohibitions designed to deter firms from suppressing competition either by colluding with rivals or eliminating or disadvantaging them by means which are at odds with long term consumer welfare. Meanwhile, sector-specific regulation is generally adopted where direct government intervention is deemed to be required because markets are either inherently imperfect or will not produce a desirable distribution of benefits. Regulation, which involves stipulating a fairly complete set of process and accompanying commitments regarding supply and quality of service, is seen as a substitute for market forces.

In terms of timing and frequency of intervention, competition policy is mainly *ex post* (except merger review) while regulation is primarily *ex ante* and continuous. When regulation is applied there will typically be a pre-supposition that market forces cannot be relied on to produce satisfactory outcome and this cannot be rectified merely by trying to change firms' incentives.

[5] Competition laws aim to protect the competition process (not market agents) towards maximizing productive and allocative efficiencies. Competition rules tell market agents what they should not do, while sector regulations does the reverse and tell market agents what to do (CUTS 2003). Sector regulators address the market power issue directly for instance, by restraining the possibility of pricing a monopoly service below a certain threshold. Competition authorities indirectly restrain market power by prohibiting a merger to become a monopoly or by impeding the monopolization of a neighboring market.

Hence, firms may be better served through ex ante instructions rather than by being surprised with unexpected requirements once sunk cost investments have been made.

In terms of information flow and monitoring of firms, competition offices usually start to acquire information only when they receive a complaint or otherwise believe that the competition law has been broken or a merger requires review. In contrast, regulators continually monitor regulated firms (because they are seeking to change behavior without altering market based incentives. In terms of type of information required, regulators may need to specify accounting systems to ensure they have relevant and understandable information particularly if they want to engage in yardstick regulation. Moreover, they will need a greater variety of information than competition agencies to ensure that universal service obligations and safety and environmental protection rules are met.

In terms preference for structural versus behavioral remedies, the two agencies also differ. Regulators are much more confident that they can alter behavior despite leaving incentives unchanged. There are some anecdotal evidence that where regulators have been given power to review mergers there appears to have been insufficient appreciation of the superiority of structural over behavioral remedies and generally a tendency to be more permissive than a competition authority would have been (OECD 1998).

The above differences in the prioritization of objectives and the methods used by sector regulators and the competition authorities may lead to friction. Jurisdiction over certain areas may not always be clear-cut and may pose certain dilemmas, the resolution of which will depend on which is judged to be the more effective of the two authorities on the basis of the specific issue under consideration (UNCTAD 2004). Since the boundaries between the respective roles of the competition authorities and sector regulators sometimes overlap, conflicts or inconsistent actions arise.

The OECD (1998) identified five competition enhancing tasks that could be assigned to either competition agency, sector regulator, or both:

- Access regulation involves ensuring non-discriminatory access to necessary inputs, especially "essential facility" networks
- Controlling other anticompetitive behavior and reviewing mergers
- Technical regulation involves setting or continuing to apply standards to assure compatibility and to address privacy, safety, and environmental protection concerns
- Economic regulation involves adopting measures to control monopoly pricing and otherwise to assure appropriate levels of consumer protection
- Periodically reassessing the scope and degree of remaining market power in markets where competition is being introduced in order to recommend whether such power justifies continuation of any sector-specific competition law or regulations (other than technical regulations)

Different countries have chosen different approaches to ensure coordination and policy coherence between sector regulators and the competition authority. The UNCTAD (2004) classified the different frameworks into five types:

1) Combine technical and economic regulation in a sector regulator and leave competition enforcement exclusively in the hands of the competition authority;
2) Combine technical and economic regulation in a sector regulator and give it some or all competition law enforcement functions;

3) Combine technical and economic regulation in a sector regulator and give it competition law enforcement functions to be performed in coordination with the competition authority;
4) Organize technical regulation as a stand-alone function for the sector regulator and include economic regulation within the competition authority;
5) Rely solely on competition law enforced by the competition authority.

Table 5 contains a list of the different approaches that countries have adopted. In analyzing the different approaches in OECD member States, the OECD concluded that there is no ideal type for the separation of functions between sector regulators and competition authorities. Australia involves both (4) and (5); while the ACCC has technical, economic and competition regulatory functions, where state regulators exist, they are given technical and economic regulatory responsibilities. Canada and France use combinations of (2) and (3) while the US has (1) and (2).

Table 5: Frameworks on the Interaction Between Competition and Regulatory Agencies

Country	Type	Description
Australia	4, 5	The Australian Competition and Consumer Commission (ACCC)'s regulatory role covers access regulation, regulation of prices of public utilities and a variety of other regulatory tasks. Australia has tended to favor general rather than industry-specific regulation, but where State Regulators exist, these bodies have technical and economic regulatory responsibilities across a range of industries and have a close association with the ACCC.
Brazil	1	The competition law is fully applicable to regulated sectors and the competition authorities are in charge of its enforcement in cooperation with sector regulators.
Canada	2, 3	There is no formal separation of jurisdiction. Apparent or possible areas of statutory conflict are resolved through recourse to the doctrine of "regulated conduct". A second approach has been for the competition authority and the sector regulator to sign a Memorandum of Understanding, which effectively sets out the respective roles of the agencies. However, this approach has not proved a lasting solution in the case of the MOU with the Canadian Radio and Television Commission, where changes in top management have resulted in the abandonment of the MOU.
France	2, 3	Sector regulator mandates in some sectors extend beyond enhancing competition and lead to an overlap with no formal separation of jurisdiction. In most cases, particularly where the question of *service public* arises, the Conseil d'Etat or the Minister of Economic Affairs, Finance and Industry makes decisions on a case-by-case basis and the Conseil de la Concurrence has an advocacy function. Decisions on mergers and acquisitions are made by the Minister and are outside the jurisdiction of the Conseil de la Concurrence. Competition law generally defers to other laws and regulations if they are inconsistent.
Kenya	2	The Competition Authority has neither jurisdiction over regulated sectors nor advocacy powers. However, sector regulators increasingly coordinate with the competition authority, although they are not obliged to do so.
Malawi	2	The competition law does not exempt regulated sectors. Sector regulators have the mandate to promote efficiency and competition. The separation of jurisdiction and clarification of the respective roles of the agencies may become an issue when the competition law is enforced (although in existence since 1998, the law has yet to be enforced).
Mauritius	2	Some sector regulators have competition competencies.
New Zealand	5	New Zealand has a policy of "light-handed" regulation and relies on a generic competition law. However, in recent years this approach has been questioned.
Portugal	3	Sector regulators have been given competition competencies and the competition authority and sector regulators are obliged to coordinate on competition matters. There is no specific provision in the event of conflict.

Korea	1, 3, 4	As a result of regulatory reform, Korea is moving towards type 3; however, in some instances types 2 and 1 apply.
South Africa	3	Sector regulators have concurrent jurisdiction. However, the Competition Act neither explicitly defers to other regulation nor explicitly claims precedence over it. The competition authority is required to negotiate agreements with sector regulators to coordinate the exercise of jurisdiction over competition matters in regulated sectors (in those sectors where the regulator has an explicit mandate over competition matters in their sector – this does not imply agreements with every sector regulator). At present, the competition authority has agreements with regulators in the broadcasting and electricity sectors, and under these agreements the Competition Authority is the lead investigator in concurrent jurisdiction matters. The competition authority also has an advocacy function.
United Kingdom	3	Sector regulators have concurrent jurisdiction. The Concurrency Regulations 2000 spell out the procedure by which it is decided which authority is better/best placed to deal with a case, and settlement procedures in the event of a dispute.
US	1, 2	Sector regulators do not have a formal antitrust enforcement role; however, the mandate in some sectors extends beyond enhancing competition, thus leading to an overlap. In such cases, the Congress makes decisions on a case-by-case basis and the competition authority has an advocacy function.

Source: UNCTAD 2004

In designing the division, a wide range of factors such as the social and economic context and legal system are important determinants of the choice of regulatory framework along with the characteristics of the regulated industry. As the UNCTAD (2004) pointed out, different countries will apply different approaches according to their circumstances, and it cannot be expected that an approach that works for one country (or industry) could be imposed on another. The powerful forces that shape countries' competition and regulatory systems are often unique to particular countries, and country differences impose significant limitations on harmonization.

Box 3 presents a number of generalization and principles that seem reasonably certain to apply in most industries and countries. The UNCTAD (2004) indicated that based on these generalizations from the OECD, the key guiding principles are given by the following:

- Subsidiarity: any particular form of regulation should be carried out at the level of governance consistent with regulatory effectiveness
- Transparency: serve to ensure access to the information necessary for making sound judgments
- Due process: participation by all parties likely to be affected by a regulation
- Proportionality: elimination of unnecessary costs due to over regulation or ineffective regulation.

Box 3: Generalizations and Guiding Principles in Designing Competition and Regulation Framework

- It might not always be necessary to employ economic regulation to address problems arising from alleged market power either because such power could be too transitional to be worth worrying about or because light-handed regulation may possibly be a superior alternative.
- Technical regulation will not likely fit well within competition agencies.
- Since there are advantages in combining economic regulation with technical regulation, economic regulation should probably not be organized as a stand-alone function.
- Given what has been said about technical and economic regulation, there seem to be three practical alternatives:
    - combine technical and economic regulation in a sector specific regulator and leave competition law enforcement entirely in the hands of the competition agency
    - organize technical regulation as a stand-alone function and include economic regulation within the competition agency
    - combine technical and economic regulation in a sector specific regulator and give it all or some competition law enforcement functions
- Separating competition law enforcement from regulation means sacrificing certain synergies and having to adopt measures ensuring firms are not subjected to inconsistent demands, but it also ensures that both policies are administered by agencies thoroughly understanding them and having cultures suited to their implementation.
- If a decision is made to combine competition law enforcement and economic regulation, serious attention should be paid to differences in how competition agencies and regulators conduct their principal functions because this could significantly influence how they would carry out a combined mandate.
- In sectors expected to evolve reasonably quickly to being workably competitive (i.e. transition sectors), assuming a decision has been made to combine economic regulation with competition law enforcement, it would probably be better to locate these functions within the competition agency than within a sector-specific regulator.
- In non-transition sectors, if it is decided to combine economic regulation with responsibility for ensuring non-discriminatory access to necessary inputs, this is probably better done within a regulator than within the competition agency.
- Because competition agencies appear to have a comparative advantage over regulators when it comes to enforcing prohibitions of anti-competitive behavior and reviewing mergers, such agencies should have exclusive jurisdiction in those domains, or at least concurrent jurisdiction along with a regulator.
- There seem to be good reasons for organizing regulators as general rather than sector-specific agencies (moreover some of the difference in performance expected from competition agencies and regulators would likely disappear if the regulator were general instead of being sector-specific in nature).
- Economic regulation, especially that being applied to markets in process of liberalization, should be subject to sunsetting, and should not be renewed unless the competition agency believes that is justified by continued market power. Thought should also be given to requiring regulatory forbearance in any market which is workably competitive, and once again the competition agency could usefully be involved in that determination.

Source: OECD (1998).

The UNCTAD Model Competition Law on the relationship between competition authority and regulatory bodies including sector regulators states that competition authorities should assess regulatory barriers to competition incorporated in economic and administrative regulations from an economic perspective, including for general interest reasons.

It is also important to point out that whatever combination of approaches is selected for economic regulation and competition law enforcement, it is important that formal and informal cooperation links are forged between the technical regulator and the other relevant institutions. These are necessary not just to avoid resource duplication but also to ensure that technical regulators take proper account of the ways in which the adoption and enforcement of technical standards can be used to distort or restrict competition (OECD 1998). The OECD also points out one advantage that competition agencies enjoy over regulators is their supposed tendency to be more resistant to capture.

Lastly, sector-specific regulation creates the need to define jurisdictional boundaries that could in turn lead to the following problems: (i) uncertainty concerning which regulations will apply for firms operating in several distinct markets; and even a risk that they will be subject to inconsistent regulatory demands such as conflicting accounting requirements; (ii) competitive distortions and consequent misallocation of resources caused by competing firms being subjected to different regulatory regimes; and (iii) further competitive distortions due to regulators trying to preserve their jurisdiction over firms by restricting the businesses that regulated entities can engage in.

The seriousness of these problems increases significantly if sector-specific regulators also acquire competition law enforcement functions and proceed to elaborate different competition "laws" for each sector. One important area of interest is found in the converging telecommunications, broadcasting and personal computer services sector. A paper by the OECD's Committee for Information, Computer and Communications Policy's Working Party on Telecommunications and Information Services Policy urged rejection of asymmetric regulation designed to help new entrants overcome incumbents' advantages at the local loop level. The answer to the problems faced by regulators in converging industries should not be to extend regulation to presently unregulated sectors.

V. Towards the Development of an Operational Framework for the Interaction Between the Philippine Office for Competition and Sector Regulators

As the Philippines move towards the legislation of its comprehensive competition law, one important issue that has emerged is the interaction between the competition agency and sector regulators. After the introduction of liberalization and deregulation, sector regulators were created including the National Telecommunications Commission, Electricity Regulatory Commission, Metropolitan Waterworks and Sewerage System Regulatory Office, Civil Aeronautics Board, Maritime Industry Authority, and the Philippine Ports Authority. The sector regulators were established to control anticipated market failure and at the same time, ensure fair competition in their respective sectors. The sector regulators are mandated not only to regulate their respective industries but also to promote competition. Box 4 contains a description of the different functions of regulators such as the Energy Regulatory Commission (ERC), National Telecommunications Commission (NTC), Maritime Industry Authority (MARINA), and the Philippine Ports Authority (PPA).

Given that the competition law to be enacted will mandate the competition authority to regulate all sectors of the economy, some confusion and conflict may arise as the law may imply that sector regulators would have to give up a portion of their "authority" relating to competition or a diminution of mandate. Note that government agencies tend to be caught up in a turf mentality which may prevent them from cooperating with each other in promoting competition. Although it is clear from both consolidated bills that the Competition Office will not derogate the power and authority of the sector regulators.

Box 4: Functions and Responsibilities of Selected Regulators

The **Energy Regulatory Commission** is responsible for the regulation of the electric power industry under the Electric Power Industry Reform Act (RA 9136: EPIRA of June 2001). It is tasked to promote competition, encourage market development, ensure customer choice, and penalize abuse of market power. Among its functions are to:

- promulgate rules and regulations including but not limited to competition rules and limitations on the recovery of system losses
- review and approve plans for the expansion and improvement of facilities submitted by TRANSCO or its buyer or concessionaire
- determine, fix and approve transmission and distribution wheeling charges and retail rates as well as the universal charge to be imposed on all electricity end-users including self-generating entities
- promulgate a Grid Code and a Distribution Code for the access and use of the transmission and distribution facilities
- enforce the rules and regulations governing the operations of the wholesale electricity spot market (WESM)
- ensure that all electricity industry participants including NPC will functionally and structurally unbundle their businesses and rates and determine the levels of cross subsidies in the existing retail rates until these are phased out as well as set a lifeline rate for marginalized end-users

The **National Telecommunications Commission** (NTC) is a quasi-judicial body which acts as the regulatory arm of the telecommunications industry under RA 7925 of 1995. While acting as an independent regulatory agency, the NTC remains under the administrative supervision of the Department of Transportation and Communications. Although in terms of its quasi-judicial functions, its decisions are appealable only to the Supreme Court. It is responsible for the following:

- fostering fair and efficient market conduct through, but not limited to the protection of telecommunications entities from unfair trade practices of other carriers
- promoting consumers' welfare by facilitating access to telecommunications services and protecting them against misuse of a telecommunications entity's monopoly or quasi-monopolistic powers
- regulation of the operations of telecommunications carriers including rules on franchise, pricing/rates and access charge/revenue determination, market entry, and interconnection.

The **Maritime Industry Authority** (MARINA) is the regulatory authority for shipping created under Presidential Decree No. 474 issued in 1974. It is mandated to provide supervision, regulation and rationalization of the organizational management, ownership, and operations of all water transport utilities, and other maritime enterprises. MARINA is an attached agency to the Department of Transportation and Communications (DOTC). RA 9295 (Domestic Shipping Development Act of 2005) has deregulated fare setting with the objective of keeping tariff competitive and affordable but MARINA was still given the power to intervene to safeguard the interest of the general public.

The **Philippine Ports Authority** (PPA) is the main developer, operator, and regulator of ports under PD 857 of December 1975 (amended in 1987 by EO 159). It is an attached agency to the DOTC. Its functions include:

- issue permit to construct and operate the port and sets and collects port charges such as wharfage dues, berthing/usage fees, and terminal handling costs
- approve increases in cargo handling rates and receives 10 and 20% from cargo handling revenues on domestic and foreign cargo, respectively
- award contracts to private terminal and cargo handling operators and sets the rates under such concessions

PPA supervises 115-owned ports and regulates over 500 private ports. Privatization in the ports sector started in 1988. The three main common-user ports in Manila are the Manila International Container Terminal (MICT), South Harbor, and North Harbor. These ports are supervised by the PPA under a "landlord system" where the ports are privately operated under long-term concessions.

Section 14 of the Consolidated House Bill states: "…. the exercise of regulatory powers by different government agencies, including local government units, over an industry or a sub-sector of an industry shall be cumulative and shall not be construed in any way as derogating from the power and authority of the concerned agency. The government agencies shall cooperate and coordinate with one another in the exercise of their powers in order to prevent overlap, to share confidential information, or for other effective measures. The Commission can seek technical assistance from sectoral regulators. The Commission shall have primary and sole jurisdiction over competition issues, while the regulatory body shall continue to exercise jurisdiction over all matters with regard to the firms' operation and existence."

Section 7 of the Consolidated Senate Bill also states: "The exercise of enforcement and regulatory powers by the Office shall be cumulative to the power and authority of the different government agencies over an industry or a sector of an industry and shall not in any way derogate the power and authority of the concerned agency. The Office shall enlist the assistance of any branch, department, bureau, office, agency or instrumentality of the government in undertaking any and all mandated functions under this Act, which may include the use of its personnel, facilities and resources for the more resolute prevention of anti-competition conduct, detection of such violations and prosecution of offenders".

The Consolidated House Bill proposes coordination and cooperation between the Competition Office and the sector regulators in the exercise of their powers. The house bill also defines the boundaries or jurisdiction between the Competition Office and the sector regulators with the Competition Office being responsible for competition matters while the sector regulators will be responsible for the firms' operation and existence.

It is important to note that the implementation and application of competition policy often requires nuanced approaches. As shown by the country experiences in establishing their respective competition agencies, there is no "one size fits all" policy that can be applied to competition policy within a single country. One of the challenges being faced by young competition bodies is the inadequacy of legislation due to heavy borrowing from experienced countries in designing the provisions of their competition law. As a result, many young competition agencies must now enforce legislation that does not properly address many of the realities of the jurisdiction they are called upon to regulate (ICN 2006).

Another difficulty is the lack of cooperation and coordination of policy between competition authorities, regulatory and other government agencies in efforts to promote and enforce competition. This problem has been attributed to the recent introduction of competition law that failed to address conflicting prior legislations or where the competition law and other sector regulation have concurrent jurisdiction. Other challenges affecting young competition agencies include limited capital resources, limited experienced human resource capacity, untrained judiciary, and lack of a competition culture. It is important to emphasize that the independent and effective review of competition agencies' decisions by courts is a necessary, critical and important aspect of many well-functioning competition regimes. Hence, a judiciary familiar with competition law and its economic aspects is a vital element of a country's competition system. In several competition agencies' experience, cases have taken years to process and in some instances, there were perceived questionable judgments handed down by courts.

There are many valuable lessons that can be learned from various country experiences particularly developing countries whose competition agencies are still young and evolving. *First*, an important area that must be addressed is the design of an appropriate framework for the interaction of competition agencies with sector regulatory agencies. Given the different interaction approaches discussed in the preceding section, the stages of development of the policy areas as well as conditions within the markets currently subject to regulation must be taken into consideration in crafting the country's framework. *Second*, in designing the framework for interaction, it is important to emphasize that whatever the respective stages of development, there are identifiable means that are likely to help a competition agency improve its interactions with sector regulators, either through coordination in the case of overlapping jurisdictions or through competition advocacy in the case of only distantly related jurisdictions (Hilke 2006).

Since the 1980s, the Philippines has carried out economic reforms through liberalization, privatization, and economic deregulation, all of which were aimed at removing barriers to competition and promoting factor mobility and firm growth as well as securing both high and sustained economic growth and rapid poverty alleviation. Substantial trade liberalization and economic deregulation were carried out in various sectors of the economy including telecommunications, financial market, airlines, ports, shipping, water, and energy. For instance, to address the power crisis in 1992 and 1993, the power generation sector was opened up to private sector participation. The late 1990s also saw the concessioning of Manila's water supply and sanitation systems and the long-term leasing of Manila's container terminal facilities.

As the country engaged in privatizing what used to be natural monopolies and government-owned and operated facilities, new regulatory frameworks particularly for the utilities sectors were devised. The legislations covering the mandate and operations of sector regulators were amended to incorporate new regulatory functions to enable them to address problems of market failure and anticompetitive practices. In the new market-driven setting, sector regulators are required to act not only as regulator but also as competition body in their respective industries. In the past, sector regulators regulated only a private monopoly (for instance, PLDT in telecommunications and PAL in airlines) and a government corporation (NPC in electricity), but with the present reforms, regulators must confront new issues that would test their regulatory efficiency. These are hardly trivial tasks. Regulatory and competition capacities are not built overnight and would entail adequate training, accumulation of knowledge through trial and error, progressive narrowing of the information gap between the regulator and the regulated firms as well as the availability of technical, managerial, and administrative resources.

It is important to point out that the establishment and implementation of an effective regulatory system is complex and requires a learning process. The difficulty of establishing an effective regulatory regime is aggravated by our lack of regulatory tradition and track record in the effective use of public regulation in a market driven setting. This is also complicated by the numerous objectives that the government attempts to fulfill such ensuring competition, high revenues from privatization for fiscal reasons, ambitious investment demands, rapid expansion of basic services, and distributional factors in the pricing of services. Moreover, politicians may use regulation to advance their short-term political goals with inappropriate regard for efficiency or implications for investors as well as information asymmetries in costs and performance that may lead to regulatory capture and diminish credibility and overall welfare.

Regulatory practice in the Philippines has shown that whenever controversial issues arise, the regulatory agency usually adopts a hands-off policy and leaves the final decision to the President. This has made the President a powerful interventionist element in resolving conflicts and has made the President and not the regulatory agency as the final regulator. The intervention of the President has also compromised the regulatory agency's credibility and independence in making decisions. For as long as the President continues to mediate and broker controversies, the Presidency as an institution becomes subject to imminent "capture" (De Vera, M., 1997).

All these factors complicate the regulatory functions of sector regulators and may also slow down the process of implementing the reforms. Hence, greater reliance on competition and market signals is necessary to ease the tasks of sector regulators and at the same time, improve the existing regulatory mechanism by emphasizing principles of openness, transparency, and accountability as well as participatory mechanisms. It is within this context that the establishment of a competition authority becomes necessary. With a separate and independent competition agency, the problem of regulatory capture which has often characterized our institutions may be addressed.

Given that both competition and regulatory agencies have concurrent jurisdiction over competition law, the importance of coordination must underlie the framework for their interaction. Based on the different approaches discussed in the preceding section, the proposed framework would cover a combination of approaches (1) and (3) where technical and economic regulation would be combined in a sector regulator and leave competition enforcement exclusively in the hands of the competition authority. At the same time, a sector regulator is given competition law enforcement functions to be performed in coordination with the competition authority.

When competition agencies and sector regulators have overlapping jurisdictions, interaction between the agencies is inevitable. Concerns will arise if the agencies do not coordinate their decisions and processes because failure to do so will create regulatory risk for investors and increase compliance costs. Both can harm consumers by raising costs and prices. One way to coordinate the actions of the competition agency and sector regulators is by delineating their responsibilities and establishing arrangements for consultation and notification. This would require the setting of clear standards and compulsory rules to govern the interplay between the competition authority and other sector regulators.

Within the context of the current stages of policy and institutional development in the agencies, the proposed approach would be one that is based on cooperation with sector regulators taking the leading role in economic and technical issues (since this is their area of knowledge and expertise given their detailed familiarity of the industry) while the competition authority will be the lead in competition issues like abuse of dominance, anticompetitive agreements, cartels and merger review. However, no matter who the lead agency is, it is important that the two coordinate and consult with each other to ensure that the policies or remedial measures taken by one would not be against the mandate of the other. Competition functions such as assuring non-discriminatory access to essential networks and controlling other forms of anticompetitive conduct and merger review may also be shared with sector regulators. Hence, the legislations for both competition and legislation should mandate that the two agencies coordinate and confer with each other.

At the same time, the competition authority should be allowed to carry out a competition analysis while the sector regulator examines technical and economic issues. Technical regulators tend to approach the industry from an engineering perspective while economic regulators tend to take the industry from an accounting viewpoint. Since both economic and technical matters may have competition impact, inputs from the competition agency would be necessary with a view towards cooperation and joint resolution. Moreover, in instances where sector regulators are contemplating the introduction of policies that are inconsistent with competition law, there should be guidelines, legislations or sector regulations that would seek to incorporate the opinion of the competition authority before other possibly conflicting procedures or policies are introduced.

In the light of the current state of competition in certain sectors like ports and telecommunications, the competition agency should also adopt a more proactive approach to promote the development of regulatory policies that are coherent with healthy competition. In the ports sector, for instance, the highly centralized port ownership and administration along with

PPA's lack of independence and multiple roles as developer, operator, and regulator of ports have resulted in conflicting interests and undermined PPA's regulatory independence and credibility. With its weak incentive to promote competition, PPA has used its regulatory powers to protect its ports from competition. Together with lack of transparent, fair and competitive bidding process, all these have slowed down reform process and privatization in the sector. There is also a need to restructure the port system and separate PPA's regulatory responsibilities from its development and operations functions. Regulatory independence and a transparent and rules-based framework are essential to safeguard private participation (see Appendix II, PPA Case Study).

VI. Conclusions and Recommendations

The transition to a more open economy requires not only the rule of law but efficient institutions[6] that will support growth and institutional change. Markets and their development require rules to orient the behavior of agents and institutions. While the Philippines has done a lot of market-oriented reforms; much remains to be done in terms of creating efficient institutions that can successfully reduce transaction costs concerning contracts and property rights processes that take place in the market as well as changing the mindset of firm managers and the code of conduct of firms.

The new concept of the role of the state and especially of competition agencies highlights functions such as market arbitrator and promoter of a competition culture. In the light of the concurrent jurisdiction between the competition authority and sector regulators over the implementation of competition law, great care must be exercised in designing an appropriate competition and regulation framework. Given the current stages of policy and institutional development in the agencies, the following approach is proposed:

> Combine technical and economic regulation in a sector regulator and leave competition enforcement exclusively in the hands of the competition authority; the sector regulator may be given competition law enforcement functions to be performed in coordination with the competition authority.

The suggested approach would be based on cooperation with sector regulators taking the leading role in economic and technical issues while the competition authority will be the lead in competition issues like abuse of dominance, anticompetitive agreements, cartels and merger review. However, no matter who the lead agency is, it is important that the two coordinate and consult with each other to ensure that the policies or remedial measures taken by one would not be against the mandate of the other. Competition functions such as assuring non-discriminatory access to essential networks and controlling other forms of anticompetitive conduct and merger review may also be shared with sector regulators.

At the same time, the competition authority should be allowed to carry out a competition analysis while the sector regulator examines technical and economic issues. Since both economic and technical matters may have competition impact, inputs from the competition agency would be necessary with a view towards cooperation and joint resolution. Moreover, in instances where sector regulators are contemplating the introduction of policies that are inconsistent with

[6] Institutions may be formal (constitution, laws, regulations or administrative decisions) or informal (customs, usage, conventions, or code of conduct that are based on market economic agents' cultural factors and subjective preferences). Douglass North points out that institutions are society's game rules determining the set of parameters and restrictions that affect market agents' behavior. Institutions provide the infrastructure of laws and norms without which the market cannot operate.

competition law, there should be guidelines, legislations or sector regulations that would seek to incorporate the opinion of the competition authority before other possibly conflicting procedures or policies are introduced. In the light of the current state of competition in certain sectors like ports and telecommunications, the competition agency should also adopt a more proactive approach to promote the development of regulatory policies that are coherent with healthy competition.

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Appendix 1: Competition Bills

Proposed bill	Authors	Description	Year filed
HB 1373	Gerardo Espina	creation of fair trade commission which can adjudicate violations & conduct formal investigations, it can issue restraining orders, writs of execution, cease & desist orders	11th Congress
HB 4455	Neptali Gonzales II & Manuel Roxas II	creation of fair trade commission, no adjudicatory powers to issue writs, cease & desist order or seizure of products	11th Congress
HB 3780	Feliciano Belmonte Jr., Jack Enrile & Oscar Moreno	monopolization of trade, more detailed provisions on various anti trust activities	11th Congress
HB 183	Rolando Briones	an act penalizing unfair trade practices & combinations in restraint of trade, creating the fair trade commission, appropriating funds therefore	11th Congress
HB 5281	Monfort & Parcon	an act creating a special body that shall regulate & exercise authority over monopolistic practices, combinations in restraint of trade & unfair competition	11th Congress
HB 271	Roilo Golez	provides for anti trust penalties	11th Congress
SB 150	Sergio Osmena III	creation of a fair trade commission & regulation of various anti-competitive practices	11th Congress
SB 1792	Juan Ponce Enrile	same as Belmonte House Bill, strengthens penal provisions prohibiting monopolies & combinations in restraint of trade leaves antitrust enforcement to Courts & DOJ, DTI, & DA	11th Congress
SB 488	Blas Ople	an act incerasing penalty for illegal act of price manipulation committed by a cartel, amending RA 7581 Price Act	11th Congress
SB 889	Sergio Osmena III	an act to strengthen prohibition against monopolies & cartels of basic necessities or prime commodities, amneding RA 7581 Price Act	11th Congress
HB 1906		an act declaring unfair trade practices as acts of economic sabatoge, it declares the fflg as acts of economic sabatoge & provides criminal sanctions: smuggling, technical smuggling, misclassification of importation, dumping, & other forms of unfair trade practices	11th Congress
HB 198		an act creating a special body that shall regulate & exercise authority over monopolistic practices, combinations in restraint of trade & unfair competition	11th Congress
HB 2439		an act penalizing unfair trade practices & combinations in restraint of trade, creating the fair trade commission, appropriating funds therefore	11th Congress
SB 1600	Panfilo Lacson	does not create an independent commission, provides for anti trust penalties including imprisonment	12th Congress
SB 1361		an act providing for effective implementation of the Constitutional mandate against monopolies, combination in restraint of trade & unfair competition by redefining & strengthening existing laws, processes & structure regulating the same	12th Congress

SB 175		an act creating the fair trade commission, prescribing its powers & functions in regulating trade, competition, & monopolies	12th Congress
HB 116	Joey Salceda	an act creating the Philippine competition commission, regualting & penalizing trade practices that lessen compatition & other anti-competitive practices & conduct, unlawful mergers, acquisitions & combinations in restraint of trade, unfair competition & appropriating funds therefore	13th Congress
HB 1874	Jose De Venecia	an act prescribing a fair competition law, its enforcement, establishment of a fair tarde commission, delineating its powers & functions	13th Congress
HB 2958	Edgar Valdez	an act prohibiting monopolies, attempt to monopolize an industry or line of commerce, manipulation of prices of commodities, asset acquisition & interlocking memberships in the Board of Directors of competing corporate bodies & price discrimination among customers	13th Congress
HB 3139	Juan Ponce Enrile, Jr.	an act prohibiting monopolies, attempt to monopolize an industry or line of commerce, manipulation of prices of commodities, asset acquisition & interlocking memberships in the Board of Directors of competing corporate bodies & price discrimination among customers	13th Congress
SB 150	Sergio Osmena III	An act creating the fair trade commission prescribing its powers & functions in regulating trade competition & monopolies	13th Congress
SB 1600	Panfilo Lacson	The anti-trusr act of 2001 or an act prohibiting monopolies, attempt to monopolize an industry or line of commerce, manipulation of prices of commodities, asset acquisition & interlocking memberships in the Board of Directors of competing corporate bodies & price discrimination among customers	13th Congress
SB 1792	Juan Ponce Enrile	an act prohibiting monopolies, attempt to monopolize an industry or line of commerce, manipulation of prices of commodities, asset acquisition & interlocking memberships in the Board of Directors of competing corporate bodies & price discrimination among customers	13th Congress
SB 1122	Defensor-Santiago	amends Revised Penal Code (RA3815), Art. 186 on monopolies & combinations in restraint of trade by providing for treble damage action	13th Congress
SB 3197	Enrile, Santiago, Trillanes IV, Roxas & Angara	An act penalizing unfair trade & anti-competitive practices in restraint of trade, unfair competition, abuse of dominant power, strengthening the powers of regulatory authorities & appropriating funds therefore	14th Congress
SB 123	Enrile	penalizes combinations or conspiracies in restraint of trade & all forms of artificial machinations that will destroy, injure or prevent free market competition	14th Congress
SB 3099	Miriam Defensor-Santiago	An act prohibiting anti-competitive practices & creating the competition regulatory commission	14th Congress
HB 3856	Junie Cua	creation of Philippine Fair Trade Commission to investigate, gather evidence, & initiate prosecution of those engaged in unfair trade practices	14th Congress

HB 3009	Rufus Rodriguez		14th Congress
HB 1678	Jose De Venecia, Jr.	Fair Competition Law of the Philippines	14th Congress
HB 913	Susan Yap	An act penalizing unfair trade & anti-competitive practices in restraint of trade, unfair competition, abuse of dominant power, strengthening the powers of regulatory authorities & appropriating funds therefore	15th Congress
HB 1007	Antonio Alvarez	An act penalizing unfair trade & anti-competitive practices in restraint of trade, unfair competition, abuse of dominant power, strengthening the powers of regulatory authorities & appropriating funds therefore	15th Congress
HB 1583	Gloria Macapagal-Arroyo & Diosdado Arroyo	An act penalizing unfair trade & anti-competitive practices in restraint of trade, unfair competition, abuse of dominant power, strengthening the powers of regulatory authorities & appropriating funds therefore	15th Congress
HB 3100	Albert Garcia, Raymond Sandejas	An act penalizing unfair trade & anti-competitive practices in restraint of trade, unfair competition, abuse of dominant power, strengthening the powers of regulatory authorities & appropriating funds therefore	15th Congress
HB 3134	Alfredo Benitez	An act penalizing unfair trade & anti-competitive practices in restraint of trade, unfair competition, abuse of dominant power, strengthening the powers of regulatory authorities & appropriating funds therefore	15th Congress
HB 4835	Ponce-Enrile,Yap, Alvarez, Apacible, Arroyo, Macapagal-Arroyo, Teodoro, Rodriguez, Garcia, Benitez, Aumentado, et al	An act penalizing anti-competitive agreements, abuse of dominant position, & anticompetitive mergers, establsihing the Philippine Fair Competition Commission & appropriating funds therefor	15th Congress
SB 3109	Teofisto Guingona III	An act to implement the the competition policy under the Constitution, strengthen the prohibition against abuse of monopoly power or dominant position, prevent cartels, combinations in restraint of trade & other anticompetitive practices & conduct	15th Congress
SB 3098	Enrile, Trillanes, Recto, Osmena III, Santiago & Villar	An act penalizing anti-competitive conduct, abuse of dominance, & anti-competitive mergers, establishing for the purpose an office for competition under the Department of Justice, appropriating funds therefore	15th Congress

Appendix II: On the Need to Separate Development Functions from Regulatory Functions Case of the Philippine Ports Authority

The Philippine Ports Authority (PPA) is the main developer, operator, and regulator of ports. PPA develops, owns, maintains, and regulates its ports. It issues permit to construct and operate the port and sets and collects port charges such as wharfage dues, berthing/usage fees, and terminal handling costs. It also approves increases in cargo handling rates and receives 10 and 20% from cargo handling revenues on domestic and foreign cargo, respectively. It is responsible for awarding contracts to private terminal and cargo handling operators and sets the rates under such concessions. It derives revenues from concession fees from the lease of its ports, port charges like wharfage, berthing, etc., and a share of cargo handling revenues from private cargo handling operators and port charges from privately operated ports. It remits 50% of its net income as dividends to the government.

PPA supervises 115-owned ports and regulates over 500 private ports. The three main common-user ports in Manila are the Manila International Container Terminal (MICT), South Harbor, and North Harbor. Under a "landlord system"[7], these ports are supervised by the PPA and privately operated under long-term concessions. The MICT contract was awarded to the International Container Terminal Services Inc. (ICTSI, led by the Razon family) while terminal operations of the South Harbor was awarded to Asian Terminals Inc. (ATI, owned by Dubai Ports Worlwide after it acquired P&O). Recently, the consortium of Metro Pacific Investments Corp (MPIC, led by Manuel Pangilinan) and HCPT was awarded a 25-year contract to modernize and operate the North Harbor.

The Harbour Center Port Terminal (HCPT led by the Romero family) is the most important private port. In 1996, PPA allowed RII Builders to construct a private port facility, although it was only in June 2002 that its permit to operate and handle all types of domestic vessels and cargoes and foreign break-bulk cargoes was issued. HCPT competes with PPA-owned ports South Harbor and North Harbor (the largest domestic cargo port, does not provide international port services). North Harbor, South Harbor and HCPT compete for domestic cargoes, whether break- bulk or containerized while South Harbor and HCPT compete for foreign break-bulk cargoes. ICTSI is not actively competing in this market and focuses on the foreign containerized cargo market. Only MICT and South Harbor compete for foreign containerized cargoes. Though HCPT has the capacity to compete in this market, PPA has not yet issued its permit to operate despite fulfilling all the necessary requirements (Llanto et al 2005).

Privatization in the ports sector started in 1988 with the awarding of the MICT contract to ICTSI. ICTSI was also awarded a container port contract at Subic in 1996 and subsequently at the Mindanao International Container Terminal in 2008. Though some considered MICT's privatization as successful due to the large revenues that it generated for PPA, the cost of shipping containers internationally and domestically has remained high. Based on the competitiveness ranking of the World Economic Forum on the quality of port infrastructure, the Philippines ranked 112th out of 133 countries surveyed indicating the lack of competitiveness of Philippine ports. Competition has been weak particularly in international port handling services where only two players, ICTSI and ATI, dominate. Given its conflicting roles, PPA has been susceptible to regulatory capture (Basilio 2003). As such, port operations have been uncompetitive. Apart from lack of transparent, fair and competitive bidding process, constitutional restriction on foreign equity has also slowed privatization in the sector.

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[7] Under this model, the infrastructure is owned by the port authority and is leased to the private sector. The port authority acts largely as regulator or landlord, the private sector carries out all port operations.

The highly centralized port ownership and administration along with PPA's lack of independence and multiple roles as developer, operator, and regulator of ports have resulted in conflicting interests and undermined PPA's regulatory independence and credibility. With its weak incentive to promote competition, PPA has used its regulatory powers to protect its ports from competition. This has disadvantaged non-PPA-owned ports and explains why competition in foreign containerized cargoes between Harbor Centre and PPA-owned ports, MICT and South Harbor, has been limited. Competition has also not been allowed in cargo handling services. The six cargo handlers in North Harbor can operate only in specific piers dedicated to specific shipping lines (Llanto et al 2005). Transparent and competitive bidding procedures for granting or extending cargo handling contracts are also absent. Moreover, since PPA approves rate increases for port charges and cargo handling in both public and private ports, any rate increase implies increases in its revenue share. This is another conflict of interest where PPA benefits from its own regulation.

With the current regulatory and institutional framework of the ports sector in the Philippines, competition has been weak and regulation difficult. This has led to inefficiencies and lack of investment in domestic and international maritime transport, increased business costs and reduced the country's overall competitiveness. To improve efficiency and competitiveness, the regulatory and legal barriers to competition and investment in the sector must be addressed. In particular, the sector needs substantial regulatory reforms to promote fair competition:

- To level the playing field and ensure fair competition for both domestic and foreign investors, there is a need to separate PPA's regulatory responsibilities from its development and operations functions. This would require an amendment of PPA's charter through Congressional action.
- Regulatory independence and a transparent and rules-based framework are essential to safeguard private (both domestic and foreign) participation. Shifting to a regulator role would entail the development of new skills, institutional capacities and practices including regulating unfair or anticompetitive practices, designing and negotiating contracts with private providers of port services, monitoring performance and enforcing compliance with general standards.
- A restructuring of the port system is suggested taking the following into account:
    - Lease PPA port facilities to operators instead of collecting a percentage of their revenues to remove the economic incentive for PPA to increase cargo handling rates (case of the regulator benefitting from its own regulation).
    - Formulate transparent, fair and competitive rules and guidelines for the grant or extension of cargo handling contracts and bidding process for port privatization.
    - Allow more competition in foreign containerized cargo operations and cargo handling.
    - Allow more foreign participation in port services by relaxing the 60-40% rule.
    - Further expansion of the RRTS e.g. prime mover trucks (Chassis RORO) must be allowed to roll on and off with loads attached.

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