

Understanding the principles underlying the Philippine competition law

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After two decades of failed attempts to pass a competition bill in the Congress, the enactment of the Philippine Competition Act (Republic Act No. 10667) under the Aquino III administration in 2015 became a breakthrough legislation intended to promote free and fair competition in economic activities. Its objective is more or less standard and universal, which is to “safeguard, protect, and promote competition and the competitive process.” Its rationale is the same, which is to optimize overall welfare by promoting efficiency through good resource allocation and yielding right prices¹ of goods and services, with highest feasible quality and variety of products. However, its passage is only the first step toward creating a working competition policy regime and a fairly competitive environment.

The benefits from competition are well understood. Under a competitive market, the rivalry among firms (actual or potential) can

force them to produce the best quality of products at the least cost and sell at the price dictated by the market. Otherwise, they would lose their market share to their competitors. (See Box 1 for simple graphic illustration.) As a result, individual firms have no market power in a competitive setting. Their only recourse is to be more innovative to keep or grow their market share.

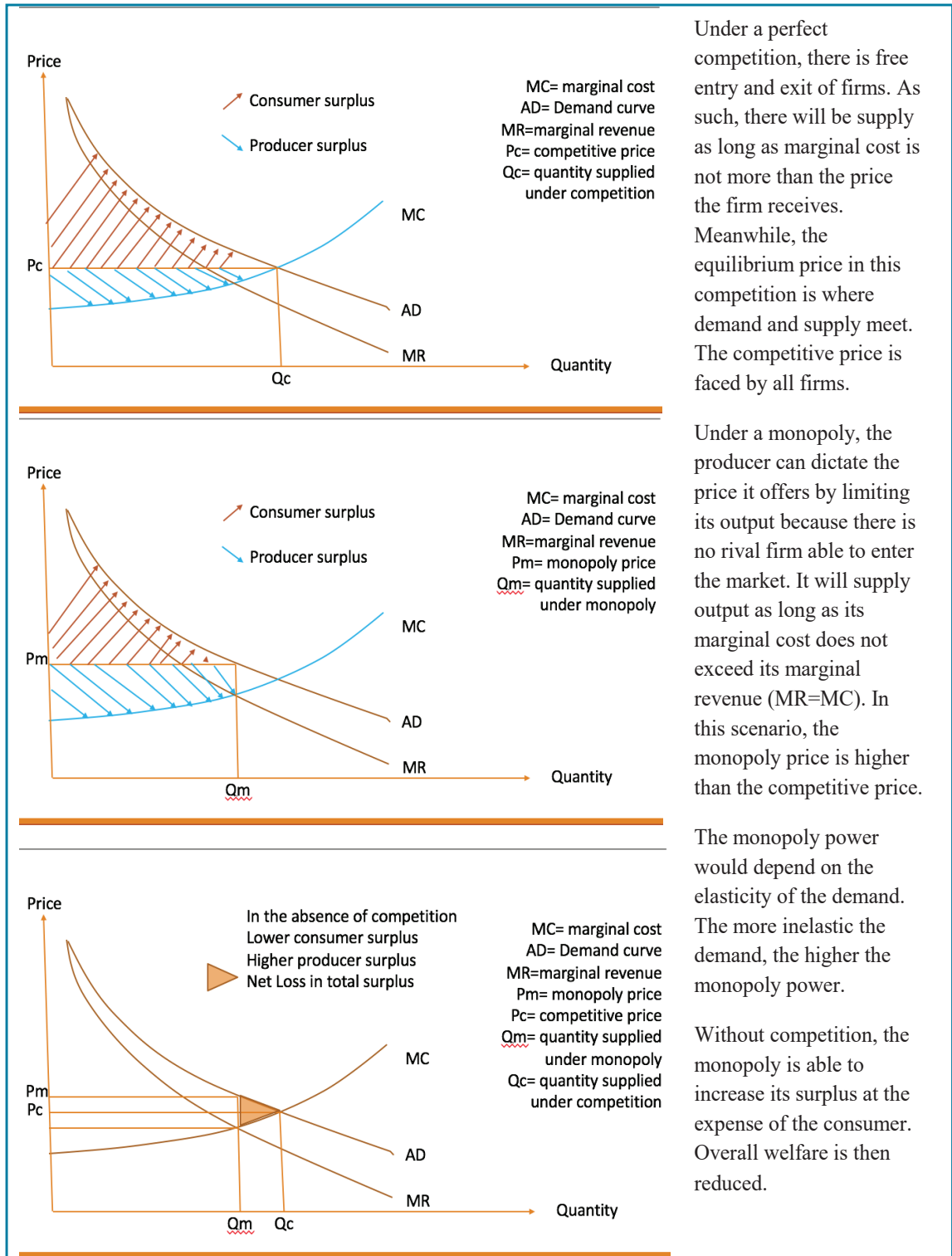
Thus, on top of the immediate benefits of competition on efficiency and consumer welfare are the dynamic gains from innovation that it fosters. The culture of competition cultivates flexibility and adaptability that enable the economy to cope better with a constantly changing environment.

¹ They refer to competitive prices which are free of excess profits.

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Box 1. Simplified graphic illustration of the impacts of and benefits from competition



Under a perfect competition, there is free entry and exit of firms. As such, there will be supply as long as marginal cost is not more than the price the firm receives. Meanwhile, the equilibrium price in this competition is where demand and supply meet. The competitive price is faced by all firms.

Under a monopoly, the producer can dictate the price it offers by limiting its output because there is no rival firm able to enter the market. It will supply output as long as its marginal cost does not exceed its marginal revenue (MR=MC). In this scenario, the monopoly price is higher than the competitive price.

The monopoly power would depend on the elasticity of the demand. The more inelastic the demand, the higher the monopoly power.

Without competition, the monopoly is able to increase its surplus at the expense of the consumer. Overall welfare is then reduced.

Source: Author's illustration

Finally, it is worth noting that by eliminating or reducing the market power of a few dominant firms, the competition law is inherently a predistribution² policy that advances equity. It prevents monopoly rents that accrue to big business, and reduces the bias against SMEs.

Unfortunately, competition, or even just effective competition³ is not inherent in a market economy. Anticompetitive outcomes may arise from various reasons and factors. The major reason is barriers to entry (and exit)⁴ of firms, which can be structural, firm behavior, or government policy induced.⁵ Barriers to entry bestow market power to the incumbent firm/s to dictate the level of output and price in the market. There is no need for a large number of rival firms. What is crucial is to have open entry and exit of firms that make the market contestable. Rivals could be actual or potential, limiting their market power and pushing them to produce products and services at optimum quality, quantity, and price. Toward this end, what is needed is an effective policy that ensures fair competition. This is what would “safeguard, protect, and promote competition and the competitive process”.

However, the theoretical discussion about what constitutes fair competition or the lack of it can be complicated. A lot depends on the nature and structure of the industry, the intricacies of the supply chain, the activities of relevant markets, and the effects of government policies, which produce the gray areas and unclear implications on the state of competition in particular

markets. In the end, competition policy is essentially about making sure firms play *fair*.

Making sure firms play fair

In general, *fair* means the competition policy should prevent firms from obtaining inequitable market power by excluding others from playing.⁶ Understanding why such behavior should not be allowed is intuitive. But, how about *unfair*? How can we say a firm’s conduct is unfair?

At first glance, unfair would appear subjective. Indeed, this is a case where it becomes a challenge to find a language to succinctly capture the concept and objectives of competition. However, defining what is unfair is not as subjective as it seems when we look instead at what it is not. According to the competition law, the only fair way for a firm to secure a dominant position is by being more efficient than its competitors.⁷

There are several means on how firms erect barriers to entry. A well-known example is predatory pricing. This happens when a firm deliberately (temporarily) underprices its

² This is in contrast with income distribution or redistribution policies, which aim to redistribute incomes from rich to poor sectors. Competition policy, at the outset, equalizes opportunities across firm sizes and incomes.

³ As opposed to pure or perfect competition where there are no barriers at all to entry of rival firms. See relevant discussion that follows.

⁴ A barrier to exit is effectively also a barrier to entry.

⁵ This will be expounded on in the succeeding discussion.

⁶ This uncompetitive market behavior is also referred to as exclusionary abuse.

⁷ The presumption here is that there are no barriers to entry. The market is contestable.

product to prevent a potential firm trying to enter the market to compete at such an artificially low price (below cost). However, such behavior rarely happens because it requires the maintenance of excess capacity over an extended period of time, which can be very costly.

Perhaps a more evident example of exclusionary behavior is *refusal to deal*. In general, firms have the right to choose who to conduct business with. However, the competition law prohibits firms from excluding some parties and limiting their business to those in a conspiracy for the purpose of controlling or leveraging the market. In the process, the excluded firms may be cut off from the supply of intermediate inputs, raw materials, facilities, or markets. This vertical refusal to deal may increase their costs and push them out of the market eventually.

Vertical refusal to deal can also happen when a firm refuses to do business with another firm, customer, or supplier (e.g., sells its output or buys certain inputs from them) unless they comply with certain conditions, such as the termination of business with another competitor. This exercise of market power allows

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firms to extract excess profits and maintain and/or reinforce its market dominance, resulting to weakened competitive process.

Of course, there are legitimate reasons for the refusal, such as unethical practices of the shunned party, or as a result of the competitive process itself. Hence, it remains a matter of fairness. The guiding principle is that the refusal to deal is not born out of a conspiracy.

This behavior can also be horizontal, or when there is a consensus among rival firms not to compete. Often understood as cartel agreement, the parties set a price higher than what would have been if they competed against each other. It can also happen when they divide the market among themselves into their own exclusive market segment, enabling them to sell at higher prices and possibly at lower quality.

Note that firms exercising these abuses would likely be incumbent monopolies already, or with dominant market positions trying to maintain or enhance their market dominance. In the earlier examples of vertical refusal to deal, there is a single dominant firm involved. In the case of the horizontal, the anticompetitive behavior is a cartel agreement among firms that bond together to secure and ensure their dominant position.

In many cases, there are sectors with market concentration and firms already enjoying dominant market position, whether as a result of efficient market allocation process, structural barriers, behavioral barriers



To create a fairly competitive environment in the Philippines, this study recommends the enforcement of competition rules, such as in providing access to essential facilities like transmission and in allocating frequencies in telecommunications (Photo by: Alexander Synaptic / Flickr).

described above, or government policies. In such cases, the task of competition law is to prevent such firms from actually abusing the market power and controlling prices and manipulating outputs.⁸

When a firm has market power because of its dominant position, it is able to affect the selling price of its output by controlling how much it supplies the market. The usual results are higher prices, possible lower quality and quantity of goods and services available to the consumers, and/or excess profits or monopoly rent, which the competition law should prevent (Box 1).

The competition law should then define what are considered anticompetitive acts

accordingly. Having clear and transparent provisions on prohibited acts can level the playing field and, hopefully, prevent firms from committing errant behaviors.

Once a firm has obtained dominant position, it is more difficult for the competition law to police its anticompetitive behavior. A preemptive measure is to have rules on mergers and acquisitions (M&A), assess the firm's possible anticompetitive behaviors, and make sure that the dominant position created by M&A produces efficiency or welfare gains. This is akin to preventing exclusionary abuse by rejecting M&As that unjustifiably limit competition. Hence, in addition to provisions

⁸ This can be referred to as exploitative abuse.

on prohibited anticompetitive acts, another major provision of competition law is the set of rules on approving M&A.

Therefore, the core functions of competition law include preventing firms from unfairly obtaining market power, barring them from actually abusing it, and setting rules for M&A, which is more of a preemptive measure.

The promotion of competition does not necessarily require imposition of sanctions but implementation of measures to make markets more contestable. This could be done by identifying the barriers to entry, such as those erected by unnecessary government regulations, and, if possible, removing them to allow more players to enter the market. In some cases, promoting competition only requires making relevant information about other players and their products available to the consuming public.

In general, however, genuine competition requires the presence of a good competition

⁹ Production and consumption outcomes that would have resulted in a competitive environment.

law that lays down the legal bases to discipline anticompetitive behaviors of firms.

When more needs to be done to assist the market

Sometimes, more needs to be done to assist the market in obtaining competitive outcomes⁹ because of the inherent structure of the industry, as in the case of the natural monopolies. Aside from prohibiting anticompetitive acts, competition law should do more to assist the market to mimic competition and obtain similar desired outcomes.

For natural monopolies, enforcing competition rules (regulation) to produce competitive-like outcomes is necessary, such as in providing access to essential facilities like transmission lines in the case of power and electricity, allocating frequencies in telecommunications, mandating interconnection among telecommunication companies, unbundling services, and opening up segments that are no longer natural monopolies. Indeed, regulatory reforms that promote competition have the most pervasive benefits because they affect public utilities.

In sum, a comprehensive competition law has two major aspects, which are promotion of competition and, where necessary, good regulation to assist the market to produce competitive outcomes. In addition, it should be able to review existing and proposed government policies and regulations, whose repeal or revision can be the appropriate action and solution to ensure market competition. 📄

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