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Surian sa mga Pag-aaral Pangkaunlaran ng Pilipinas

Interface Between Competition Policy and Infrastructure Regulation in the Philippines

Erlinda M. Medalla

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Interface between Competition Policy and Infrastructure Regulation in the Philippines

Abstract

This short paper attempts to lay down the framework and basic principles for the optimum interface between competition policy and infrastructure regulation. Competition policy should address exclusionary and exploitative acts and discipline firms when such acts are committed. In certain cases, more may be required by way of additional competition rules needed to assist the market and substitute for lack of a competitive process of allocation. This is where competition policy in the form of direct regulation comes in. This is usually where market power is inherent (in the structure), specifically the case of infrastructure sectors. The basic issues relate to: tendency for "overregulation," problems with price regulation, privatization, unbundling, regulatory capture, and multiple objectives. The paper also highlights the findings from past studies on three major infrastructure/utilities sectors, namely power, shipping and telecommunications. For all these sectors, there have been significant attempts to enhance competition, mainly in terms of relaxing entry regulation and some effort at deregulating prices and privatization. It was not surprising to find difficulties in dealing with the trade-offs between social objectives, principally equity and access, and competition (efficiency) objectives.

Keywords: competition and regulation interface, competition policy framework, infrastructure regulation

Interface between Competition Policy and Infrastructure Regulation in the Philippines

Part 1. Overview and Principles

Erlinda Medalla

Introduction

- ***Poor infrastructure: a major constraint in Philippine competitiveness and growth***

Poor infrastructure has long been identified as a bottleneck and major constraint in fostering Philippine competitiveness and growth. Its dampening effect on productivity cannot be overemphasized. As such, any research project examining policies to enhance productivity would need to contend with the infrastructure problem. To be sure, deregulation policies in the past have been aimed at addressing this concern. Nonetheless the need for more analysis in the area remains critical. Specifically, with success still being limited in the deregulation of major utilities, there is a growing realization of the need to look more closely at the interface between competition and infrastructure regulation. It is primarily against this backdrop that the third major study under the joint PIDS-WB project on *Policies to Promote Competition in the Philippines to Enhance Productivity and Competitiveness* is being carried out.

- ***Need to look more closely at the interface between competition and infrastructure regulation***

This study component on the interface between competition policy and infrastructure regulation has two parts. Part 1 aims to provide the framework and basic principles for the optimum interface between competition policy and infrastructure regulation. It will also highlight the findings from past studies within this context. How well does the regulatory framework incorporate competition policy objectives? How much has the regulatory reform enabled operational efficiency and competitive provisions, given the need to accommodate at the same time other social objectives? With these questions in the background, Part 2 focuses on selected major infrastructure sectors: power, telecommunications and shipping. It aims to review and evaluate in more detail the regulatory framework that has been established and/or suggested for the Philippines, and determine the nature, extent and sufficiency of the competition-related provisions of the regulatory framework for these sectors.

This short paper in particular covers Part 1 of the study. It has two main sections. The first provides an overview of the competition policy framework and the role of regulation. The other section briefly looks at some major findings from past studies on

infrastructure regulations to shed light on the problems and constraints that need to be addressed.

Brief overview of the competition policy framework: the role of regulation

- ***Link between competition and efficiency: competition an efficient regulator***

The link between competition and efficiency is well founded. In general, competition is expected to yield optimum welfare, acting like *Invisible Hands* (as postulated by Adam Smith) in leading resources to go where they would produce best results. With competition, the seller or firm must make sure that he produces the best quality of product at least cost and sell his product at the price dictated by the market. Otherwise, he loses his clientele and his market share to some other seller or firms who could do better. At the same time, allocative efficiency is encouraged because producers and investors receive the correct market price signals which help to direct investments to where there are highest returns. Hence, "competition forces" discipline and regulate the market, limiting the market power of any individual or group of individuals, and inducing production and consumption at optimal levels and at least costs.

By and large, where present, market competition is an efficient regulator, helping to allocate resources efficiently and maximize consumer welfare. In reality, most industries would not completely possess the characteristics of a perfectly competitive market.[1] Nevertheless, in practice, there need not be perfect competition for the benefits to be realized. In general, the presence of "effective" competition that could threaten the firm - a viable, actual or potential rival, that is, a contestable market would be enough. The problem is there are cases when there could be serious deviations from a fairly competitive market setting, *e.g.*, where there are inherent structural factors and/or deliberate anti-competitive firm behavior. In these cases, market power could be abused, leading to sub-optimal outputs and high prices (usually hand in hand with low quality and limited choices of products and services).

- ***Competition policy impacting directly on productivity and competitiveness***

It is thus not difficult to comprehend why a policy that **safeguards and promotes competition and the competitive process** bears directly on productivity and competitiveness. Exclusionary and exploitative acts of dominant firms would raise costs (and competitiveness) of downstream industries or raise consumer prices, above the real opportunity (social) costs. Competition policy would act to limit such abuses of market power, leading in general to greater efficiency and competitiveness.

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[1] The main characteristic is the existence of many firms and/or open entry and exit of firms.

- ***A bona fide competition policy should be able to address exclusionary and exploitative acts and discipline firms when such acts are committed. In certain cases, market power is inherent (in the structure), more may be required by way of additional competition rules (regulation).***

At the same time, neither is competition an end in itself, as there are times when the market could fail completely and competition *per se* (or market contestability) would not lead to efficient resource allocation. For example, some essential facilities are natural monopolies, and duplication would be unviable and wasteful. In such cases, "competition rules" (or regulation) on access to such facility and at what price are necessary to reach optimum levels of related consumption and production. Thus, ideally, the government should promote competition when the market can fulfill its role as an effective regulator, and step in as a regulator when it cannot.[2]

This, in essence, is the role of competition policy. Its primary task is two-fold: (1) to make sure that no entity would have market power it can abuse, and (2) where necessary, to implement competition rules to assist the market when it fails to perform its price-allocation function. In most instances, the most effective competition measure may simply be to make the market more contestable (*e.g.*, by removing barriers to entry of new firms). However, a bona fide competition policy should be able to address exclusionary and exploitative acts and discipline firms when such acts are committed. And in certain cases, more may be required by way of additional competition rules needed to assist the market and substitute for lack of a competitive process of allocation. This is usually where market power is inherent (in the structure), especially the case of natural monopolies. This is where competition policy in the form of direct regulation comes in.

To reiterate, ideally, the government should promote competition when the market can fulfill its role as an effective regulator, and step in as a regulator when it cannot. In other words, an ideal regulation is pro-competitive, the other side of competition policy. That is, it is there (generally in the case for major infrastructure sectors) to compensate for the market's lack and to help mimic a competitive market.

- ***Need to review regulation from the perspective of competition policy***

But of course, the problem is that in practice, regulation becomes something more, intended to address other social objectives which may be essential but could have harmful anti-competitive effects. As such, it becomes doubtful whether it really serves national welfare on the whole and its stated objectives in particular. Especially considering the power that the regulator has, and the (monopoly) rights given the firm allowed entry, there is a need to re-evaluate these regulations and determine whether they could pass a "competition" test or, if not, if they could be justified on grounds of public welfare, in general, or of the objectives they are supposed to achieve, in particular.

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[2] Moreover, the government might have other social (and development) objectives for which, most likely, the market left to itself would not provide. These should be taken into account. Ultimately, the goal is to increase welfare.

A lot depends on how the regulation is actually applied, and how necessary the regulatory measures used are. In this regard, there are a number of issues that have to be addressed.

- ***Tendency for the regulator to "over-regulate"***

First, there is a tendency for the regulation to cover a greater portion of the industry than necessary (breadth) and for the regulator to "over-regulate" (depth). Is there a rationale for the regulation in the first place? And if there is, how much of the industry could be deregulated, and/or how much of the regulation can be relaxed? Are there elements/activities in the industry covered by the regulation which should be made subject to competition? (This is related to the issue below on unbundling services.) If any of these possibilities is true, the cost of the regulation could be very high. Indeed, especially after the era of controls under the Marcos regime, there was increased realization of these costs of regulation and this spurred the policy thrust towards deregulation in the concerned industries. Deregulation has mainly been done by easing entry into the industry and allowing more players to come in. The benefits of deregulation are still being felt—in shipping, domestic air travel, and telecommunications in particular. Nonetheless, a lot more could probably still be done.

- ***Basic regulatory instruments: entry and price regulations***

Second, there are issues in the entry and price regulatory measures that may be used. For natural monopolies, duplication is costly and wasteful. Hence, regulation in terms of entry restriction seems justified. However, the "legitimate" monopolist would then be in the position to abuse his market power. He would be able to extract rents and produce below the level that maximizes welfare. Hence, some form of price regulation seems the rational policy, and in implementing such policy, two major regulatory instruments appear to be needed: entry and price regulations. However, there are more complicated issues involved than simple entry and price regulation problems.

- ***Issues in price regulations***

At the outset, price fixing appears to be a logical policy handle of the regulator. Where competition as market regulator fails, the ultimate impact is on prices and it seems reasonable that this is where the regulator takes over. Price fixing is also very politically appealing. However, as often experienced in many countries, government price fixing often creates more problems than it solves. A major reason is information problem. It is difficult to predict demand and supply. Data on costs are likewise difficult to come by. Nonetheless, where price regulation is necessary, the need for transparency and predictability of regulation cannot be overemphasized.

In addition, if the firm is vertically integrated, it could refuse access and exclude competitors in downstream industries. Thus, more than price regulation is needed. An anti-trust enforcement is required, which should not be different than that applicable to other firms, sectors, or industries. In other words, a necessary complement to the regulation of monopolies is a universal anti-trust law that governs unjustified restrictive business practices, for whatever kind of business. This means formulating competition

law that is based on public interest and allows for concentrations and monopolies for pro-competitive efficiency objectives. A working universal/national competition law should ideally be tasked with possible abuse of market power, whatever sector is involved. However, the problem arises because of other objectives that need to be addressed. We go back to this point later.

- ***Unbundling services***

Third, it is also important to examine more closely the presumption that the major utilities covered by regulation (power, telecommunications and transportation) are natural monopolies. Global trends in the industrial organization of these utilities suggest that they are not as "natural" a monopoly as they used to be or thought to be. Possibly the only segments that are real natural monopolies are in the provision of the "local loop" in the fixed line telecommunications, international ports in the transport industry, and transmission in the power sector. Of course, in the developing country setting beset by low technology and imperfect capital market, there would be more segments that could be considered as natural monopolies. With an imperfect capital market, particularly for investments with huge capital requirements and long gestation period, and with a limited domestic market, it becomes even more costly to duplicate investments. As such, monopoly becomes "more natural." Nonetheless, unbundling the services to separate segments that should be subject to greater competition is an important competition policy provision that should be included in infrastructure regulation.

However, even if indeed certain products/services can be identified as not displaying natural monopoly characteristics and can be separated, there would remain the possibility that regulated companies have extended operations into otherwise unregulated areas, e.g., via tied selling. As such, unbundling provisions would not be enough and might have limited impact on competition/extracted rents. Hopefully, there would be an effective anti-trust law which could deal with such anti-competitive business behavior.

- ***"Regulatory risks" in rate of return regulation***

The cap on rates of return is another regulatory measure used. This is usually not just as an alternative to, but on top of, user price fixing. Presumably, it is much easier to manage and determine. However, if government wants investments to happen, it should not put limits on how much the firm can earn, certainly not at an unreasonably low nominal rate of return of 12 percent which is not even enough to cover interest costs. It creates, for prospective investors, "regulatory risks" on top of the commercial risks they already have to face. (If the firm makes money, it runs the risk of losing it because of the regulation.) Moreover, to a large extent, the regulation only encourages cheating and effectively forces out of the market honest new players.

- ***Privatization and competition provisions***

Another issue to look at is privatization. Most of the natural monopolies are, or used to be, public monopolies. Privatization has been part of the reforms undertaken during the past decade. While it is competition, not ownership *per se* which is the driver of efficiency, there is a perception, especially in the Philippine experience, that publicly owned and run corporations are less efficient than private enterprises. This is due to a

number of factors. First is the hiring and firing scheme which is constrained by civil service regulations that make it extremely difficult to fire and hire employees. The second factor is the incentive and compensation structure. Third is lack of accountability. These factors, among others, deprive the public enterprise of the usual motivation for profit maximization as is present in private firms.

However, transfer of ownership alone would not ensure increased efficiency if the necessary conditions for a competitive market are not set forth beforehand. Indeed, it may only transfer rents. The problem may not be whether to transfer ownership or not but rather how the competition process and discipline could be introduced. If there would be transfer of ownership, all unnecessary advantages previously enjoyed by the firm should be removed. These issues need to be examined further in the reforms of public enterprises.

- ***The risk of regulatory capture***

Then, there arises a problem common to all regulations--the regulator could become subject to "capture" (Stigler 1968). The regulator could become beholden to the incumbent firm and would serve to protect the "competitor" rather than the competitive process. A review of the regulation should determine if and to what extent there is such regulatory capture. Perhaps, the task of regulation could, in reality, even be in the hands of the monopolist. What safeguards need to be put in place to preclude this from happening?

- ***Problem of multiple objectives: need to separate competition concerns from other objectives; implications on the relationship between sector regulator and a "national" competition body***

Finally, the regulation would often have various objectives other than competition, including safety and standard regulations, equity and access, and even sector development. Pricing regulation for monopoly regulation is complex enough. Mixing it with equity objectives complicates it even more, such that it becomes unclear how the objectives are being met. A case in point is the policy of cross-subsidization, which complicates even further the problem of price fixing. There is a need to re-evaluate the costs and benefits of cross-subsidization. This has been used as a reason for limiting entry (to prevent new entrants from "skimming off the top"). In the first place, it is very difficult to set the right prices and the cost of making a mistake could be high. In the second place, are there other alternatives to attaining the objective, e.g., the use of vouchers in place of general subsidy? These considerations make the assessment of how well objectives are satisfied very difficult to do.

In general, the problem is how to separate the issues. Hopefully, there are ways to separate "competition concerns" from other social objectives. Accordingly, the appropriate relationship, especially the demarcation in functions, between a sectoral regulatory body and a national competition body would follow from a clear separation of issues. For the enforcement of safety regulations, the delineation is clear. But for equity and development objectives, the issues could become conflicting and intertwined.

Aside from these major issues involving concepts and substance, a problem common to all regulations is the tendency for regulators to use complicated and cumbersome procedures which could negate whatever pro-competitive effects there could be. Regular review to update and streamline the procedures would go a long way to increasing the efficiency of the regulatory process and the industry itself.

- ***Issues in implementing competition policy***

In the end, there is a range of practical issues in implementing competition policy and the organizational skills and culture needed. Choices will need to be made, particularly about whether competition policy and regulation should be carried out within a single agency or whether regulation is better undertaken by sector-specific agencies, the institutional design, and the division of powers and responsibilities between sector specific regulatory agencies and the general competition authority. As mentioned earlier, the appropriate relationship, especially the demarcation in functions, between a sectoral regulatory body and a national competition body would follow from a clear separation of issues. For the enforcement of safety regulations, the delineation is clear. But for equity and development objectives, the issues could become conflicting and intertwined.

Some findings from past studies

Anti-trust legislation is not new to the Philippines. It is covered in the Philippine Constitution and the Criminal and Civil Codes, with provisions apparently adopted from old anti-trust provisions of the U.S. Sherman Act (Abad 2002). Despite the considerable number of competition laws, the Philippines has no explicit national competition policy framework. The anti-trust law has never been used or implemented. Instead, there are several sectoral regulatory bodies which aim to regulate what have been traditionally considered natural monopolies. These include the Energy Regulatory Commission (ERC) for electricity, the National Telecommunications Commission (NTC) for the telecommunications industry, the Philippine Ports Authority (PPA) and the Maritime Industry Authority (MARINA) for the shipping industry, and the Civil Aeronautics Board (CAB) for civil aviation industry. The regulations would have various objectives other than competition and monopoly regulation, including not just safety and standard regulations, but also equity and access, and even sector development. This section briefly looks at some major findings from past studies on infrastructure regulations to offer some overview and preliminary insights into how much competition elements have been taken into account. These studies are in electricity, shipping and telecommunications.

Electricity

The industry sector in the Philippines has long complained that high power cost is a major factor severely hindering its competitiveness. Unless the root cause of the problem is properly and effectively addressed, it will continue to pose a major constraint holding back sustained and respectable growth for the country, not to mention its potential to create a recurring power crisis.

Before 1993, the industry was dominated by a vertically integrated state-owned company, the National Power Corporation (NPC). *The* NPC owned all generating plants

and electricity is sold to distributors and delivered through its transmission network. Distribution is largely a private sector enterprise (MERALCO), but there was government participation through the rural electric cooperatives that the government organized and funded.

The electricity sector was highly regulated, in terms of both entry and price regulations. To summarize briefly, these could be generally described as follows (Abrenica and Ables 2001).

In terms of entry constraints:

1. The terms of the power supply contract had to be negotiated with the NPC. The NPC used a benchmark price ("avoided cost") for negotiating power purchases which investors claimed to be unfair and not transparent.
2. There is limitation on the size of the private generating facility, which was set by EO 215 at 10 percent of the coincident NPC grid demand.
3. Independent power producers (IPPs) are not allowed to directly connect to the electric distribution utility and bypass the NPC's grids.

With respect to pricing regulation, the Energy Regulatory Board (ERB) has sanction over user price, which is supposed to take into account the social objective through cross-subsidization, e.g., between low income and high income users. At the same time, it is supposed to impose a rate of return to base (RORB) ceiling of 12 percent.

The power crisis in 1992 required drastic and immediate measures to stave off even more severe power shortages that would have more long-run costs to the economy. The government's response was to relax some of the entry constraints on generation mainly along the following lines:

1. The Electricity Power Crisis Act and the Expanded BOT Law (RA 7718) eliminated the restrictions on size of generating facilities and encouraged the establishment of independent power producers (IPPs)
2. Self-generation of power was allowed; consumers with power requirements of at least 100 megawatts can directly connect to the NPC's transmission grid.

Government's response also included a guarantee scheme of take or pay (where the government projects energy requirements and guarantees to buy corresponding energy generated by the IPPs based on the pre-established estimate of demand) and the granting of income tax holiday (ITH) under an expanded BOT (Build-Operate-Transfer) Law administered under the Board of Investments (BOI). Price regulation remains, and is currently managed by the Energy Regulatory Commission (ERC).

While the acute power shortage was relieved, it was not long before new problems became manifested:

1. Due to the urgent nature of the need for power, the generation plants established were generally producing high-cost power. At the same time, there is projected overcapacity until 2007, after which another power crisis

might ensue with no new investment in power (and not enough time to choose lower-cost power generation alternatives).

2. The take or pay guarantee left the NPC with unused power, yielding huge stranded costs which it had to finance from borrowing and/or transferring some of the losses through higher power rates. The NPC loss was exacerbated by MERALCO's decision to break its contract with the NPC and purchase power from its own IPP.

The end result is high power costs and increasing debt. With the political decision later on to suspend the payment of the PPA (or part of it), more debt needed to be incurred (or financed through general taxation). This summarizes the dilemma faced by government in coping with the power crisis: how much to pass on to consumers through a higher power price, how much to finance through borrowing, and how much to finance through general taxation. These are extremely difficult choices to make, all entailing painful adjustments, either now, or in the future, considering at the same time equity and efficiency objectives. Incorporating competition provisions generally means the creation of competitive markets, allowing firms to price at costs, and veering away from commercial guarantees. It should create a market environment that would induce new investments that are responsive to market opportunities. In short, there is a need for reforms and restructuring, which is what the EPIRA is supposed to address.

To summarize, the main features of restructuring include (Abrenica and Ables 2001):

1. Vertical separation of generation, transmission, distribution and electricity supply;
2. Privatization of the NPC, excluding transmission - TRANSCO;
3. Cross-ownership constraint;
4. Open and mandatory access to the transmission and distribution grids;
5. Establishment of a wholesale spot electricity market and later, adoption of retail competition to ensure that consumers reap the maximum benefits from restructuring;
6. Capacitating existing regulatory institutions to enable them to assume their new roles under a restructured industry; and
7. Providing mechanisms to service commercially unviable areas and to promote the use of indigenous and clean fuel, even as cross-subsidies are eliminated.

The deregulation policy and reforms provided under the EPIRA are, for the most part, aimed at introducing competition elements. Part 2 of this study on the interface between competition policy and regulation would look more closely at:

1. Major factors leading to 1992 power crisis. The analysis would seek to highlight what could go wrong under the existing regulatory environment and what kind of reforms are needed.
2. The EPIRA features and provisions—how well will these address the problem.

In the meanwhile, there are obvious implications for competition provisions on the BOT law (private investment on public infrastructure). A deliberate policy to bring in competition policy concerns is particularly crucial in infrastructure projects which are usually characterized by large capital requirements and long gestation periods. Private risks higher than social risks and positive externalities provide reasons for government intervention, but this should not preclude the inclusion of competition provisions which would help rationalize the process and minimize risks. And this deliberation should be done from project inception to project completion, to its actual operation. This means, for example, the proper bidding process (or the so-called Swiss Challenge for unsolicited projects) and clear access policies in its operating stage.

Liner Shipping

The discussion below is drawn from Austria (2003).

The shipping industry has three major subsectors:

1. Liner shipping, which has regular ports of call and fixed schedule and frequency;
2. Tramp shipping, which is hired on a contractual basis; and
3. Industrial carriage, which is operated by companies for their own needs.

Only liner shipping is regulated.

In examining problems and constraints in shipping and related transport costs, it is equally important to look at other shipping services. This would include:

1. Auxiliary services, which entail cargo manipulation in ports and ships; and
2. Port services, which involve ship management in ports (towing and tug assist, navigation, etc.)

The discussion below, however, covers only liner shipping. Part 2 of the study would attempt to look more comprehensively into the sector.

There are no significant economies of scale in the shipping industry,[3] with natural monopoly occurring in international ports. In principle, regulation should focus primarily on the safety objective; that is, competition and regulation interface should apply primarily in port management, and market contestability in other areas should be the first rule of thumb. Safety and standard regulation issues in the sector regulation should be a separate and primary concern. Equity and access have been other reasons for government intervention. As such, additional concerns would have an unavoidable implication on output and prices, the interplay between efficiency and equity objectives would necessarily make the regulation more complex. How the regulatory framework manages such interplay would be tricky and crucial.

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[3] Renardet Sauti Consulting Engineers 1986, Interisland Shipping Regulation Study. National Transportation Planning Project. Quezon City, Ministry of Transportationa and Communication as cited in Austria, 2003.

Before reforms. Regulation in shipping has a long history in the Philippines: Since 1928, liner rates have been regulated me, to protect the investments of incumbent operators by "preventing ruinous competition." In 1972, route regulation was introduced, to balance demand and supply.

Price regulation. Tariffs are fixed by government. The tariff structure is set by class of passenger and by class of commodity. There was uniform-rate formula for all routes. Tariff adjustment is made using the revenue deficiency method.

Entry regulation. Entry is restricted through "grandfather rules" in granting licenses to operate on the basis of the following prioritization: prior operator, prior applicant and protection of investment. This means that if a route is being opened for entry, priority is given to existing operator and if there is more than one, the first applicant gets priority. Where there are no existing operators, entry is allowed (application evaluated) and his investment is protected by restricting entry of new operators until his investment is recovered.

These regulations have imposed serious distortions and have had adverse impacts on the market, mainly in terms of availability of services, further cargo inflow imbalances, high storage costs, commodity value losses, etc. As such, a need for reforms and some deregulation became apparent.

Reforms starting in 1989. Reforms were introduced to address the adverse impacts of the past regulatory system starting in 1989. With respect to pricing regulations, these reforms included:

1. abolition of *ad valorem* surcharge
2. reclassification of basic commodities
3. deregulation of first and second class passenger rates, with a mandatory allocation requirement of 50 percent to third class passengers.
4. introduction of fork tariff system, under which tariffs are allowed to fluctuate from a reference rate within set limits

Further deregulation continued over the years:

5. under EO 213 in 1994, the deregulation of all freight rates except for noncontainerized basic commodities. Before 1999, deregulated rates were determined by the Domestic Shipping Consultative Councils (DOSCONs) composed of shippers/consumers, operators and government representative. This system was abolished in 1999 and only notification with MARINA was required and valid within 30 days when qualified.
6. continued regulation of monopolized and cartelized routes, where fork tariff system applies and tariff adjustment made through the revenue-deficiency method

There were also reforms easing entry regulation in routes. These included:

7. reforms in routes licensing introduced in 1992 under two general principles:
8. Primacy of public interest over "grandfather rules"
9. Presumption of public need for a service in favor of the applicant for the route. Burden of proof on oppositor (current operator), both of which resulted in opening routes to at least two operators
10. opening of entry to monopolized routes
11. limiting to five years the period for which investments for developmental routes are protected
12. further liberalization with EO 185 (in 1994 and MC 106 in 1995 and MC 161 in 2000), under which routes serviced by an operator for at least five years are opened to entry, and operators in developmental routes pioneering in new technology could apply market-determined rates

These reforms have generally made the liner shipping sector more competitive. These are manifested on the market structure, traffic and capacity and quality of service.

- On market structure

On passenger service, top five players operate most of the primary routes, although they don't operate together, except in routes originating from Manila where the top three operators operate together in eight routes.

In 1998, 26 out of 52 primary routes had more than one operator and the other 26 with only one. Moreover, 27 out of 46 secondary routes (around 59 percent) have only one operator, while 166 out of 214 tertiary routes (around 78 percent) had only one operator.

For cargo service, the impact on market structure is similar (see Tables 1 and 2).

Table 1. State of competition, passenger service, 1998.

Route Classification	**Primary**		**Secondary**		**Tertiary**	
	Number	(%)	Number	(%)	Number	(%)
Routes with only 1 operator	26	50.0	27	58.7	166	77.6
Routes with at least 2 operators	26	50.0	19	41.3	48	22.4
Routes with only 1 effective operator	5	9.6	7	15.2	10	4.7
Routes with substantial competition	7	13.5	6	13.0	17	7.9
Routes with mild competition	14	26.9	6	13.0	21	9.8
Total number of routes	**52**		**46**		**214**	

Source: Table 8 of Austria (2003). *Basic data*: 1998 Annual Traffic Reports of shipping companies submitted to MARINA.

Table 2. State of competition, cargo service, 1998.

Route Classification	Primary		Secondary		Tertiary	
	Number	(%)	Number	(%)	Number	(%)
Routes with only 1 operator	25	36.2	16	34.8	444	76.7
Routes with at least 2 operators	44	63.8	30	65.2	135	23.3
Routes with only 1 effective operator	7	10.1	9	19.6	39	6.7
Routes with substantial competition	10	14.5	6	13.0	38	6.5
Routes with mild competition	27	39.1	15	32.6	58	10.0
Total number of routes	**69**		**46**		**579**	

Source: Table 10 of Austria (2003). *Basic data*: 1998 Annual Traffic Reports of shipping companies submitted to MARINA.

- On traffic and capacity

There were marked increases in passenger capacity. There was around a 35 percent increase in 1990-91, 47 percent in 1993-94 and more than 10 oercent for the succeeding years until 1998 in passenger volume. For cargo, increases were not as dramatic, and had more fluctuations (see Table 3).

Table 3. Annual growth rate of traffic and capacity (%)

Year	Passenger		Cargo	
	Capacity	Traffic	Capacity	Traffic
1990-91	34.7	6.4	21.8	2.2
1991-92	1.1	6.4	-2.8	4.8
1992-93	0.6	7.8	2.1	5.3
1993-94	47.7	11.2	22.2	9.2
1994-95	10.4	-6.4	0.7	-4.4
1995-97	14.4	9.4	-22.1	12.6
1997-98	10.3	6.5	23.4	-1.5
1998-99	0.2	-2	18.4	2.5

Notes: Data for 1996 not included. Capacity is based on passenger cargo GRT for passenger and general cargo plus container GRT for cargo.

Source: Austria (2003) *Basic data:* MARINA (GRT); Philippine Statistical Yearbook (passenger traffic)

- On quality of service

There was overall improvement in the quality of service, such as the improvement and upgrading of facilities, bigger and better vessels, and the advent of fast craft vessels.

While substantial progress in these areas has been achieved, more reforms are still needed. Deregulation efforts need to continue. To name a few, Austria (2003) suggests that the following be addressed:

1. Second class passenger rate for non-DOT-accredited vessels with less than 50 percent of total passenger capacity allocated to third class passenger is still regulated.

2. Regulated rate for third class passengers is regulated at rates considered very low, and not enough to cover costs.(cross-subsidization). This is aggravated by the requirement to allocate 50 percent of capacity to third class passengers except for DOT-accredited vessels
3. RORB regulation and revenue deficiency method of tariff adjustment has become inconsistent with deregulation reforms. The ceiling has become a disincentive to new and more efficient investors. (Regulatory risk for new investors.)

In addition, there is a need to look at vertical relationships—between shipping and auxiliary and port services. There are many issues in other shipping activities which would need to be addressed. Do foreclosure and exclusion happen? What constraints and problem arise? These and other related issues are dealt with in more detail in Part 2 of this study component.

Telecommunications

The discussion below draws from Serafica (2002).

The benefits from the liberalization and demonopolization of the telecommunications sector have been undeniable. This is clearly manifested in the expanded consumer choice. Though largely due to technology advancements, the deliberate policy of expanding supply via the entry of new players has facilitated the realization of these gains for consumers. Carriers compete to be the first to provide advanced features that current technology makes possible (e.g., caller id, three-way calling).

1. Executive Order 109, and subsequently, RA 7925 demonopolized the industry.
2. There are now at least two operators allowed to compete in the same geographic market for each of the service categories identified in RA 7925.
3. Of these service categories, only value-added service has been deregulated such that even registration with the NTC is not being strictly enforced.

Entry requirements into the regulated segments of the industry:

1. a congressional franchise to operate a telecommunications service in all or some parts of the country
2. a Certificate of Public Convenience and Necessity (CPCN) or a Provisional Authority (PA) granted by the NTC.
   - This requires carriers to demonstrate that they are technically and financially able to carry out the service and that sufficient demand exists.
   - The PA would include a description of the service, the specific rate or a general rate structure that may be charged for the service and the regulations under which that service can be provided.

3. PLDT is the only carrier that operates a local exchange service (including Public Calling Offices) all over the country
4. The rest are restricted by their PAs to serve only specific geographic areas

Price regulation

1. end-user rates regulated and set by the NTC
2. RORB ceiling of 12 percent
3. access charge (the price of intermediate good) negotiated between interconnecting carriers, although as specified in the RA 7925, the access charge is supposed to "make provision for the cross subsidy to unprofitable local exchange service areas."

End user price (price paid by consumers) is set by the NTC but interconnecting carriers are allowed to negotiate access charges between them (intermediate price). A firm, that is, the one enjoying network externalities, can effect a price squeeze in its effort to gain market power before the regulator can step in. One can thus question if it would be better for the regulator to intervene at the intermediate level and deregulate end user price where enough competition exists. This would also lower the cost of negotiations across firms and type of service.

While huge benefits have been gained from the reforms which introduced greater competition in telecommunications during the past decade, there are emerging weaknesses that threaten the sustainability and success of these reforms. Serafica (2002) singles out two most serious threats: (1) lack of explicit rules, and (2) the asymmetric regulation in the universal access strategy.

Lack of explicit rules:

1. on access to essential facilities,
2. determination of what is "essential" facility (what is natural monopoly),
3. policy on vertical and horizontal mergers

This sector is where, because of technological change, the presence of natural monopolies has become increasingly less "natural." Hence, what should be considered "essential" is no longer cut and dried. Transparent and rational determination of what are "essential", which have implications on rules of access, is very important. In addition, there should be clear guidelines, those based on an objective "competition test" (i.e., with clear efficiency and consumer benefits), on addressing vertical and horizontal mergers.

Asymmetric regulation in the universal access strategy

1. To address the universal access goals of the government, the law mandates that the access charge include cross-subsidy on top of the cost of interconnection.
2. PLDT has the advantage. It does not have to install a line in an unserved or underserved area but is still able to impute a subsidy component into the access charge for its local exchange.

Such a regulatory set-up preserving an unequal distribution of service obligations would unevenly affect the cost structure of competing firms. Moreover, cross-subsidies, as they are currently administered, are hidden and could actually be used for anti-competitive conduct.

Xavier (OECD 1995, 133-9) proposes alternative mechanisms for the financing and provision of universal service even in the face of competition.

1. Broad uniform tariff policies sustained by cross-subsidization;
2. Specifically-targeted subsidies paid directly by government with funds paid from general taxation revenue;
3. Specifically-targeted subsidies paid by government, but funded through universal service levy on all telecommunications users;
4. Specifically-targeted schemes with costs borne by the dominant carrier (but not by competitors); and
5. Specifically-targeted schemes with costs shared among all operators.

These recommendations should be assessed on the grounds of transparency, equity, efficiency, ease (and cost) of administration. Part 2 of the study component examines the interface between competition and regulation in the telecommunication sector more closely.

Concluding Remarks

This short paper attempts to lay down the framework and basic principles for the optimum interface between competition policy and infrastructure regulation. In a nutshell, it is that the government should promote competition when the market can fulfill its role as an effective regulator, and step in as a regulator when it cannot. Competition policy should address exclusionary and exploitative acts and discipline firms when such acts are committed. However, in certain cases, more may be required by way of additional competition rules needed to assist the market and substitute for lack of a competitive process of allocation. This is where competition policy in the form of direct regulation comes in. This is usually where market power is inherent (in the structure), specifically the case of infrastructure sectors. With direct regulation, however, some basic issues arise that need to be looked at more closely. In general these relate to the following: tendency for "overregulation", problems with price regulation, privatization, unbundling, regulatory capture, and multiple objectives, among others.

The paper also highlights the findings from past studies on three major infrastructure/utilities sectors, namely power, shipping and telecommunications, within the context of competition. For all these sectors, there have been significant attempts to enhance competition, mainly in terms of relaxing entry regulation and some effort at deregulating prices and privatization. It was not surprising to find difficulties in dealing with the trade-offs between social objectives, principally equity and access, and competition (efficiency) objectives. Nonetheless, there is increasing recognition of such trade-offs. Where safety and standards are concerned, there is clearer delineation of objectives and measures, and these are areas where more reforms could be made. In

particular, these concerns should not be used as reasons for imposing regulations which unnecessarily restricts competition.

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